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

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Treasury Department : : Bureau of Internal Revenue

Internal Revenue Bulletin

Cumulative Bulletin VI–2

JULY–DECEMBER, 1927

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

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

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

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U. S. GOVERNMENT PRINTING OFFICE

The Internal Revenue Bulletin service for 1928 will consist of weekly bulletins and semiannual cumulative bulletins.

The weekly bulletins will contain the rulings and decisions to be made public and all Treasury Department decisions (known as Treasury decisions) pertaining to Internal Revenue matters. The semiannual cumulative bulletins will contain all rulings and decisions (including Treasury decisions) published during the previous six months. The annual digest for 1927 will contain 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.

Of the 1927 service, Cumulative Bulletin VI–1 (January–June), price 40 cents, and Cumulative Bulletin VI–2 (July–December), price 40 cents, are now available.

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–2, in addition to all decisions of the Treasury Department (called Treasury decisions) pertaining to Internal Revenue matters, contains General Counsel's opinions, and rulings and decisions pertaining to income, estate, sales, capital stock, and miscellaneous taxes, as indicated on the title-page of this Bulletin, published in the weekly Bulletins (Volume VI, Nos. 27–52, inclusive) for the period July 1 to December 31, 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.—Tobacco Division.
T. B. M.—Advisory Tax Board memorandum.
T. B. R.—Advisory Tax Board recommendation.
T. D.—Treasury decision.
x and y are used to represent certain numbers, and when used with the word "dollars" represent sums of money.

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.

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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.

[a] VI-52-3548

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

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Aluminum Flake Co	4669 8444	6	1193
American Manganese Steel Co	8145	7	659
American Show & Entertainment Co	7679	5	954
Armstrong, Bird	3297	6	384
Armstrong, J. H	3297	6	384
Autovent Fan & Blower Co	240	5	282
B.			
Backus & Sons, A., jr	3777	6	590
Bastrop Mercantile Co., Ltd	8124	7	529
Batson-Cook Co	5458	6	1191
Bird, Samuel	6721	4	259
Blair Veneer Co	6703	5	886
Bloch, J. H	10076	6	563
Bloomfield, Frederick	6501	6	298
Blue Ridge Overalls Co	10210	6	1335
Borden, Spencer, estate of [1]	5909	6	255
Borden, Spencer, jr., executor [1]	5909	6	255
Boulden, Charles H	7965	7	490
Boyd, H. B	6751	6	1330
Brand, Alfred	8572	5	297
Brand, Philip R	8432	5	297
Brown, Edward T	7994	6	895
Bruner Woolen Co., Inc	7892	6	881
Buedingen, Robert	5855	6	335
Bullard, Bernice K	7566	7	456
Burkitt, George W., estate of [1]	2038	3	1158
Burtsell, Bertram W., executor	2650	6	412

[a] Ruling No. 3548 includes rulings Nos. 3292, 3300, 3308, 3325, 3340, 3351, 3362, 3376, 3395, 3407, 3419, 3435, 3442, 3450, 3458, 3468, 3477, 3485, 3493, 3499, 3506, 3517, 3525, 3531, and 3538. These rulings, published in the weekly Bulletins during the semiannual period July 1 to December 31, 1927, have been combined and the names of the taxpayers arranged in alphabetical order.

[1] Estate tax decision.

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Canton Steel Ceiling Co	7112	6	446
Capitol Park Hotel Corporation	7705	5	1160
Carey, C. W.[2]	2432	6	539
Carroll, Julia A., executrix	7228	6	752
Chapin Laundry Co	7650	6	609
Clement, Norman Parsons, executor	2650	6	412
Colvert, Warner L	9170	6	623
Connorized Music Co	7179	7	213
Cooper, C. E	2206	4	1267
Cooper, Edna V	2206	4	1267
Corsicana Gas & Electric Co	4499	6	565
Coulter, Charles J., jr	8181	6	426
Coxe et al., Alfred C., jr., trustees	6805	6	1322
Crews, David W., estate of [1]	9010	8	949
Crews et al., Frank H.[1]	9010	8	949
Crowell Corporation	5411	5	737
Crowell Lumber & Grain Co	366	6	826
Curlee, W. S	1638	6	557
Curtis, Frank G., estate of	4720	6	472
Curtiss, George W	2327	4	269
D.			
Dartt Co., C. E	1372	5	76
Davis Co., The	5497	6	281
De Van & Co	8630	7	94
Dibble, Leon N., executor [1]	2528	6	732
Dibble, Louis N., estate of [1]	2528	6	732
Dietrick, Herman T	9730	6	1371
Donaghey Real Estate & Construction Co	1050	5	766
Dyer, George R., executor [1]	3351	5	711
E.			
Eggink, Henry	6413	7	152
Elm City Nursery Co	6503	6	89
Empire State Finance Corporation	6805	6	1322
Evans, Leroy G	7347	5	806
F.			
Farlow, Samuel, estate of [1]	7268	7	172
Federal Plate Glass Co	1055	6	351
Fell, A. H	2089	7	263
Fellows Medical Manufacturing Co	5592 8980	6	232
Fidelity Trust Co	4920	4	411
Finance Exploration & Development Corporation of America	6805	6	1322
Fink Co., George A	1369	5	76
Finsilver, Charles	6468	8	391
First National Bank of Durant, Okla	6913	6	545
First National Bank of Goodland, Kans	1280	5	1174
First National Bank of Los Angeles	2817	6	850
First National Bank of Sleepy Eye, Minn	2334	7	84

[1] Estate tax decision.
[2] Acquiescence relates to issues 2 and 4 in decision.

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Fox River Iron Co	4743	5	810
Franklin, Wirt	9266	7	636
Fraser, George H	5929	6	997
G.			
Gallen Paper Co	1377	5	76
Gardner Printing Co	5061	4	37
George, Mike	5774	6	124
Georgia Manufacturing Co	1718	5	893
Girard Coal Co	3724	6	105
Goodlatte, Raymond R	4007	4	165
Gopher Granite Co	6631	5	1216
Gottfried, Hedwig B	8553	5	297
Greenville Coal Co	3784	3	1323
Greever, Mr. and Mrs. B. B	5690	6	587
Griffin, P. P	11546	7	1094
H.			
Hall, Charles Ward	11650	6	15
Hammack, Rish Sons Co	10516	6	1054
Haney, Edgar P., and wife	3486	5	1039
Hanly, W. W	8516	6	613
Harrolds Motor Car Co	6184	5	429
Hartford Hat & Cap Co	7400	7	714
Hart-Wood Lumber Co	2984	5	1171
Haskell, J. Amory, estate of	7102	6	890
Haynes, Charles H., executor	9584	6	1166
Haynes, R. R., estate of	9584	6	1166
Henderson Co., F. C	5272	5	570
Henderson Overland Co., The	4776	4	1088
Henry, Mattie F., conservatrix [1]	7268	7	172
Heyn, Otto P	3788	4	1256
Hibbard, Spencer, Bartlett & Co	7431	5	464
Hickox, Lee	6702	7	142
Hinckley, Ralph L	4193	6	312
Hirst & Begley Linseed Co	7482	4	1160
Hitchcock, Halbert K	6107	4	273
Hof Brau Co., The [3]	6134	6	442
Hoffman, H. C	6611	4	474
Hudson, Charles I., estate of [1]	3351	5	711
Hudson, H. Kierstede, executor [1]	3351	5	711
Hughes Co., Ed. S	6748 14120	6	949
Hurley, A. W	7339	6	695
Hymel Planting & Manufacturing Co., Louis	2903	5	910
I.			
Innes-Behney Optical Co	3368	7	982
Iron City Improvement Co	2138	4	305
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[1] Estate tax decision.
[3] Acquiescence relates to first issue in decision.

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Jones Lumber Co	3275	5	1159
Joyce-Koebel Co., The	4267	6	403
K.			
Kaufman, Harry S., Ltd	8154	5	823
	11845	5	823
Kaweah Lemon Co	4583	5	992
Keller Mechanical Engineering Corporation	6741	6	990
Kellogg Commission Co	3945	6	771
Kelsey, S. R	6082	6	1068
King-Parker, Inc	8315	6	884
Kniffin, Leonard	7959	5	1274
Knutson Hardware Co	4384	5	9
L.			
Lamb Lumber & Implement Co	14242	6	429
Larsh, D. L	12621	6	1086
Lash Co., Lee	6190	6	165
Lassen Lumber & Box Co	3431	6	241
Lathrop & Co., Inc., C. P	6603	5	879
Lee, Jeanne, Mrs	5985	6	1005
Lee, John C	5984	6	1005
Lee, Matilda Holz	7676	6	1132
Leflang, E. M. F	7309	6	4
Leighton Supply Co	5744	7	99
Lenox Land Co	1083	5	1206
Levin, N	6444	5	892
L'Hommedieu & Sons Co., Charles F	5902	6	41
Liberty Agency Co	6257	5	778
Liberty Iron Works	4398	6	181
Lickumovitz, Morris	6842	4	1181
Lindlahr Sanitarium, Inc	1619	4	1245
Live Stock National Bank	2467	7	413
Loftis, J. M. and J. S., administrators	7581	6	725
Loftis, S. T. A., deceased, estate of	7581	6	725
Lord Motor Car Co	4718	5	818
Los Angeles Trust & Savings Bank	2818	6	850
Lozier, Charlotte C., estate of [1]	7513	7	1050
M.			
Maine Dairy Co	4675	4	375
Mallinckrodt, Edward, sr. [3]	1750	4	1112
Malone, Edwin B	5225	5	1226
Marigold Garden Co	1580	6	368
Marshall & Spencer Co	4574	7	454
Martin, Darwin D	3001	6	472
Mayer's, Inc	3774	5	181
McConnell, E. H	3211	6	116
McKinnon, L. E., estate of	2650	6	412
McLean, Caroline S	1534	4	487

[1] Estate tax decision.
[3] Acquiescence relates to first issue in decision.

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Megeath, S. A	2815	5	1274
Megeath, Samuel A	9248	5	1274
Meinel, Edward, estate of [1]	3098	6	341
Meinel, Ethel G., executrix [1]	3098	6	341
Melick, J. J	7623	6	70
Melton, Alger	5699	7	717
Mercer, John W	8233	6	564
Merchants National Bank	8179	6	1167
Merckens, August	10108	7	32
Metzger, L	9682	5	1230
Milliken, George W., estate of [1]	10123	7	785
Milling Moore Mercantile Co	7560	5	1060
Moon, Annie	8675	6	385
Moon, O. L	8674	6	385
Morton, A. D	3559	6	1295
Mosby & Co., Inc., J. B	2781	6	722
Mosher Manufacturing Co	1886	7	187
Multibestos Co	7598	6	1060
N.			
National Pneumatic Co	3651	5	637
National Sash & Door Co	5788	5	931
National Talking Machine Sales Corporation	5272	5	570
Northeastern Oil & Gas Co	2231, 3525	5	332
Northern Hotel Co	2768	3	1099
Northwestern Yeast Co	1511	5	232
O.			
Ocean Accident & Guarantee Corporation, Ltd	3114	6	1045
Owen-Ames-Kimball Co	1637	5	921
P.			
Pabst, Fridoloin	2227	6	843
Pacific Coast Redwood Co	1847	5	423
Pacific Realty Corporation	4526	5	1223
Paget, J. H	4279	6	310
Palais de Modes	5502	5	189
Pantazas, Charles	3382	5	975
Pantazas, James	3382	5	975
Paris Cloak, Suit & Millinery House	5500	5	189
Park Bros. & Rogers, Inc	2460	6	719
Pearsall & Co., Inc	12722	5	1177
Peebles, W. S., administrator [1]	9380	5	386
Perkins, B. F	5152	6	781
Persons, James H	3250	5	716
Pictorial Review Co., The	4487, 6661, 11303	5	416
Pine Bluff Compress & Warehouse Co	7989	5	938
Pioneer Laundry Co	4739	5	821
Pittard, J. T	1804	5	929

[1] Estate tax decision.

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Pomonis, Spiro	3382	5	975
Pope Sanatorium Co	4148	4	1085
Potter Farms, Inc	5928	6	110
Powers, Mary A., executrix [1]	5422	6	633
Powers, Richard J., estate of [1]	5422	6	633
Pryor, Luke, estate of [1]	9380	5	386
Pryor, Lutie Patton, administrator [1]	9380	5	386
Q.			
Quealy, P. J	7196	6	419
Queen City Printing Co	6985	6	521
R.			
Ramming, R. W	5983	6	188
Randolph Hotel Co	1580	6	368
Real Estate & Trust Co. and Samuel M. Gayley, executors [1]	10123	7	785
Redlands Security Co	5703	5	956
Reed, F. M	6776	6	1140
Retailers Fire Insurance Co	3733	3	1186
Richmond Hosiery Mills	7763	6	1247
	3703	6	1247
Riker, Samuel, jr., executor	7102	6	890
Robinson Co., A. M. [4]	5652	5	1217
Roesch, William V	2551	7	293
Ross Co., Inc., F. J	7281	7	196
Rudolph, E. L	4571	6	265
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Ryman, B. A., estate of	1706	5	1288
Ryman, Nancy J	1705	5	1288
S.			
Saehs, Charles H	7561	6	68
Schlett, Adolph	10016	7	150
Schoellkopf, Walter H	6212	4	1032
Selwyn Operating Corporation	4851	5	723
Serrien, Anna, executrix [1]	8836	7	1129
Serrien, John, estate of [1]	8836	7	1129
Sheakley & Kennedy Bros	6282	7	1156
Shipowners & Merchants Tugboat Co	3955	4	403
Shope Brick Co	6531	5	1042
Shure Co., N	3655	4	1181
Shuttleworth, Wollny Co., Inc	1362	5	76
Silverman, Alexander	10389	6	1328
Simon, H. S	4912	4	1078
Slater, Chas. W	4134	5	804
Smith, Harry A., executor [1]	3098	6	341
Smith, Harry A. P	2552	7	293
Southern Sand & Gravel Co., Inc	6603	5	879
Standard Gas Products Co	9843	5	1221
Standard Refractories Co	3617	6	24
	3618		
Stern, Carl	19377	5	871
Stern, Louis	19376	5	870

[1] Estate tax decision.
[4] Acquiescence relates to issues 2, 3, 4, 5, and 6 in decision.

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Superior Pocahontas Coal Co	5377	7	380
Swaney, Ewing B	2863	5	990
Sylvan Electric Bath, Inc	7411	5	1293
T.			
Thomas, E. L	9213	6	297
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Troy Manufacturing Co	6585	7	119
Turner, Mrs. W. A	4162	5	1006
U.			
Union Metal Manufacturing Co	2524	4	287
V.			
Vaughan & Barnes, Inc	7311	6	1279
Virden, M. L	5200	6	1123
Voelbel, Jacob, estate of [1]	6009	7	276
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W.			
Walter & Co., Inc., D. N. & E	4006	4	142
Walter, T. Hendry, executor [1]	3351	5	711
Warren, Kib H	2550	7	293
Watson, Martha A., estate of	7228	6	752
Weaver, James A	8488	8	943
Webb, Stuart W	5591	5	366
Weeks Co., L. S	2604	6	300
Weiss, Paul E	10059	7	615
Werbelovsky, Abraham, executor	10106	8	442
Werbelovsky, J. H., estate of	10106	8	442
Western Star Milling Co	2852	5	109
Whitmeyer, Ella	3090	6	472
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Wood Bros. Thresher Co	5877	4	43
Woodruff Lumber Co	7262	6	515
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Y.			
Yahola Sand & Gravel Co	2281	6	820
Yokohama Ki-Ito Kwaisha, Ltd	2653	5	1248
Young, Minal E., executor	4720	6	472

[1] Estate tax decision.

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

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Bronson, James D., trustee [1]	7702	7	127
C.			
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Carey, C. W. [5]	2432	6	539
Cleveland, Painesville & Ashtabula R. R. Co	4927	4	637
Cleveland, Painesville & Eastern R. R. Co	4927	4	637
Collins-McCarthy Candy Co	4302	4	1280
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Crabtree Co., E. B	5889	5	732
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De Forest, Julia N	5857	4	1059
Doehne, George, estate of	9344	6	1071
F.			
Fitzgerald, Mary A	810	5	178
Frank, William G., administrator	9344	6	1071
G.			
Gibson, Kate Viola, estate of [1]	7402	7	1144
H.			
Harriet Cotton Mills	6228	5	734
Hof Brau Co., The [6]	6134	6	442
Hoffman, Isabella C., estate of [1]	5338	3	1361
Hoffman et al., Meyer C., executors [1]	5338	3	1361
K.			
Keen, Herbert Ide	8423	6	275
L.			
Lee Live Stock Commission Co	280	7	532

[1] Estate tax decision.
[5] Nonacquiescence relates to issues 1 and 3 in decision.
[6] Nonacquiescence relates to third issue in decision.

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Mahoning Coal R. R. Co	2202	4	923
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Mercantile Trust & Deposit Co., executor [1]	4166	5	952
Murphy, James C., executor [1]	4166	5	952
N.			
National Products Co	6136	7	632
Nelson, C. N., estate of [1]	7702	7	127
Norwood Lumber Co	3785	6	341
O.			
Old Colony R. R. Co	7820	6	1025
P.			
Pelton, Honoro Gibson, executrix [1]	7402	7	1144
Pietsch, Amy Lake, deceased, estate of [1]	5424	6	582
Pietsch, Walter G., executor [1]	5424	6	582
Pittsburgh Knife & Forge Co	7464	6	1083
Pittsburgh Valve, Foundry & Construction Co	9089	6	460
Prince, George H., trustee [1]	7702	7	127
Prosser, Seward	8520	7	734
Provident Trust Co., administrator [1]	4976	5	1004
R.			
Robinson Co., A. M. [8]	5652	5	1217
S.			
Sage, Margaret Olivia, estate of	5882	6	36
Sarfert, Max	3436	5	977
Sinkler, Charles, administrator [1]	4976	5	1004
Sinsheimer Bros., Inc	6498	5	918
Slocum et al., Herbert Jermain, executors	5882	6	36
Stanton, John, jr., estate of [1]	5892	(9)	(9)
W.			
Warner, Fred W	3713	5	963
Windfelder, John H., estate of [1]	4166	5	952
Y.			
Young, James K., estate of [1]	4976	5	1004

[1] Estate tax decision.
[7] Nonacquiescence relates to second issue in decision.
[8] Nonacquiescence relates to first issue in decision.
[9] Unreported in Board of Tax Appeals Reports.

TITLE I.—GENERAL DEFINITIONS.

SECTION 2.—GENERAL DEFINITIONS.

ARTICLE 1504: Association distinguished from trust.

VI–41–3459
G. C. M. 2405

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

Where the business engaged in by a company under a declaration of trust is the buying and selling of merchandise, the buying and selling of real estate, and the lending of money, and negotiable certificates of beneficial interest similar to shares of stock are issued, the trust is carrying on a business in the manner and form of a corporation and is taxable as an association, and the fact that the trust is administered by a sole trustee does not place the case beyond the scope of the decision in *Hecht* v. *Malley* (265 U. S., 144; T. D. 3595, C. B. III–1, 489).

An opinion is requested as to whether the M Company should be taxed as an association or as a trust.

The M Company was organized on November —, 1920, under a declaration of trust, created by A, B, C, and D, who are referred to as subscribers. E is named as sole trustee. The subscribers to the trust and the sole trustee are the beneficiaries. There are y shares of beneficial interest having a par value of z dollars each. It is provided in the trust instrument that the trustee, in so far as practical and convenient, shall be designated by, and for convenience act under, the name of the M Company, and shall conduct all business and execute all instruments in writing in performance of this trust. The trustee has the legal title of the property which is administered by him and used in carrying on the business contemplated by the terms of the trust. The beneficiaries have no right to the earnings until they are distributed by the trustee, nor have they any right to call for a partition of the trust property or a dissolution of the trust. The assets of the trust estate are held by the trustee for the use of the business of the trust, which is specified as follows:

The buying and selling of goods, wares, and merchandise of any description by wholesale and retail, particularly the buying and selling of real estate, chattels, real estate notes, lending moneys, buying and selling stocks and bonds of any kind whatsoever, and the purchase and sale of such goods, wares, and merchandise used for such business; and the accumulation and loan of money in the purchase and sale of bills, notes, and other negotiable instruments.

It is provided that the trust shall continue for the term of 21 years after the death of E, the named trustee, at which time the then trustee shall proceed to wind up its affairs and liquidate the assets and distribute the same pro rata among the holders of the certificates of beneficial interest.

After a careful consideration of the facts in the case of the M Company this office is of the opinion that the trust is organized for the purpose of carrying on a business ordinarily carried on for profit, and that it is conducting the business in the manner and the form of a corporation. In the case of *Hecht* v. *Malley*, supra, the court held that the word "association" is used in the Revenue Act of 1918 in its ordinary meaning, and includes a "Massachusetts trust" having a quasi corporate organization under which trustees are engaged in

carrying on business enterprises, irrespective of the measure of control vested and exercised by the beneficiaries, as beneficial certificate holders. The court stated in part as follows:

> We conclude, therefore, that when the nature of the three trusts here involved is considered, as the petitioners are not merely trustees for collecting funds and paying them over, but are associated together in much the same manner as the directors in a corporation for the purpose of carrying on business enterprises, the trusts are to be deemed associations within the meaning of the Act of 1918; this being true independently of the large measure of control exercised by the beneficiaries * * *.

In the case of *Burk-Waggoner Oil Association* v. *Hopkins* (269 U. S., 110; T. D. 3582, C. B. III–1, 1) it was held that, as used in the Revenue Act of 1918, the term "corporation" includes associations and joint stock companies, and the term "partnership" refers to ordinary partnerships. Furthermore, that unincorporated joint stock associations which conduct their business in the same form and mode of procedure as corporations are taxable as corporations, although technically such associations are partnerships under the laws of the State where organized.

The taxpayer contends that the rule laid down in the case of *Hecht* v. *Malley*, supra, should not be followed where there is a sole trustee, but is applicable only in cases where the trustees are associated together in a manner similar to that of directors. This office is unable to agree with this contention, for the reason that where a business is organized and conducted in a manner corresponding to that of a corporation it is immaterial that the management of the organization is vested in one individual. Where, as in the instant case, the business is the buying and selling of merchandise, the buying and selling of real estate, and the lending of money, and negotiable certificates of beneficial interest similar to shares of stock are issued, the trust is carrying on a business in the manner and form of a corporation and is taxable as an association, and the fact that the trust is administered by a sole trustee does not place the case beyond the scope of the decision in *Hecht* v. *Malley*, supra.

It is concluded that the M Company is an association within the meaning of the Revenue Act of 1918 and the Acts of subsequent years, and it should be taxed accordingly.

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

ARTICLE 1504: Association distinguished from trust.

VI–45–3494
G. C. M. 1736

REVENUE ACTS OF 1921, 1924, AND 1926.

Two individuals conveyed real property to a trustee to secure the unpaid portion of the purchase price due from the buyers, the beneficiaries of the trust. The general purpose of the trust to the beneficiaries was the improving, subdividing, and reselling of the property in smaller portions, the proceeds to be applied to the payment of the balance of the purchase price, etc., and the remainder to be distributed to the beneficiaries. The beneficiaries positively control the trust. Through their selling agent and executive committee they improve, subdivide, and sell the property, and determine the sale prices thereof.

Held, that an organization engaged in business in quasi corporate form was created which must be taxed as an association.

An opinion is requested as to the taxable status of a certain real estate development project operating under a trust instrument in which the M Company is named as trustee.

It appears that A and B, hereafter referred to as the "sellers," conveyed real property to the M Company, as trustee, to secure the unpaid portion of the purchase price due from the buyers, who are the beneficiaries of the trust. The general purpose of the trust to the beneficiaries was the improving, subdividing, and reselling of the property in smaller portions.

The beneficiaries are to improve and subdivide the property at their expense. The trustee is to sell and convey the lots to purchasers at such prices and on such terms as the beneficiaries may direct, subject to a schedule of "minimum prices" attached to the declaration of trust; but no conveyance of any lot is to be made to the purchaser until there are sufficient moneys in the trustee's hands to the credit of the sellers for payment to them of a release price in accordance with a schedule of release prices attached to the declaration.

All contracts of sale and deeds for the lots are to be executed by the trustee, subject to such covenants and restrictions as shall be agreed upon by the beneficiaries and the trustee, and all moneys received from the sale of the lots are to be paid only to the trustee and disbursed by it, first, to the payment of the trustee's fees; second, to the selling agents a commission of — per cent of the selling prices; third, to the payment of all costs of improvements; fourth, the balance to be divided equally between the sellers and the beneficiaries until the balance of the purchase price has been fully paid; fifth, the remainder to the beneficiaries.

The beneficiaries are under no obligation to pay a mortgage indebtedness which was a lien on the property when the trust was declared, or to pay the balance of the purchase price except for one payment of $12x$ dollars, and in the event of a foreclosure of the mortgage or of the declaration of trust, no deficiency judgment is to be taken against the beneficiaries. The beneficiaries promise, however, on demand from the trustee, to pay, in proportion to their respective beneficial interests, all sums of money necessary for the improvement of the property, for taxes, and for fees and expenses of the trustee, unless the equivalent thereof, realized from the sale of the lots, shall then be standing to their credit with the trustee; and on default in payment, the trustee or any beneficiary may advance the sum demanded, and the trustee may sell the share of the defaulting beneficiary in order to recover the sum advanced. The defaulting beneficiary, however, is not liable for any deficiency which might result from such sale. If default is made in the payment of any sums due the sellers, the trustee may sell the trust property and pay the sellers out of the proceeds, and distribute the net remainder to the beneficiaries.

The beneficiaries are to have possession, management, and control of the property as long as there is no default, subject to the provisions of the declaration, and may select such agent to sell the property as they see fit, and by their ratification of the declaration they appoint a named corporation as the exclusive selling agent. The agent is to be allowed x dollars as an advertising fund, to be paid

out by the trustee as required, and x dollars for supervising the improvements and subdividing the property.

After full payment of the purchase price due the sellers and of all expenses of improving the property, all restraints imposed on the beneficiaries in the management and sale of the property are to terminate, and the remaining property is to be sold as directed by the beneficiaries. All moneys realized therefrom are to be applied by the trustee as directed by the beneficiaries, or paid to them in proportion to their respective interests, provided that all fees of the trustee and all advancements made by it have been fully paid. When each of the beneficiaries has received back a sum equal to the amount of his subscription, and in addition thereto a net profit equal to his subscription, then all the proceeds, less proper costs, charges, and expenses, are to be distributed in the proportion of — per cent to the beneficiaries and — per cent to the selling agent.

No transfer of any beneficial interest is to be binding on the trustee until an executed original of assignment is filed with the trustee, except where the interest is transferred by order of court.

In the management of the property and sale of the lots, the trustee, as regards the beneficiaries, and on all matters not specifically set forth in the declaration, is authorized to act upon the order of any two of three persons named in the declaration as an executive committee to manage the affairs of the beneficiaries. The holders of a majority of the beneficial interest may at any time elect a new committee of three.

The trust is not to terminate until the trustee shall have been paid in full all sums provided in the declaration to be paid to it.

It is evident that the enterprise described in the declaration is engaged in business in quasi corporate form. Like the directors and officers of a corporation, a group of persons, consisting of the trustee, selling agent, and executive committee, are carrying on the business for a larger number, who, like the stockholders of a corporation, do not actively participate in the management, but share in the profits. The beneficiaries resemble stockholders still further in that the declaration specifically provides that the beneficiaries are not personally liable for the debts of the organization.

Although certificates of beneficial interest are not specifically provided for, the beneficial interest has been divided into fractional shares, owned by different persons, which, like shares of corporate stock, and in much the same manner, are freely transferable on the books of the organization, so that the enterprise proceeds without regard to changes in its personnel. The actual issuance of stock certificates is not essential even to the existence of a corporation (14 C. J., 391), much less to the existence of an association. (S. M. 4104, C. B. IV–2, 8.)

An enterprise thus engaged in business in quasi corporate form is an association under the Revenue Acts. (*Hecht* v. *Malley*, 265 U. S., 144 [T. D. 3595, C. B. III–1, 489]; *Burk-Waggoner Oil Association* v. *Hopkins*, 269 U. S., 110 [T. D. 3582, C. B. III–1, 1].)

Moreover, in the instant case, the beneficiaries positively control the trust. Through their selling agent and executive committee they improve, subdivide, and sell the property, and determine the sale prices thereof. The beneficiaries have positive control of the executive committee, since they can remove members and replace them

with others at any time, and, presumably, they also control their selling agent. These powers are sufficient to constitute positive control of the trust, even though the beneficiaries have no power to amend the declaration, terminate the trust, or remove the trustee. (S. M. 5382, C. B. V–1, 8.)

Article 1504 of Regulations 69, which is retroactive to the years in question (section 1108(a), Revenue Act of 1926), provides in effect that a trust is an association if the beneficiaries have positive control. Similar implications are found in *Crocker* v. *Malley* (249 U. S., 223); and there have been numerous decisions to that effect in this office. (S. M. 1068, C. B. 1, 5; Sol. Op. 49, C. B. 3, 13; S. M. 4104, supra.)

The contention that the enterprise is a joint venture seems beside the point. It can not be denied that a trust has been created and that a trust under which a business is carried on in quasi corporate form or in which the beneficiaries have positive control is an association. If the joint-venture contention means anything it is a claim that in the instant case a business is not carried on in quasi corporate form and that the beneficiaries do not positively control the trust. This claim would be just as effective if the term "joint venture" were omitted from the argument. It adds nothing and simply confuses the issues. In the instant case it is too plain for discussion that the enterprise is carried on under a trust deed. It is evident, also, that the subdivision, improvement, and sale of lands for profit is a business enterprise. (*Von Baumbach* v. *Sargent Land Co.*, 242 U. S., 503; S. M. 5382, C. B. V–1, 8; G. C. M. 715, C. B. V–2, 7.) It has already been shown that the trust is organized in quasi corporate form and that the beneficiaries have positive control. The organization must therefore be taxed as an association.

TITLE II.—INCOME TAX.

PART I.—GENERAL PROVISIONS.

SECTION 201.—DISTRIBUTIONS BY CORPORATIONS.

ARTICLE 1547: Dividends paid in property.

REVENUE ACT OF 1926.

Distribution of bonds received in exchange for part of the distributing corporation's properties. (See I. T. 2373, page 19.)

ARTICLE 1549: Distribution in redemption or cancellation of stock taxable as a dividend. VI–48–3518 I. T. 2388

REVENUE ACT OF 1926.

The taxpayer corporation by appropriate action redeemed one-half of its class "A" stock of no par value at a price of x dollars a share and accumulated dividends thereon. There were on hand at this time earnings or profits equal to or in excess of the amount

required to effect such redemption of the stock. None of the class "B" stock was redeemed, and the holders of that stock received nothing from the corporation.

Held, under the circumstances shown, that, as to the corporation, the redemption of the stock had the effect of reducing capitalization to the extent of the stock so redeemed, and that, as to the shareholders, the excess of the x dollars received in payment for their stock over the cost or other basis represented profit subject to normal tax and surtax, while the amount received by the shareholders referred to as "accumulated dividends" is subject only to surtax to the extent that it represents a distribution from earnings accumulated since February 28, 1913.

An opinion is requested as to whether a certain distribution made by the M Company in the redemption and cancellation of a portion of its outstanding capital stock is to be treated as equivalent to the distribution of a taxable dividend under section 201(g) of the Revenue Act of 1926 and article 1549 of Regulations 69.

The outstanding capital stock of the corporation prior to such redemption and cancellation consisted of y shares of class "A" stock and $2y$ shares of class "B" stock, both classes being without par value. An amendment to the certificate of incorporation was adopted at a special meeting of the shareholders on June —, 1927, in accordance with the laws of the State of R, under which the corporation was organized, providing that the class "A" stock might be redeemed in whole or in part at the option of the corporation upon resolution of the board of directors by the payment of x dollars a share and accumulated dividends thereon. In accordance therewith a resolution was adopted by the board of directors calling for redemption on August —, 1927, one-half of the outstanding class "A" stock, most of which has since been redeemed. It appears that x dollars a share was in excess of the cost to the various holders thereof and that there were on hand at the date of redemption earnings or profits equal to or in excess of the amount required to effect such redemption of stock. None of the class "B" stock was redeemed, and the holders of that stock received nothing from the corporation.

The conclusion reached, under the circumstances shown, is that the amendment of the certificate of incorporation providing for the reduction of the outstanding capital stock by the redemption of all or a portion of the class "A" stock and the actual redemption in accordance with appropriate corporate action of a portion of such stock in accordance with the amendment, automatically had the effect of reducing the capitalization of the corporation to the extent of the stock so redeemed and canceled, and that the distribution made in connection with such redemption to the extent of x dollars a share was not equivalent to the distribution of a taxable dividend, under the provisions of section 201(g), but was a distribution in partial liquidation, which is governed by section 201(c) of the Revenue Act of 1926. This latter section provides as follows:

Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 202, but shall be recognized only to the extent provided in section 203. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of subdivision (g) of section 203 of stock or securities in connection with a reorganization)

the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subdivision (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

In the instant case, it is to be noted that the amount realized by the holders of class "A" stock was the amount of x dollars per share redeemed plus accumulated dividends. It is the opinion of this office that the excess of the x dollars received by the shareholder in payment for his stock over the cost represents profit subject to both normal tax and surtax, but the amount received by the shareholder referred to as "accumulated dividends" is subject only to surtax to the extent that it represents a distribution from earnings accumulated after February 28, 1913.

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

ARTICLE 1573: Exchanges of property for other property and money. VI–50–3532 G. C. M. 2641

REVENUE ACT OF 1926.

Before an exchange between A and B took place A owned farm property, costing $6.3x$ dollars, which it was agreed had a market value of $22.4x$ dollars and upon which there was an indebtedness of $7.4x$ dollars secured by a mortgage. As a result of the exchange A acquired city property which the parties agreed had a market value of $20x$ dollars and he was relieved of the indebtedness of $7.4x$ dollars, in place of which he assumed an indebtedness of $6.6x$ dollars on the new city property received by him. He also received $1.6x$ dollars which was paid to him by B.

Held, that the gain recognized to A on the transaction was the amount of the net reduction of his mortgage indebtedness of $.8x$ dollars plus the $1.6x$ dollars paid to him by B.

An opinion is requested relative to the gain to A recognized under the Revenue Act of 1926 in respect of an exchange of real estate in 1926. The facts are as follows:

A, the taxpayer, bought a farm in November, 1913, for $6.3x$ dollars. In January, 1926, this property was encumbered by an indebtedness of $7.4x$ dollars, representing borrowed money secured by a mortgage on this farm. B owned city property, on which there was a mortgage of $6.6x$ dollars. B deeded his property to A, who assumed the indebtedness of $6.6x$ dollars. A deeded the farm property to B, who secured a loan of $9x$ dollars on the farm. Of this loan, $7.4x$ dollars was paid to cancel the indebtedness on this farm and the remaining $1.6x$ dollars was paid to A in cash. The two parties agreed between themselves that the market value of the A property was $22.4x$ dollars and that the market value of the B property was $20x$ dollars and the exchange was on the basis of these values.

Section 203(b)1 of the Revenue Act of 1926 reads in part as follows:

No gain or loss shall be recognized if property held for productive use in trade or business or for investment * * * is exchanged *solely* for property of a like kind to be held either for productive use in trade or business or for investment, * * *. [Italics supplied.]

Section 203(d)1 of the Act provides:

> If an exchange would be within the provisions of paragraph (1), * * * of subdivision (b) if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of *other property or money*, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property. [Italics supplied.]

Before the transaction took place A owned a farm property which the parties agreed had a market value of $22.4x$ dollars and upon which there was an indebtedness of $7.4x$ dollars, secured by a mortgage, which represented money borrowed by A. As a result of the exchange A acquired city property which the parties agreed had a market value of $20x$ dollars and he was relieved of the indebtedness of $7.4x$ dollars, in place of which he assumed an indebtedness of $6.6x$ dollars on the new city property. He also received $1.6x$ dollars in cash, which was paid to him by B. Upon these facts it seems clear that the only "other property or money" received by A was the amount of the net reduction of his mortgage indebtedness ($.8x$ dollars) plus the $1.6x$ dollars paid to him by B, making a total of $2.4x$ dollars in "other property or money" received in 1926 on the transaction.

The computation for establishing the maximum amount of gain to A recognized upon the exchange would be as follows:

	Dollars.
Mortgage on A's property paid by B	$7.4x$
Mortgage on B's property assumed by A	$6.6x$
Net reduction of A's indebtedness	$.8x$
Cash paid to A	$1.6x$
Extent to which profit is recognized in 1926	$2.4x$

Should A sell the city property, the basis for determining gain or loss from such sale will be that provided in section 204(a)6 of the Revenue Act of 1926.

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

ARTICLE 1574: Exchanges in connection with corporate reorganizations. (Also section 213(a), Article 39.)

VI–51–3539
I. T. 2392

REVENUE ACT OF 1926.

The incorporation in 1925 of a new company to take over the assets and assume the liabilities of the M Company and the exchange of the stock of the old company by its stockholders for stock and securities of the new company constitute a "reorganization" as defined by section 203(h) of the Revenue Act of 1926 and articles 1574 and 1577 of Regulations 69.

The gain or loss on a sale of fractional warrants issued in connection with the reorganization representing rights to subscribe to notes issued by the new company should be determined as set forth in article 39, Regulations 69.

Advice is requested relative to the exchange of securities in connection with the reorganization of the M Company. The reorganiza-

tion was carried out in accordance with the plan of reorganization dated ——, 1924, by which a new company was incorporated in 1925 to take over the assets and assume the liabilities of the old company. The stock of the old company consisted of both common and preferred stock, while that of the new company consists entirely of common stock of no par value. The transfer of the interests of the stockholders in the old company was made by an exchange of stock whereby the holders of the old common stock received in exchange for each share in the old company —— of a share of stock in the new company and the holders of the old preferred stock received in exchange for each share in the old company —— shares in the new company, the stock in the new company being represented by voting trust certificates. In addition thereto the new company issued — year — per cent class — notes of a par or face value of x dollars which, with y shares of stock of the new company, were offered under certain subscription rights to the old stockholders evidenced by subscription warrants issued to them in connection with the reorganization.

In accordance with the subscription warrants so issued, the holders of the old common stock were, for each share of the old common stock together with the payment of $—— as the subscription price of exercising the right, entitled to acquire —— of a share of stock in the new company, represented by voting trust certificates, and a par or face value of $—— of the class — notes. The holders of the old preferred stock were, for each share of the old preferred stock together with the payment of $—— as the subscription price of exercising the right, entitled to acquire —— shares of stock in the new company, represented by voting trust certificates, and a par or face value of $—— of the class — notes. This involved the issuing of fractional warrants, which could either be sold for the purpose of combining them before exercising the same or could be exercised in the acquisition of fractional stock scrip and fractional note scrip. These could likewise be combined for the purpose of acquiring the stock or notes or, being negotiable as in the case of the subscription warrants, could be sold. The company reserved the right to redeem the outstanding fractional note scrip and to purchase or call in the fractional stock scrip, represented by voting trust certificates, at any time after ——, 192–, the stock scrip to be redeemed at the then market value.

Particularly by reason of the subscription warrants being issued in fractional denominations, some of them were sold without the right being exercised by the original holder. The question is presented as to the basis upon which to compute the gain or loss resulting from the sale of the fractional subscription warrants and as to the effect on the stockholders of the old corporation of the exchange of stock and securities pursuant to the plan of reorganization as above outlined.

As the new company acquired all the assets and assumed all the liabilities of the old company pursuant to a plan of reorganization calling for an exchange of securities, the plan as carried out constituted a "reorganization" as defined by section 203(h) of the Revenue Act of 1926 and articles 1574 and 1577 of Regulations 69. As the interests of the stockholders in the old company were ex-

changed solely for stock or securities in the new company, no taxable gain or deductible loss resulted to the stockholders from such exchange. See section 203(b)2 of the Revenue Act of 1926 and article 1574 of the Regulations 69.

The basis for determining gain or loss on a sale of the fractional warrants by the stockholders to whom they were issued in connection with the reorganization should be determined in accordance with the principles set forth in article 39 of Regulations 69. Accordingly, the basis of each stockholder's shares of stock in the old corporation should be apportioned between the fractional warrants and the new stock received in the exchange in proportion to the respective values thereof at the date of the exchange. The basis for determining gain or loss from the sale of a warrant will be the quotient of the basis assigned to the warrants divided by the number of warrants issued.

ARTICLE 1577: Definitions. VI–35–3396
(Also Section 201, Article 1547.) I. T. 2373

REVENUE ACT OF 1926.

Where one corporation transferred approximately three-fourths of its properties to another corporation for a consideration of bonds and cash, it did not dispose of "substantially all the properties" owned by it at the time, and therefore no corporate reorganization took place, but the transaction constitutes an exchange of property resulting in a gain or loss to the transferor for income tax purposes.

The subsequent distribution of the bonds to the shareholders of the transferor resulted in a taxable dividend to the extent of the earnings and profits on hand accumulated since February 28, 1913.

An opinion is requested relative to the taxable status of a distribution of bonds of the M Company received by a taxpayer as a stockholder of the O Company during the year 1925. The bonds were acquired by the distributing company in connection with a transaction by which it disposed of its manufacturing plant, consisting of land, buildings, and equipment, situated in or near the city of R, State of S, to the M Company, for a consideration consisting of $180x$ dollars par or face value of its bonds and a sum in cash.

A lease was first entered into whereby the O Company leased the plant to the M Company at a stipulated rental for a term of years. The lease granted to the lessee an option to purchase the plant, including all the property covered by the lease, there being two prices specified, one in case the option was exercised prior to January 1, 1925, and another and different price in case the option was exercised after that date. Although the option was exercised prior to January 1, 1925, by notice in writing as required, the transfer of the properties by deed or other instruments of conveyance was made and the consideration therefor received in 1925. The sale accordingly took place in the year 1925, and is, therefore, governed by the Revenue Act of 1926.

The consideration received for the property disposed of consisted of the $180x$ dollars par or face value of bonds and approximately $3x$ dollars in cash, the latter amount representing an adjustment computed as interest allowable to the selling company for the period cov-

ered by the lease. As there was no obligation to pay the purchase price until the option was exercised, the amount of $3x$ dollars received in cash does not represent interest but is merely an adjustment in arriving at the actual selling price of the property. The total consideration so received was accordingly the fair market value at the time of the $180x$ dollars par or face value of the bonds plus the amount received in cash.

In March of 1925 the O Company distributed to its stockholders $140x$ dollars par or face value of such bonds, of which amount the taxpayer, as a stockholder of the company, received bonds of a par value of $17.3x$ dollars. The question is presented as to whether the transaction by which the property of the M Company was disposed of constitutes a corporate reorganization as defined by section 203(h) of the Revenue Act of 1926 and, if so, whether the distribution in question is to be treated as a distribution, in pursuance of the plan of reorganization, of securities in a corporation a party to the reorganization, in accordance with section 203(c) of the Act.

One of the transactions specified by section 203(h)1 of the Act as coming within the meaning of the term "reorganization" is the acquisition by one corporation of "substantially all the properties of another corporation." In that connection, however, it is noted that immediately after the transfer of the property in question the assets of the O Company consisted of the following:

	Dollars.
Bonds collectible from the M Company	$180x$
Accounts receivable	$7x$
Contract sale to the P Company for Q Company stock	$59x$
Furniture and fixtures	$.1x$
T Company stock (no value)	$5x$

It, therefore, appears that the total assets of the transferor company at the date of the transaction were worth approximately $240x$ dollars, and that the consideration received in exchange for the manufacturing properties disposed of represented approximately three-fourths of that total value. It must, therefore, be held that the O Company did not dispose of "substantially all the properties" owned by it at the time and, accordingly, that the transaction did not constitute a corporation reorganization as defined by the statute. On the contrary, it was a disposition of property by way of exchange for bonds of the transferee corporation and a sum in cash, and one that resulted in a gain or loss to the transferor company recognized for income tax purposes.

Inasmuch as the bonds of the M Company were not acquired by the O Company in connection with a reorganization, the distribution thereof in March, 1925, to the stockholders of the O Company was not a distribution made in pursuance of a plan of reorganization and section 203(c) of the Act is not applicable. Such being the case, the distribution must be recognized for tax purposes as an ordinary or liquidating dividend, as the case may be, distributed by the O Company on its outstanding capital stock. The amount of such dividend received by the taxpayer was the fair market value of the bonds as of the date when they first became available to the taxpayer as a stockholder of the distributing company. To the extent of the taxpayer's pro rata share of the earnings or profits of the O Company on hand at the time and accumulated since February 28, 1913, the

dividend constitutes income taxable to him at surtax rates only for the year 1925. Any amount distributed to the taxpayer in excess of his pro rata share of such earnings or profits should be treated as a return or distribution of capital and applied to reduce the cost or other basis of the stock in respect of which the distribution was made.

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

ARTICLE 1601: Stock or securities acquired in "wash sales."

REVENUE ACT OF 1926.

Interpretation of "wash sales" provisions. (See G. C. M. 1210, page 60.)

ARTICLE 1602: Basis for allowance of depletion and depreciation. VI–39–3443 G. C. M. 2315

REVENUE ACTS OF 1921, 1924, AND 1926.

Under the Revenue Act of 1926, if a taxpayer elects to treat development expenditures as ordinary and necessary business expenses deductible in computing taxable net income, such expenditures must be deducted in determining the net income from the property, which amount is used as a limitation in the computation of the depletion allowance based on income.

In applying the limitation on discovery depletion in the case of oil and gas wells provided for in section 234(a)9 of the Revenue Act of 1921, the gross income from a discovery property should not be reduced by development expenditures in the computation of the net income from the property. A like construction should be followed in applying the provisions of section 214(a)10 of the Revenue Act of 1921 and of section 204(c) of the Revenue Act of 1924.

An opinion is requested as to whether development expenditures made in connection with oil or gas wells should be deducted from the gross income of a discovery property in determining the net income from the property within the meaning of section 234(a)9 of the Revenue Act of 1921 where the taxpayer corporation, pursuant to article 223 of Regulations 62, elected to deduct such expenditures from its gross income in computing net income subject to Federal income or profits taxes.

Shortly after the enactment of the Revenue Act of 1921, the construction of the proviso inserted in section 234(a)9 of the Act that the "depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made" was given consideration by the Bureau, and the decision was reached that the "net income from the property" referred to in the proviso should be computed without regard to development expenditures, that is, that development expenditures should not be treated as a deduction in computing the "net income from the property" regardless of whether the taxpayer corporation under article 223 of Regulations 62 elected to treat such

expenditures as operating expenses deductible in computing taxable income or to charge them to capital returnable through depletion. In view of the decision made at that time, the fact that it has been uniformly followed in closing a great number of cases, and the desirability of a consistent administration of the provision in question, the conclusion is reached that in applying the limitation on discovery depletion in the case of oil and gas wells provided for in section 234(a)9 of the Revenue Act of 1921, the gross income from a discovery property should not be reduced by development expenditures in the computation of the "net income from the property," which amount measures the maximum depletion allowance based on discovery which can be allowed in respect to such property. A like construction should be followed in applying the provisions of section 214(a)10 of the Revenue Act of 1921 and the provisions of section 204(c) of the Revenue Act of 1924. The latter section restricts a depletion allowance based on discovery value to "50 per centum of the net income (computed without allowance for depletion) from the property upon which the discovery was made."

The construction herein adopted relative to discovery depletion in the case of oil and gas wells under the 1921 and 1924 Acts should be confined to those Acts. Under section 204(c)2 of the Revenue Act of 1926, provision is made that in the case of oil and gas wells the allowance for depletion based upon the gross income from the property "shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property." The term "net income" as used in that section should be taken to mean the net income defined in sections 212 and 232 of the Act. Accordingly, if a taxpayer elects to treat development expenditures as ordinary and necessary business expenses deductible under section 214(a)1 or 234(a)1 in computing taxable net income, such expenditures must be deducted in determining the net income from the property, which amount is used as a limitation in the computation of the depletion allowance based on income.

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

ARTICLE 1602: Basis for allowance of depletion and depreciation. (Also Section 214(a)9, Article 216.)

VI–42–3469
I. T. 2384

REVENUE ACT OF 1926.

The essential consideration in determining whether the depletion provisions of article 216(e) of Regulations 69 apply in any given case is whether or not the lease is of an oil or gas well. Article 216(e) is not applicable to leases covering properties on which no well is in existence.

The opinion of this office is requested concerning the following portion of article 216 of Regulations 69, relative to depletion deductions:

(e) In lieu of the treatment provided for in the above paragraphs the lessor of oil and gas wells may take as a depletion deduction in respect of any bonus, royalties, and other income from the property for the taxable year 27½ per

cent of the amount thereof, but the deduction shall not exceed 50 per cent of the net income (computed without allowance for depletion) from the property.

The question is raised as to whether, under the provisions above quoted, the lessor is entitled to a deduction for depletion of 27½ per cent of any amount received as a bonus for oil and gas leases or of any amount received as oil or gas lease rentals.

Section 204(c)2 of the Revenue Act of 1926, upon which article 216(e) is based, provides that—

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 will be noted that the above-quoted section of the law operates only in cases of oil and gas wells and that the allowance for depletion at the rate therein provided is expressly limited to the gross income from such property. Accordingly, it must be concluded that the application of article 216(e) of Regulations 69 is dependent upon whether or not the lease in question is of an oil or gas well, and that article 216(e) of the regulations does not apply to leases covering properties on which no well is in existence.

ARTICLE 1602: Basis for allowance of depletion and depreciation. VI–52–3549 G. C. M. 2817

REVENUE ACT OF 1926.

Three mining corporations, one of which was entitled to discovery value as a basis for depletion deductions, transferred their entire assets to the taxpayer in exchange for its capital stock under circumstances constituting a reorganization. No gain or loss was recognized on the transaction and the basis of such property for determining gain or loss to the taxpayer was the same as it would be in the hands of corporations from whom the assets were acquired.

Held, that the taxpayer is not entitled to take a depletion deduction based on the discovery value previously allowed one of the transferor corporations.

The opinion of this office is requested with reference to the following question:

In a consolidation of several corporations under the same stock control and management into one new corporation where no gain or loss is recognized, should depletion deductions based on discovery value previously allowed to one of the transferor corporations be allowed to the new corporation?

The facts in the case are as follows: Prior to April 1, 1925, the M Company, the O Company, and the P Company (the three corporations being called hereinafter, collectively, the predecessor corporations) were actively engaged in the mining business and were under the same management and stock control. On April 1, 1925, the taxpayer, the Q Company, was organized under the laws of the State of R and acquired the entire assets of the three predecessor corporations in consideration of the issuance of its stock of a par value of 29x dollars. The three predecessor corporations were shortly

thereafter dissolved, after distributing among their shareholders the shares of the taxpayer. One of the three predecessor corporations was entitled to discovery value as a basis for its depletion allowance.

It is obvious from the facts that the taxpayer is not the same legal person as any one of the three predecessor corporations, nor endowed or charged by the mere fact of its corporate existence with the sum of the rights, duties, privileges, and liabilities of any of the three predecessor corporations—a result which sometimes occurs under some State statutes with respect to mergers. Furthermore, it would seem that the transfer of the entire assets of the three predecessor corporations to the taxpayer in exchange for the capital stock of the taxpayer constitutes a reorganization, as that term is defined in section 203(h)1, Revenue Act of 1926; that no gain or loss is recognized to the transferor corporation from such transfer of its properties under section 203; and that, under the provisions of section 204, the *basis for determining gain or loss* from the sale or other disposition of such property by the taxpayer is the same as it would be in the hands of the particular transferor corporation from which acquired.

Section 204(c) of the Revenue Act of 1926 prescribes the basis upon which depletion is to be allowed in respect of any property and reads in part as follows:

> (c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—
>
> (1) In the case of mines discovered by the taxpayer after February 28, 1913, the basis for depletion shall be the fair market value of the property at the date of discovery or within 30 days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost. * * *

Unless the taxpayer can bring itself within the exception provided in paragraph (1) of section 204(c), it is obvious that the general rule laid down in the introductory paragraph of that section, namely, that the basis for depletion is the same as the basis for determining gain or loss upon the sale or other disposition of property as provided in section 204 (a) or (b), must apply.

The exception allows as the basis for depletion, in lieu of the basis for determining gain or loss under section 204 (a) or (b), the "fair market value of the property at the date of discovery or within 30 days thereafter," but conditions such allowance upon the concurrent existence of three facts:

(1) The mine must have been discovered by the taxpayer after February 28, 1913;

(2) The mine must have been acquired otherwise than as the result of purchase of a proven tract or lease; and

(3) The fair market value of the property must be materially disproportionate to the cost.

In the instant case the mine was not discovered by the taxpayer, since "taxpayer" as used in this provision of the Act can mean only the person subject to the tax imposed. Nor did the taxpayer have any right, title, or interest, legal, equitable, or beneficial, in the property at the time the discovery was made. (See 32 Op. Atty. Gen., 328; T. D. 3089, C. B. 3, 175.) The taxpayer therefore fails to satisfy the requirements of the first condition.

Nor would it seem that the taxpayer can satisfy the second condition, namely, the acquisition of the mine otherwise than as the result of purchase of a proven tract or lease. Certainly, under the facts submitted, when the taxpayer acquired the properties they were proven properties. Whether the statutory term "purchase" is construed to mean "purchase" as it is understood in the law of conveyancing, or a transaction in which a valuable consideration is given, or a technical "sale," or merely a nongratuitous transaction (gifts, bequests, or acquisitions by operation of law being excluded), it would seem that the taxpayer acquired the properties "as the result of purchase." The taxpayer fails, therefore, to satisfy the second condition.

No facts appear upon which an opinion can be expressed as to the satisfaction of the third condition.

The taxpayer is not entitled to a discovery value as the basis for depletion if it fails to satisfy any one of the three statutory conditions. Upon the facts submitted the taxpayer has failed to satisfy at least two of the statutory conditions and therefore has not brought itself within the provisions of the exception contained in paragraph (1) of section 204(c). Accordingly, the taxpayer must take as its basis for depletion the same basis as is prescribed in subdivisions (a) or (b) of section 204 for determining gain or loss from the sale or other disposition of property.

The memorandum of this office (see G. C. M. 1345A, on page 154) holding "To the extent that the intercompany transferor of a natural resource deposit would have been entitled to depletion on the basis of discoveries previously made discovery depletion should be allowed to the intercompany transferee," deals exclusively, so far as all issues here relevant are concerned, with transactions between corporations which are affiliated within the meaning of section 240 of the various Acts, and which are either required to file consolidated returns or have elected to file such returns. As was said in General Counsel's Memorandum 1345A—

> A transfer of assets between members of an affiliated group effected during years for which consolidated income tax returns were required, an intercompany transaction, is productive of neither taxable gain nor deductible loss in computing the net income of the affiliated group.

The enterprises conducted by affiliated corporations being conceived of as a single enterprise operated through several corporations as branch establishments, and the transactions between such branches of a single enterprise being intercompany transactions productive of neither taxable gain nor deductible loss in computing the consolidated income of the affiliated group, it is logical that such intercompany transactions should not result in any new or independent basis for the computation of gain or loss on the disposition by any one of the affiliated corporations of assets, nor be productive of any new basis for depletion, nor destroy or create any discovery value basis. These principles are, and can be, applicable only to affiliated corporations which have elected, or are required, to file consolidated returns under section 240 of the various Acts and the regulations made pursuant thereto.

Whether or not the corporations involved in the instant case were entitled to file consolidated returns under section 240, it is apparent that they did not do so, and that the principles applicable in the case

of affiliated corporations are not applicable to the transactions under consideration. These transactions must accordingly be governed by the provisions of the statute applicable thereto, and, as has been previously shown, the taxpayer can not bring itself within the only provision of the Act which allows discovery value to be taken as a basis for depletion.

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

SECTION 208.—CAPITAL GAINS AND LOSSES.

ARTICLE 1653: Partnerships, estates, and trusts. VI–43–3478
G. C. M. 2364

REVENUE ACT OF 1926.

Where an estate sells investment property of a decedent less than two years after his death but more than two years after its acquisition by the decedent, the estate may claim the benefit of the capital gain provisions of section 208.

An opinion is requested as to whether in the case of the sale of investment property by an estate in the process of administration the two-year period provided by section 208(a)8 of the Revenue Act of 1926 begins to run from the date of the decedent's death, or from the date the property was acquired by the decedent.

Section 208(a)8 of the Revenue Act of 1926 defines the term "capital assets" to mean "property held by the taxpayer for more than two years," and further provides that:

In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 204 such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

This provision does not appear in the prior Revenue Acts.

Following the decision of the United States Court of Claims in the case of *May McKinney et al.* v. *United States* (62 Ct. Cls., 180), article 343 of Regulations 69 was amended by Treasury Decision 4011 [C. B. VI–1, 77] to read in part as follows:

Where * * * 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.

It is apparent, therefore, that the Bureau has adopted the principle of the McKinney case that the basis for determining gain or loss upon the sale of property by an estate is the same as it would be were the sale made by the decedent. In view of the language of section 208(a)8 of the Revenue Act of 1926, above quoted, and the general intent of Congress as shown by such language, it is the opinion of this office that where an estate during the period covered by the 1926 Act sells investment property of a decedent less than two years after his death, but more than two years after its acquisition by the decedent, the estate may claim the benefit of the capital gain provisions of section 208 of that Act.

SECTION 209.—EARNED INCOME.

ARTICLE 1661: Earned income. VI–30–3326
G. C. M. 236

REVENUE ACT OF 1926.

No attempt should be made to lay down a general rule defining earned income which is applicable to all cases.

Whether royalties received by an author are derived from the sale, leasing, or renting of the intellectual product, they are not paid for "personal services actually rendered," and do not come within the meaning of the term "earned income."

Where a publisher contracts with an author to write articles on certain subjects weekly for a period of one year for a newspaper or to write a book on a certain subject, the publisher to copyright the literary work and pay the author a stipulated amount in cash, or cash plus a percentage of the income derived from other publishers using the articles or material in the book, the compensation comes within the term "earned income" as defined in section 209(a).

An opinion is requested as to whether the full amounts received by taxpayers as royalties from publishers should be considered as earned income.

As stated in Solicitor's Memorandum 4088 (C. B. IV–2, 26), no attempt should be made to lay down a general rule defining earned income which is applicable to all cases, but the individual cases should be considered upon the facts in each case. The question presented for opinion is so general in its scope that it can not be answered so as to cover all cases that may arise involving royalties as a part of the taxpayer's income.

The view is presented that all royalties paid by publishers to authors are paid as a consideration for the author selling, renting, or leasing his property to the publisher, and that royalties received by an author from his publishers do not come within the meaning of the term "earned income." The question whether an author sells, leases, or rents his intellectual product to a publisher depends upon the terms of their contract. The contract may provide for the transfer of both the tangible and intangible property rights of the author in his product for which the publisher agrees to copyright, advertise, publish, and market the intellectual product and to compensate the author in the form of royalties for his property rights. Where the royalties received by an author are derived either from the sale, leasing, or renting of the intellectual product, it is the opinion of this office that they are not paid for "personal services actually rendered," but are paid for the use or sale of property, and do not come within the meaning of the term "earned income" as defined in section 209(a).

A publisher may enter into a contract with an author to write articles on certain subjects once a week for a period of one year for a newspaper or to write a book on a certain subject, the publisher to copyright the literary work and pay the author a stipulated amount in cash, or a certain amount of cash plus a percentage of the income derived from other publishers using the articles or material in the book. In this class of cases there exists the relationship of employer and employee and the consideration paid the author is for his personal services. Intellectual products of an author who contracts

or is employed to write articles or books at some time in the future for publishers, in a majority of cases, belong to the employer, and the author has no tangible or intangible property right in the published property. It is the opinion of this office that both the lump-sum amount and royalties paid in this class of cases are for "personal services actually rendered" and come within the term "earned income" as defined in section 209(a).

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

ARTICLE 1661: Earned income. VI–32–3352
(Also Section 219, Article 346.) I. T. 2370

REVENUE ACT OF 1926.

Amounts contributed by the M Company to a trust fund under a "stock bonus, pension, or profit-sharing plan" for the benefit of participating employees, and accretions to such amounts, except that portion of such accretions which represents an accumulation of dividends on stock purchased by the trustee of the fund, may be treated as earned income within the limitations specified in section 209 of the Revenue Act of 1926.

An opinion is requested regarding the income tax liability of A with respect to an amount distributed to him under the stock purchasing plan of the M Company.

It has been determined by the Bureau that the employees' stock purchasing plan of the M Company under which a distribution was made as of March —, 1926, constituted a "stock bonus, pension, or profit-sharing plan" for the exclusive benefit of the participating employees within the meaning of section 219(f) of the Revenue Act of 1926. The earnings of the trust created as a part of that plan are, therefore, not taxable in the hands of the trustee. The gain, if any, realized by a participating employee, however, is taxable income to him for the year in which his share in the trust fund accumulated under the plan was distributed or made available to him. That gain is measured by the excess of the amount actually distributed or made available to the employee over the amount contributed by such employee to the fund, and may be the result of contributions to the fund made by the employer, dividends or interest realized by the trustee on investments of the fund, or other accretions to the fund under the administration of the trustee.

The stock purchasing plan of the M Company provided that an employee might share in the ultimate benefits thereof only upon condition that he remain a participant for the period fixed by the plan. A participating employee, A, contributed to the fund provided for by the plan $10x$ dollars. The M Company contributed to the fund on his behalf $5x$ dollars. The trustee kept the fund invested, in so far as practicable, in the stock of the M Company, and received from the company as dividends on that portion of the stock ultimately distributed to A, $3x$ dollars. A's distributable share of the remainder of the general fund was $2x$ dollars. The total of $20x$ dollars distributable to A was received by him in the form of y shares of the common stock of the M Company and a check for $\$$——.

The income realized by A at the date of the distribution as one of the participating employees was $10x$ dollars, or the difference be-

tween the total amount received (i. e., the fair market value of the stock plus the cash) and the amount contributed by him to the fund.

To the extent that the taxable gain realized by A was representative of dividends paid by the M Company to the trustee of the fund, the gain so realized is subject to taxation at surtax rates only.

To the extent that the taxable gain realized by A was representative of the contributions by the M Company to the fund and of fund accretions apportionable to the contributions of the M Company other than dividends, the gain so realized should be regarded as additional compensation to A for services rendered and should be treated as earned income within the limitations specified in section 209 of the Revenue Act of 1926.

The balance of the gain involved in the distribution should be regarded as ordinary gains or profits realized by A as the result of his contributions to and the liquidation of the fund.

PART II.—INDIVIDUALS.

SECTION 212.—NET INCOME OF INDIVIDUALS DEFINED.

ARTICLE 23: Bases of computation.

REVENUE ACT OF 1926.

Accrual of State, county, and municipal taxes in Washington and Oregon. (See I. T. 2377, page 59.)

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

ARTICLE 31: What included in gross income.

REVENUE ACT OF 1926.

Interest received on certificates issued by receivers of insolvent State banks taken over by Guaranty Fund Commission of Nebraska. (See G. C. M. 2453, page 35.)

ARTICLE 39: Sale of stock and rights. VI-40-3451
I. T. 2383

REVENUE ACT OF 1926.

Method outlined for computing gain or loss resulting from a sale by the taxpayer in 1926 of rights received on shares of corporate stock, a portion of which stock was acquired prior to March 1, 1913, and with respect to which rights to subscribe were issued in 1914, 1917, 1922, 1923, 1924, and 1925.

Advice is requested relative to the method of computing the gain or loss under article 39 of Regulations 69 resulting from the sale on June —, 1926, of rights received on 80 shares of the capital stock of the M Company.

The taxpayer purchased 10 shares of the capital stock of the company in 1912 at a cost of $1,430, which shares on March 1, 1913, had a fair market value of $1,525. Stock rights were subsequently issued on such stock in 1914, 1917, 1922, 1923, 1924, and 1925. Most of the rights were sold without being exercised, although some were exercised and the additional stock acquired. As a result of a reorganization or recapitalization of the company, effective as of May 26, 1926, new stock of no par value was exchanged for the old stock on the basis of 5 new shares for each old share then outstanding. The stockholders were also given the right as of that date to acquire 1 additional share at a subscription price of $20 for each 2 shares of the new common stock then held as a result of the exchange. As a result of the transactions to that time the taxpayer was the holder of 80 shares of the no par value stock and, therefore, received rights to subscribe for 40 shares in addition thereto. Such rights were sold on June —, 1926, at a price of $1,089.20, and a ruling is requested as to the method of computing the gain or loss resulting from such sale.

The question presented in connection with the transaction arises chiefly from the fact that the method of computing such gain or loss as prescribed by article 39 of Regulations 69 differs from the method provided by article 39 of Regulations 65 and the corresponding provisions of the prior regulations. With reference thereto, it is held by Treasury Decision 4018 [C. B. VI–1, 36] that article 39 of Regulations 69 is not to be applied with retroactive effect beyond January 1, 1925.

It will be seen from the foregoing with reference to the case at hand that the result of such transactions which took place prior to January 1, 1925, is to be determined in accordance with the regulations in effect for those years, treating the transaction in each instance as if the rights had been exercised and the additional stock acquired. With reference to the rights which were sold without being exercised the computation herein is made only to the extent of showing the portion of the old basis which attached to the stock retained. As the value of the 10 shares as of March 1, 1913, $1,525, was in excess of the cost, the computation is made on such value as the basis. In each instance prior to January 1, 1925, the subscription price required to acquire the additional stock was $100 a share. The 10 rights received in 1914 entitled the taxpayer to acquire 1⅔ shares of stock; the 10 rights received in 1917, 1 share; the 11 rights received in 1922, 2⅕ shares; the 13 rights received in 1923, 2⅗ shares; and the 13 rights received in 1924, 2⅗ shares. Based on such data, the computation is as follows:

Value of the 10 shares as of Mar. 1, 1913	$1,525.00
Subscription price required to acquire the 1⅔ shares by the 10 rights received in 1914 (rights sold without being exercised)	166.67
Total basis applicable to 11⅔ shares	1,691.67
Portion of such total basis which attached to the 10 shares still held is the portion thereof which 10 shares is of 11⅔ shares, or	1,450.00
Subscription price required to acquire the 1 share by the 10 rights received in 1917 (rights exercised)	100.00
Total basis applicable to 11 shares	1,550.00

Subscription price required to acquire the 2⅕ shares by the 11 rights received in 1922 (1 right sold and 10 exercised)	$220.00
Total basis applicable to 13⅕ shares	1,770.00
The portion of such total basis which attached to the 13 shares then held is the portion thereof which 13 shares is of 13⅕ shares, or	1,743.18
Subscription price required to acquire the 2⅗ shares by the 13 rights received in 1923 (the 13 rights sold)	260.00
Total basis applicable to 15⅗ shares	2,003.18
The portion of such total basis which attached to the 13 shares still held is the portion thereof which 13 shares is of 15⅗ shares, or	1,669.32
Subscription price required to acquire the 2⅗ shares by the 13 rights received in 1924 (the 13 rights sold)	260.00
Total basis applicable to 15⅗ shares	1,929.32
The portion of such total basis which attached to the 13 shares still held is the portion thereof which 13 shares is of 15⅗ shares, or	1,607.77

The receipt of the 13 rights on October —, 1925, is governed by article 39 of Regulations 69. It is, therefore, necessary to apportion the old basis as last adjusted of $1,607.77 then applicable to the 13 shares held at that time between the 13 shares and the 13 rights in the ratio or proportion of the respective values thereof as of October —, 1925, in accordance with subdivision (1) of article 39. As the values as of that date are not given, the computation can not be shown. Of the total basis so allocated to the 13 rights, the proper aliquot part thereof should be allocated to the 12 rights exercised and to the 1 right sold. The portion so allocated to the 12 rights exercised plus the $300 subscription price required is the basis applicable to the 3 new shares acquired by the exercise of such rights.

In the exchange made in connection with the reorganization or recapitalization which took place on May —, 1926, 5 new shares of stock without par value were received in exchange for each old share then held, and, as no gain or loss resulted therefrom for income tax purposes, the old bases applicable to the two lots of 13 shares and 3 shares, respectively, determined as above stated, attached to the respective 65 shares and 15 shares received in the exchange.

At the same time rights were received entitling the taxpayer to acquire 1 additional share of the stock without par value for each 2 shares then held at a subscription price of $20 a share. In this instance the old bases applicable to the 65 shares and the 15 shares, respectively, as last determined above, should be allocated between the stock and rights as to each lot in the ratio or proportion of the respective values of the stock and rights as of May 26, 1926, in accordance with article 39 of Regulations 69. The sum of the two amounts so allocated to the rights received on the two lots of stock is the amount to be compared with the selling price of the rights, $1,089.20, for the purpose of determining the gain or loss resulting from the sale of the 80 rights on June —, 1926.

ARTICLE 39: Sale of stock and rights.

REVENUE ACT OF 1926.

Basis for determining gain or loss on a sale of fractional warrants representing rights to subscribe to notes. (See I. T. 2392, page 17.)

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

ARTICLE 72: Proceeds of insurance—Compensation—Pensions. VI-38-3436 I. T. 2380

REVENUE ACTS OF 1924 AND 1926.

Method outlined for determining income tax liability arising on the maturity of certain endowment insurance policies issued prior to March 1, 1913, where the insured survived the endowment period.

Advice is requested relative to certain endowment insurance policies issued by the M Company where the insured survived the endowment period.

There is submitted with the first case a copy of policy No. ——, issued to A on February —, 1905. The policy was for $1,000, on the 20-year endowment plan, and matured on February —, 1925. The net cost to the insured to the date of maturity (premiums less dividends) was $884.61, with an additional dividend or refund at that date of $22.67 as an adjustment on the last premium paid. The net cost to the insured to March 1, 1913, was in excess of the cash surrender value at that time, the former being $409.93 and the latter $331.83. The maturity value was of course $1,000, and the insured elected to have settlement under the plan referred to as Option A, designating himself as beneficiary with his wife as contingent beneficiary. In accordance with the terms of the settlement he received a dividend or refund of $22.67 and left the principal sum of $1,000 with the company, from which he receives an annuity (so called) of 4.8 per cent of the principal sum. The first annuity-paying date was February —, 1926. The principal sum of $1,000 so left with the company may be withdrawn at any annuity-paying date, in which case the payment of the annuity will cease.

Attention is directed in this connection to section 213(b)2 of the Revenue Act of 1926, effective for 1925 and subsequent years, the provisions of which are as follows:

(b) The term "gross income" does not include the following items, which shall be exempt from taxation under this title:

* * * * * * *

(2) Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph; * * *.

The entire amount of $1,000, called for by the policy, was available to the insured at the maturity date, and, in fact, at any annuity-paying date thereafter. Although under the settlement made it was left with the company, the insured as beneficiary receives a return thereon of 4.8 per cent, and, as before stated, the principal sum may be withdrawn at any annuity-paying date. The settlement made,

therefore, amounts to the constructive receipt of the proceeds of the policy at the maturity date and the reinvestment of the same in accordance with the terms of the settlement. The so-called dividend of $22.67 paid to the insured at the maturity date represented merely an adjustment or refund on the last premium paid and, so treated, the net premiums paid are shown to have amounted to $861.94. As this amount of the proceeds is exempt from the income tax under the above-quoted provisions of the statute, the portion of the proceeds which constitutes taxable gain is $138.06, this being the amount by which $1,000 exceeds the net premiums paid. This amount, therefore, represents taxable income for the year 1925, subject to both the normal tax and surtax. With reference to the so-called annuity of 4.8 per cent payable to the insured, as the principal sum is not exhausted and, in fact, may be withdrawn at any annuity or interest-paying date, it is evident that the annual payments are for the use of the money, having the status of interest. Such payments, therefore, constitute taxable income to the insured in their entirety, subject to both the normal tax and surtax.

In the second case presented a policy with similar optional settlements, No. ——, was issued to B for $2,000 on November —, 1905. The dividend or refund to the insured at the maturity date on the last premium paid was $42.76 and, treated as a refund on such last premium, it shows the net cost to the insured (premiums less dividends) to have been $1,461.23. Although not so stated, it is assumed that, as in the preceding instance, the net cost to the insured to March 1, 1913, was in excess of the cash surrender value as of that date. The insured designated himself as beneficiary and elected to have settlement made for the principal sum under the plan referred to as Option B, in accordance with which he is to receive 15 annual payments of $162.64 each, the first of which was received on November —, 1925. As in the preceding instance, the entire amount of the principal sum was available to him at the maturity date and any unpaid balance may be withdrawn at any installment-paying date.

The principles governing this settlement are the same as in the preceding instance. The amount of the taxable gain resulting to the insured is $538.77, this being the amount by which the principal sum of $2,000 exceeds the net amount paid by the insured. The taxable gain so computed is subject to both the normal tax and surtax for the year 1925, in which it became available to him. The transaction has the further effect of the proceeds in the sum of $2,000 being invested or paid as the purchase price of the 15 annual payments to be received under the plan of settlement agreed upon. Under the provisions of the statute hereinbefore quoted, no taxable gain will result to the recipient of such annuity payments until the aggregate of the payments received exceeds the sum of $2,000, the cost of the annuity contract.

The third case presented pertains to policy No. ——, for $1,000, issued to C on January —, 1894, on the 30-year endowment plan with semitontine period of 20 years, and the policy, therefore, matured on January —, 1924. The premiums paid by the insured up to March 1, 1913, amounted to $597.60 and the cash surrender value on that date is stated to have been $473.87. The total premiums paid after March 1, 1913, amounted to $298.80, and this amount reduced by the divi-

dends subsequently applied ($75.13 plus final dividend of $10.98) shows the net premiums paid after March 1, 1913, to be $212.69. The semitontine period expired in 1914, at which time there was paid to the insured a dividend of $214.39, representing accumulated surplus of the company apportioned to the policy. This policy also provided that the amount named in the policy might be applied "* * * to purchase a participating paid-up life policy of like amount and a life annuity equal to four (4) per cent of such paid-up policy." At the maturity date the insured elected to and did receive in settlement of the principal sum of $1,000 a paid-up life policy, No. ——, for $1,000 and an annuity contract, No. ——, which provides for the payment to him of an annuity of $40 a year, the original policy having been surrendered at the date of settlement. It is further stated that of the $1,000 as proceeds of the original policy, $551.16 was applied to purchase the paid-up life policy and $448.84 to purchase the annuity.

Inasmuch as this policy matured in 1924, the principles for determining the taxable gain resulting to the insured from the receipt of the proceeds upon the maturity of the policy are controlled by the provisions of section 213(b)2 of the Revenue Act of 1924, which are as follows:

(b) The term "gross income" does not include the following items, which shall be exempt from taxation under this title:

* * * * * * *

(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract; * * *.

As the cash surrender value on March 1, 1913 ($473.87), evidently took into account the amount of the accumulated surplus which had been apportioned to the policy to that date, if any, the cash surrender value as of that date should be reduced by the amount of the semitontine dividend of $214.39 received in 1914, or by the proper portion thereof which had been apportioned to the policy up to March 1, 1913, and the result so obtained is the capital or asset value of the policy as of that date. This value is then to be increased by the portion of the net premiums paid subsequent thereto ($212.69), which represented the cost of the capital or asset value of the policy, excluding the portion of such premiums which represented the cost of earned life insurance and was a recurring, annual, personal expense. The result so obtained is the amount to be compared with the amount of $1,000 realized by the insured as being available to him at the maturity date, and the excess thereof over the amount representing the capital or asset value ascertained in accordance with the foregoing constitutes taxable income to the insured subject to both the normal tax and the surtax for the year 1924.

As the first annual payment of $40 on the annuity contract, along with the payment of the dividend of $6.58 on the paid-up life policy, was made in the year 1925, the receipt of these payments is governed by section 213(b)2 of the Revenue Act of 1926. These amounts, accordingly, do not constitute taxable income for the year 1925 but should be applied to reduce the cost of the annuity contract and the paid-up life policy, respectively.

ARTICLE 74: Interest upon State obligations. VI–45–3495
(Also Section 213(a), Article 31.) G. C. M. 2453

REVENUE ACT OF 1926.

Certificates issued by receivers of insolvent State banks which have been taken over by the Guaranty Fund Commission of Nebraska are not obligations of a State or a political subdivision thereof, and the interest received on such certificates should be included in the gross income of the recipient.

An opinion is requested relative to the income tax liability of the M Company for interest accruing on certificates (notes) issued by receivers of insolvent State banks which have been taken over by the Guaranty Fund Commission of Nebraska. The taxpayer claims such interest is exempt under section 213(b)4 of the Revenue Act of 1926, as interest upon the obligation of a State, Territory, or a political subdivision thereof. By its banking laws (secs. 7982 to 8082, inclusive, Revised Statutes of Nebraska, 1922, as amended) the State of Nebraska has declared the business of banking a quasi public business, subject to regulation and control by the State. The department of trade and commerce is given general supervisory and regulatory powers over all State banks. The State further requires a depositors' guarantee fund (secs. 8024–8028, revised statutes, 1922) to be assessed, collected, and disbursed under the direction of the department of trade and commerce for the protection of depositors in all State banks. For administrative purposes the State is divided into seven banking groups, from each of which the local bankers select one representative to sit as a member of the guaranty fund commission, accountable to the secretary of the department of trade and commerce, and "created for the purpose of assisting in conserving and administering the depositors' guarantee fund of the State of Nebraska and providing a more thorough and complete supervision of State banks." This commission is empowered to take over, operate, or liquidate any bank the condition of which appears unsafe or unsound to the examiners. In such case a receiver is appointed by the commission, with full authority to conduct the affairs of the insolvent bank toward the end desired.

In order to raise cash to pay depositors in full a receiver is authorized to issue receiver's certificates (sec. 41, ch. 191, Session Laws, Nebraska, 1923), which are his personal notes, as receiver, payable only out of the assets of the bank and/or the depositors' guarantee fund of the State of Nebraska and payable to the guarantee fund commission or its order. Such certificates constitute a first lien on the assets of the bank and on the rights of the depositors in the depositors' guarantee fund. By the language of the certificate it is the receiver's "promise to pay *out of* funds available for such purpose, received from the assets of said bank or from funds received from the depositors' guarantee fund of the State of Nebraska, as directed by the court, *to* the guarantee fund commission, etc." To make the certificate valid the secretary of the department of trade and commerce must approve it and "certify that the same is payable *out of* funds available for such purpose received from the assets of said bank or from funds received from the depositors' guarantee fund of the State of Nebraska, as directed by the court, etc." Last, the guarantee fund commission indorses it "without recourse."

Section 213(b) of the Revenue Act of 1926 provides:

The term "gross income" does not include the following items, which shall be exempt from taxation under this title: * * * (4) Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, * * *.

A receiver's certificate is not an obligation of the State itself. By its terms it binds only (1) funds in the hands of the receiver representing the assets of the defunct bank, and (2) funds turned over to the receiver from the depositors' guarantee fund. In order to secure a charter and engage in business in Nebraska, banks must cooperatively maintain a sufficiently large fund, backed by the united credit and capital stock of all State banks, to guarantee every depositor in every bank against loss through the failure of any one or more of them. The assessments necessary to maintain this fund are determined by the guarantee fund commission, composed of representative bankers of the seven banking groups; the secretary of trade and commerce collects the assessments; and the State treasurer acts as a holding agent subject to the orders and requirements of the said commission and the banking bureau of the department of trade and commerce. The State undertakes no obligation whatever, but merely places complete supervisory powers in its department of trade and commerce. It authorizes the selection of the guarantee fund commission by the State bankers, for the proper administration of the required depositors' guarantee fund.

Nor are the receiver's certificates obligations of a "political subdivision" of the State. Article 74, Regulations 69, defines a political subdivision of a State or Territory as "any division of the State or Territory made by the proper authorities thereof acting within their constitutional powers." In its administration of its banking laws the State of Nebraska recognizes no such subdivision, and the only mention made of any physical division whatever is found in section 8032, Revised Statutes of Nebraska, 1922, as amended by Session Laws of 1923 and 1925, which for the purpose of selecting members of the guarantee fund commission divides the State into seven banking groups of counties and provides that the bankers located in each group may select one of their number to represent them on the guarantee fund commission.

It is the opinion of this office, therefore, that the certificates issued by receivers of insolvent State banks which have been taken over by the Guaranty Fund Commission of Nebraska are not obligations of a State or political subdivision thereof, and the interest received on such certificates should be included in the gross income of the recipient.

ARTICLE 74: Interest upon State obligations. VI–35–3397
I. T. 2374

REVENUE ACT OF 1926.

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

An opinion is requested relative to the taxability of interest on bonds issued by corporations formed under an act of the Legislature

of Indiana, approved on March 10, 1927, referred to as "Engrossed house bill No. 368," providing for the formation of corporations under the laws of Indiana solely for the purpose of financing the acquisition of school sites and the erection of school buildings in the case of a specified class of private school corporations of the State.

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

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

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

The only provision of the Revenue Act of 1926 which is suggested as exempting from taxation the interest here involved is that portion of section 213 which provides:

> (b) The term "gross income" does not include the following items, which shall be exempt from taxation under this title:
>
> * * * * * * *
>
> (4) Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; * * *.

It will be noted that interest received by a taxpayer would be exempt from taxation under this provision only in case it is interest upon the obligations of a State or a political subdivision thereof. While the corporations which issued the bonds in question are formed to further education within the State of Indiana, they are essentially private corporations. The bonds issued are the obligations of such private corporations. The corporations alone are responsible for their payment. The bonds are not the obligations of the State of Indiana or a political subdivision thereof. It must accordingly be held that the interest receivable on such bonds is not exempt from the income tax.

ARTICLE 87: Income of States. VI-48-3519
I. T. 2389

REVENUE ACT OF 1926.

Citizens residing along a public highway appointed a committee to negotiate with a bridge company for the purpose of ascertaining the best method of acquiring a toll bridge, in order that it might ultimately be used without the payment of tolls. The bridge company agreed to sell its bridge for a certain sum and to continue the operation thereof. After the payment of upkeep, operating expenses, and interest, the amount of tolls and other income remaining was to be applied upon the purchase price, including mortgages or other liens on the bridge, title to be conveyed to two adjacent counties when the purchase price had been fully paid. It does not appear that the committee was acting for the State, the two counties referred to, or any political subdivision of the State.

Held, that neither the State nor any political subdivision thereof, prior to the payment of the purchase price, has such an interest in the bridge as to render the income derived from its operation exempt from income tax.

An opinion is requested as to whether the income derived from the operation of a toll bridge across the M River at the city of O, State of R, is subject to income tax.

It appears that the Q Bridge Co.'s toll bridge across the M River at O, State of R, is a link in the public highway known as the main highway between the cities of T and U. The citizens residing along the highway appointed a committee of seven members, known as the W Committee, hereinafter referred to as the committee, for the purpose of ascertaining the best means of acquiring the bridge in order that it might ultimately be used without the payment of tolls. On August —, 1926, the committee and the Q Bridge Co., hereinafter referred to as the bridge company, entered into an agreement whereby the bridge company agreed to sell the bridge for $10x$ dollars. The agreement provided that the bridge company should operate the bridge, keep it in proper repair, keep it insured, and that after the payment of operating expenses and interest on the unpaid portion of the purchase price at the rate of — per cent per annum from August 1, 1926, the amount of the tolls and other income remaining should be applied upon the purchase price, including mortgages or other liens on the bridge. The bridge company agreed to convey title to the bridge to X and Y Counties when the purchase price was fully paid in the manner provided. It was further provided that the agreement should of itself be considered a transfer and conveyance of title, effective immediately upon the payment of the purchase price and the interest thereon. Any material change in the bridge tolls must be approved by the committee. No additions or betterments can be made by the bridge company prior to the transfer of title without the approval of the committee. The R State Highway Commission may, if and when so authorized by law, assume all of the rights and powers of the committee.

The stock of the bridge company has been placed in escrow. Each share of stock bears an indorsement to the effect that it is subject to the contract of August —, 1926. All payments on the purchase price are noted on the stock certificates. For the five-month period ended December 31, 1926, the tolls received were sufficient to pay the operating expenses and interest and x dollars on the purchase price.

There is nothing in the facts submitted indicating that the State of R or any political subdivision thereof is a party to the agreement with the bridge company. The committee does not appear to have been acting for the State of R, the counties of X and Y, or any other political subdivision of the State in its negotiations with the bridge company. It is the opinion of the Bureau that neither the State of R nor any political subdivision thereof, prior to the payment of the purchase price, has such an interest in the bridge as to render the income derived from its operation exempt from income tax, as income accruing to the State of R or a political subdivision thereof.

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

VI–32–3353
G. C. M. 1867

REVENUE ACTS OF 1921, 1924, AND 1926.

Compensation received by the New Jersey Sandy Hook pilots and the New York Sandy Hook pilots for services rendered as such is not exempt from Federal income tax. (Recommended that I. T. 2256, C. B. V–1, 34, exempting from income tax the compensation received for services rendered as Texas branch pilots, be reversed.)

Briefs have been filed on behalf of the New Jersey Sandy Hook pilots and the New York Sandy Hook pilots in support of claims for refund which have been filed by such pilots. The claims relate to taxes for the year 1921 upon compensation received by the taxpayers as pilots licensed under the laws of the States of New Jersey and New York. It is contended that they are entitled to the relief provided for in section 1211 of the Revenue Act of 1926, which reads as follows:

Any taxes imposed by the Revenue Act of 1924 or prior Revenue Acts upon any individual in respect of amounts received by him as compensation for personal services as an officer or employee of any State or political subdivision thereof (except to the extent that such compensation is paid by the United States Government directly or indirectly), shall, subject to the statutory period of limitations properly applicable thereto, be abated, credited, or refunded.

It is necessary under this section for the claimants to establish that they were officers or employees of a State or a political subdivision thereof, and that the income in question was received by them for personal services as such officer or employee.

Both briefs rely largely upon I. T. 2256 (C. B. V–1, 34), wherein it was held that the pilots of a port of Texas were officers of that State. That ruling, although not controlling in these cases, might, if sound, be persuasive here, owing to similarities in the statutes of the States upon the subject.

In coming to the conclusion that the Texas pilots were State officers the following was quoted from the opinion of the Court of Civil Appeals of Texas in the case of *Petterson* v. *Board of Commissioners of Pilots for the Port of Galveston* (24 Tex. Civ. App., 33; 57 S. W., 1002, decided May 24, 1900):

Whether a pilot exercises any of the functions of government, and to what department he is properly assignable, are questions which we will not stop to determine. That the legislature intended to make them officers is manifest from the terms of the law. This does not seem to be controverted.

That case involved a mandamus proceeding to compel the board of commissioners of pilots to examine the plaintiff "for the position of a branch pilot." Except for the rather vague statement that the "legislature intended to make them officers"—over which there was no controversy—the court does not discuss the status of the pilots as State officers, and makes no direct decision that they actually were officers. Nor does the necessity for so deciding appear from the opinion, though the court did decide that the Federal license did not make a pilot an officer of the United States.

A later case, decided by the Texas Court of Criminal Appeals June 20, 1900, involved a prosecution under a statute penalizing any person "who shall falsely assume or pretend to be a judicial or executive officer of this State," and the court said:

> We are inclined to the view that a branch pilot, though appointed by the governor, is not a public officer at all. His is merely an employment on account of his skill, and the governor, for the advantage of commerce, and to regulate the business, grants a license to pursue the vocation. In pursuance of his employment, he exercises none of the sovereign power of the State, nor is he paid by the State, nor are his duties prescribed by any law of the State. He is merely a navigator—one who is or ought to be familiar with taking charge of a ship, and taking it into or out of the port at the particular place where he is engaged in the business. (18 Am. and Eng. Enc. Law, p. 444; *United States* v. *Forbes*, 1 Crab., 558, Fed. Cas. No. 15,129; *Dean* v. *Healy*, 66, Ga., 503.)
>
> However, it is not necessary to hold that a branch pilot is not an officer of this State, and it may be that the view entertained by the court of civil appeals at the present Galveston term, in the mandamus proceeding of *Petterson* v. *Board* (57 S. W., 1002), is correct in this regard. But if it be conceded that a branch pilot is some sort of an officer of this State, and not a mere licensed employee such as a physician or lawyer, then it by no means follows that he is an executive officer of the State. An "executive officer" is defined to be one whose duties are mainly to cause the laws to be executed and obeyed. (Bouv. Law Dic.) An executive officer of the State is one whose duty it is to execute the laws of the State. (19 Am. & Eng. Enc. Law, p. 391.) If we turn to the act creating branch pilots, we find no law of the State they are to execute. They are simply appointed to exercise their employment of skill as pilots. These duties are prescribed by the laws of navigation, and he is merely expected, on account of his familiarity with the harbor, to steer the vessel safely into or out of port. (*Petterson* v. *State*, 58 S. W., 100.)

This case must be taken as directly deciding that a pilot of Texas is not an executive or judicial officer of that State, for although no discussion of judicial officers is entered into, the statute punishes the impersonation of both classes. Obviously a pilot could not belong to the legislative department of the State; and the court's reasoning excluding a pilot from the executive branch is of equal force in excluding him from this, the only remaining class of public officers.

Although the decisions upon this question ordinarily turn upon other phases of the official status, as in *Metcalf & Eddy* v. *Mitchell* (269 U. S., 514, published as T. D. 3824, C. B. V-1, 218), the principle set forth in the later Texas case is universally recognized and is generally suggested by the judicial definitions. Thus in the Metcalf & Eddy case the Supreme Court defined an office 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; * * *.

Stress also is laid upon the fact that an officer usually takes an oath of office. Among the authorities cited under this definition is

the case of *Hall* v. *Wisconsin* (103 U. S., 5), where the language used in *United States* v. *Hatch* (1 Pinn. (Wis.), 182), was adopted: "* * * the term * * * 'civil officers'" (civil is used as covering all officers except those of the Army and Navy, 22 R. C. L., 303) "embraces only those officers in whom a portion of the sovereignty is vested, or to whom the enforcement of municipal regulations or the control of the general interests of society is confided and does not include such officers as canal commissioners." This test is stated somewhat more definitely in a leading case as follows: "Every office, in the constitutional meaning of the term, implies an authority to exercise some portion of the sovereign power, either in making, administering, or executing the laws." (*Shelby* v. *Alcorn* (Miss.), 72 Am. Dec., 169.) As said in the comprehensive note to this case, if a person's "powers and *duties* be not of this nature, he is not a public officer." (See, to the same effect, *Sheboygan* v. *Parker*, 3 Wall., 93; In re: Opinion of the Justices, 73 N. H., 621, 62 At., 969, 5 L. R. A. N. S., 415; *Atty. Gen.* v. *Drohan*, 169 Mass., 534, 48 N. E., 279, 61 Am. St. Rep., 301; *State* v. *Jennings*, 57 Ohio St., 415, 49 N. E., 404, 63 Am. St. Rep., 723; Mechem, Public Offices, sec. 4.)

The term "pilot" does not in itself imply any official capacity as, for instance, do the words sheriff—chief executive and administrative officer of a county—or governor—the chief executive officer of a State. On the contrary, it denotes a purely private *calling*—"a person taken on 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, or, as it is commonly called, his pilotage ground." [Italics supplied.] (*Hobart* v. *Drogan*, 10 Pet., 108, 123.) In *Dean* v. *Healy* (66 Ga., 503 (quoted in *Atty. Gen.* v. *McCaughey*, 21 R. I., 341, 43 A., 646)), it was said a "*pilot is one who steers a vessel—a guide*—and in no sense exercises or discharges the functions of a public office. No portion of the sovereignty of the country attaches to his position or duty. *It is neither legislative, executive nor judicial* * * *." [Italics supplied.] (See also *Newton* v. *The Carrie L. Tyler*, 45 C. C. A., 374, 106 Fed., 422, 54 L. R. A., 236, reviewing numerous Supreme Court cases where pilots are referred to as being engaged in a "calling," "vocation," etc.)

It must follow, therefore, that unless there is imposed upon a pilot duties or authority such as are above described, in addition to the ordinary duties incident to his calling, he can not be an officer of the State; for the position then fails to meet the test implied by the terms "public station," and "duties fixed by law," as used in the Metcalf & Eddy case, which is emphasized in the other cases cited above.

The brief filed on behalf of the New Jersey Sandy Hook pilots fails to point out any provision of the New Jersey statutes imposing any duty of this sort upon a pilot. Under the heading "Powers and duties of pilots are regulated by law * * *" there are quoted sections 38 and 39 of the New Jersey statute on "Pilots" (N. J., Comp. Stats., p. 3956). The former section only provides for a penalty in case a pilot is convicted of refusing or neglecting to go to a vessel signaling him, and the latter merely penalizes the "offense" of negligently losing, or running a vessel on shore. Obviously these do not impose any duty upon the pilots of "making, administering, or

executing" any law. Numerous provisions of the statute specifying duties for, and granting authority to, the pilot commissioners are cited, but neither the brief nor an independent search of the New Jersey statutes discloses a single provision requiring any official duty of a pilot or imposing on pilots any power or authority to "make, administer, or execute" any law of the State. The "By-laws of the New Jersey Board of Pilot Commissioners," which contain the regulations for pilots, are equally silent on this point.

The case for the New Jersey pilots, indeed, is appreciably weaker than was that for the Texas pilots. The latter were, as stated in I. T. 2256, supra, appointed by the governor for a term of two years; the tenure was continuous; they took the regular official oath and gave an "official" bond. The position there, in fact, lacked only the essential "duties" or the "public" character of an office. According to the New Jersey statute, pilots are given what is termed "a certificate of appointment" by the commissioners of pilotage, which may be produced to the governor, who administers the oath, whereupon the commissioners issue a "license" to the pilot. (Secs. 2, 3, and 25, Pilots, N. J. Comp. Stats., p. 3948 and p. 3954.) Throughout the statute only the terms "branch" or "license" are used with reference to the pilot's evidence of his position. A "branch" is the diploma or commission issued by the proper authority to a pilot who has passed an examination for competency (Cent. Dict.); and "license," when used with reference to governmental regulations, means the authority to do some act or carry on some *trade* or *business*. (Bouv. Law Dict.) The "term" is not fixed with any certainty by the statute, but is specified by the commissioners. (Sec. 10.) The oath (sec. 3, supra) is prescribed in a form quite different from the regular oath required of officers generally (page 3770, N. J. Comp. Stats.). By it the pilot does not swear to fulfill the duties of an office, but that he will "execute and discharge the *business* and duty of a branch pilot" and will "make the best dispatch in my power to bring safely over the bar of Sandy Hook, every vessel committed to my care, etc." The word "office" is used but once in the statute, and there in the connection "business, duty or office" (oath, supra), as indicating merely a private capacity constituting established and legally recognized functions, as it is frequently used in the case of attorneys at law, or receivers, and where certain stations are held not to be public offices. (Funk & Wagnalls New Stand. Dict.; Ex p. Garland, 4 Wall., 333; *Fleming* v. *Bowers*, 11 Fed. (2d), 789, published as T. D. 3833, C. B. V–1, 201; *Low* v. *Pilotage Com'rs.* (Ga.), R. M. Charlt., 302, where it was said that the "*office* of pilot is not a public one.") The word "office" seems to be employed more in this sense in the quotation from *State* v. *Nerney* (29 N. J. L., 189), appearing in the brief, or as indicating a service or duty devolving upon the assumption of a position or occupation. (Funk & Wagnalls New Stand. Dict.) For it was merely said that Nerney (a pilot) "was entitled to exercise his office." The court there was only passing upon the right of the commissioners to further *penalize* a pilot by revoking his *license* after a previous punishment, and did not pretend to try the title to a public office. The word "employment" is also used in the statute when referring to a pilot's station (sec. 4, Tit. Pilots, supra), and this is a term fre-

quently used to distinguish a position lacking the elements of an office. (*Groves* v. *Barden*, 169 N. C., 8, 84 S. E., 1042, L. R. A. 1917, A. 228.) Altogether, throughout the statute, the language is generally inconsistent with the idea of an office.

It is not seriously contended that these pilots are employees of the State, and it is clear that they are not. They are not employed by the State, for a pilot's compensation is received by virtue of a contract with the shipowner. (*Steamship Co.* v. *Joliffe*, 2 Wall., 450; Ex parte McNeill, 13 Wall., 236.) So far as pilots have been treated as employees at all, they are said to be "servants" of the shipowner (*Sherlock* v. *Alling*, 93 U. S., 99); though in cases involving compulsory pilotage it is said that pilots could not have the status of employee because, for the time being, a pilot is master of the vessel. (*Guy* v. *Donald*, 203 U. S., 399; *Homer Ramsdell Co.* v. *La Compagnie Gen. Trans.*, 182 U. S., 406.) Hence the prime characteristic of the relationship of employer and employee—control by the employer—exists either on the part of the shipowner, or does not exist at all. (See *Metcalf & Eddy* v. *Mitchell*, supra.)

It may also be observed that the contract feature of a pilot's compensation argues strongly against the official status. 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., 548), except that an implied contract may arise *after* the services are performed. (*Fisk* v. *Police Jury*, 116 U. S., 131.) Pilotage is not within this exception because the contract arises before performance. (*Steamship Co.* v. *Joliffe*, and Ex parte McNeill, supra.)

There is even less of dignity and official form connected with the position of a New York Sandy Hook pilot. The statutes relating to these pilots are contained in the consolidation act (ch. 410, Laws of 1882, ch. 29, Title I, Sandy Hook Pilots, as amended by L. 1883, ch. 276); and the rates of pilotage are fixed by Law of 1909 (ch. 42, art. 4, sec. 56).

Three of the pilot commissioners are elected by the chamber of commerce of the city of New York and two by the presidents and vice presidents of certain marine insurance companies of the city of New York for a term of two years. Section 2097 provides that "The commissioners, or a majority of them, shall *license* for such term as they may think proper, so many pilots as they may deem necessary for the port of New York * * *," and they are given the power to revoke or annul the licenses for misconduct. Section 2098 provides for the examination of applicants for a license. No oath is required, though a recognizance in a penalty not exceeding $500, conditioned that the pilot shall "diligently and faithfully perform his duties as pilot and observe the rules and regulations and decisions of the board * * *," is required. As in the case of the New Jersey pilots, no provision is found requiring the duties or imposing the authority implied by the term office; but, as the language of the section requiring a recognizance indicates, a pilot is bound only to perform "his duties *as pilot*," and these, as was stated in *Hobart* v. *Drogan*, supra, only involve "*properly* the duty to *navigate* the ship."

It is therefore the opinion of this office that the New Jersey Sandy Hook pilots and the New York Sandy Hook pilots, even assuming the

positions to have the other characteristics of an office—and, as we have seen, this is not at all clear—can not be considered officers of the States or subdivisions thereof, because the stations are not "public" and no duties or powers of an official nature are fixed by law for the positions. The claims for refund filed by such pilots should be denied.

In view of this opinion, it is recommended that I. T. 2256, supra, exempting from income tax the compensation received for services rendered as Texas branch pilots, be reversed.

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

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

VI–33–3363
G. C. M. 1832

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

The compensation of pilots of Boston Harbor is not exempt from income tax under the Revenue Acts of 1918, 1921, 1924, and 1926.

An opinion is requested as to whether the compensation of pilots of Boston Harbor is exempt from income tax under the Revenue Acts of 1918, 1921, 1924, and 1926.

Section 1211 of the Revenue Act of 1926 provides for the abatement, credit, or refund of any taxes imposed by the Revenue Act of 1924 or prior Revenue Acts upon any individual in respect of amounts received by him as compensation for personal services as an officer or employee of any State or political subdivision thereof, except to the extent that such compensation is paid by the United States Government directly or indirectly.

Article 88 of Regulations 69 requires that in order to be nontaxable under the Revenue Act of 1926 the compensation of such an officer or employee must be for "services rendered in connection with the exercise of an essential governmental function of the State or political subdivision."

In the case of *Metcalf & Eddy* v. *Mitchell* (269 U. S., 517, published as T. D. 3824, C. B. V–1, 218) the Supreme Court defined an office as:

* * * a public station conferred by the appointment of government. The term embraces the idea of tenure, duration, emolument, and duties fixed by law. * * * The term "officer" is one inseparably connected with an office; * * *.

Section 1, chapter 103, General Laws, Massachusetts, 1921, provided for the appointment by the governor, with the advice and consent of the council, of two commissioners of pilots for the harbor of Boston, for a term of three years. Section 2 of that chapter provided that "the commissioners shall grant commissions as pilots for the harbor of Boston to such persons, approved by the trustees of the Boston Marine Society, as they consider competent," and for the suspension of pilots and revocation of commissions for misconduct, etc.

The act of May 14, 1923, amended chapter 103 (supra) by striking out the first 14 sections thereof and inserting in their place 6 new

sections. This amendment divides the shore line of Massachusetts into 4 districts, of which the harbor of Boston is district 1, but it makes no substantial change in the manner of appointment of the commissioners or of the pilots. Section 2, as amended, provides in part:

> In the year 1923 the governor, with the advice and consent of the council, shall appoint two commissioners of pilots for district 1, and one deputy commissioner of pilots for each of the other three districts. Such commissioners and deputy commissioners shall hold office until November 30, 1926. * * * Appointments of commissioners for district 1 shall be made upon the recommendation of the trustees of the Boston Marine Society, provided such recommendation is made. * * * No commissioner for any district shall be such a trustee.

Section 3, as amended, reads:

> The commissioners, subject to the approval of the trustees of said society, shall formulate rules and regulations for pilotage and establish rates within their respective districts, which, for district 1, shall be the rates established in section 31, and which for the other three districts shall not exceed the rates established by said section. The commissioners also, in accordance with such rules and regulations, shall grant commissions as pilots for their districts or for special locations therein, to such persons as they consider competent; provided that for district 1 such persons shall first be approved by said trustees. The commissioners may, upon satisfactory evidence of his misconduct, carelessness, or neglect of duty, suspend any such pilot until the next meeting of said trustees and may thereafter continue such suspension until the close of the next stated meeting of said trustees, but no longer for the same offense. If said trustees decide at either of said meetings that the commission of such pilot ought to be revoked, the commissioners may revoke it at any time after said decision is rendered and before it is reversed. The commissioners shall cause the laws and regulations for pilotage within their district to be duly observed and executed, and shall receive, hear, and determine complaints by and against pilots for said district.

Section 6, as amended, is similar to section 14 of chapter 103, and requires that—

> No person shall receive a commission to exercise the office of pilot until he has given to the State treasurer a bond with two sureties * * *, conditioned on the faithful performance of the duties of his office and the payment of all damages accruing from his negligence, unskillfulness, and unfaithfulness.

Although the statutes of Massachusetts refer to the "office of pilot," and require a bond conditioned upon the faithful performance of duties of that "office," the courts of Massachusetts have refused to say definitely that pilots are officers of the Commonwealth or subdivision thereof. In *Dolliver* v. *Parks* (136 Mass., 499), for instance, it was said:

> We have assumed in this case that the office of pilot is a public office, which is the view most favorable to the plaintiff; but we do not intend definitely to decide that question.

A pilot is frequently referred to as an officer, meaning a ship's officer (see 30 Cyc., 1608), and the word "office" may refer to semi-public or private capacities constituting established and legally recognized functions. (Funk & Wagnalls New Stand. Dict.) Thus, although an attorney at law is not recognized as a public officer in the constitutional or statutory sense of that term (Ex p. Garland, 4 Wall., 333), it is quite common to refer to the "office of attorney," as in chapter 221, section 38, General Laws, Massachusetts, 1921; and in *Low* v. *Pilotage Commissioners* (Ga.) (R. M. Charlt., 302), it was said that the "*office* of pilot is not a public one * * *.

It is a private profession, trade, or calling." See also *Fleming* v. *Bowers* (11 Fed. (2d), 789, published as T. D. 3833, C. B. V–1, 201), where the court holds that the "office" of receiver of the assets of a person or corporation is not a public office within the definition of *Metcalf & Eddy* v. *Mitchell*, supra.

In applying the criteria of an office set forth in *Metcalf & Eddy* v. *Mitchell*, supra, it seems clear that a pilot of the harbor of Boston receives his position "by appointment of government," for the pilot commissioners are designated as officers and have been held to be such in the case of Opinion of the Justices (154 Mass., 603; 31 N. E., 634). Apparently the tenure of the pilots is also fixed by law to continue during good behavior. And likewise the statute designates what fees or "emolument" the pilot may receive for his services.

But the qualification "public" attached to the term "position" by the Supreme Court must not be overlooked; and it is in considering the last requisite of the Supreme Court's definition in this connection that difficulty is met. The duties to be "prescribed by law" must be *public* in order to constitute a station an office. In *Hall* v. *Wisconsin* (103 U. S., 5, cited in *Metcalf & Eddy* v. *Mitchell*), the court adopted the language of *United States* v. *Hatch* (1 Pinn. (Wis.), 182) that the term "civil officers" ("civil" is used in contradistinction to "military offices" and covers all offices other than those of the Army and Navy, 22 R. C. L., 303) embraces "only those officers in whom a portion of the sovereignty is vested, or to whom the enforcement of municipal regulations or the control of the general interests of society is confided * * *." And in *Sheboygan Co.* v. *Parker* (3 Wall., 93), a county "officer" was defined as "one by whom the county performs its usual political functions; its functions of government." To be a public officer one must have the duty and authority "to exercise some portion of the sovereign power, either in *making*, *administering*, or *executing* the laws." (*Shelby* v. *Alcorn* (Miss.), 72 Am. Dec., 169.) This, then, although not commonly elaborated upon, is the universal implication of the terms "public station" and "duties prescribed by law," and, as said in the editorial note to *Shelby* v. *Alcorn* (supra), if a person's "powers and *duties* be not of this nature, he is not a public officer." It is the one *indispensable* attribute of an office, and its importance has been emphasized in Massachusetts in the case of *Attorney General* v. *Drohan* (48 N. E., 279), where the court said:

> A public office is one whose *duties are in their nature public;* that is, involving in their performance the *exercise of some portion of sovereign power,* whether great or small * * *. [Italics supplied.]

The term "pilot" does not in itself imply any official capacity, as does the word "sheriff," for instance, which is defined as "the chief executive and administrative officer of a county * * *" (35 Cyc., 1488), or "governor"—the chief executive officer of a State. A pilot is defined in *Hobart* v. *Drogan* (10 Pet., 108, 123), as "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, or, as it is commonly called, his pilotage ground." Pilots "are engaged in a perilous

calling and must be ready to brave the perils of their *vocation* * * *." The laws regulating them "rest upon the propriety of securing lives and property exposed to the perils of dangerous navigation by taking on board a person peculiarly skilled to encounter and avoid them * * *." "A vessel must have a pilot whether she needs one or not; and this to secure compensation to the *privileged class* of pilots." [Italics supplied.] *Newton* v. *The Carrie L. Tyler* (45 C. C. A., 473, 106 Fed., 422, 54 L. R. A., 236), citing numerous Supreme Court decisions.

The pilot commissioners are the officers who are charged with the duty of causing the laws and regulations concerning pilots to be observed and executed; of hearing and determining complaints against pilots and of formulating regulations for pilotage (sec. 2, ch. 103, General Laws, Massachusetts, supra, and sec. 1, amendment of May 14, 1923). These duties are clearly executive in their nature, and possibly partake of a judicial and legislative character as well. But no duties of this type are imposed upon a pilot. The statute does not empower him to make, administer, or execute a single law or regulation of the Commonwealth. On the contrary, it is specific only in requiring his obedience to the particular statutes and regulations governing pilotage in like matter as common mariners and ship's masters are obliged to observe the special laws to which they are subject. (Compare, for instance, ch. 102, General Laws, Massachusetts, "Shipping and Seamen, Harbors and Harbor Masters.") The laws of Massachusetts may endow pilots with more dignity than is given to them in many other States, but, by omitting to charge them with the duty of exercising some portion of the sovereign power, they have left them merely a "privileged class" who follow an unusual "calling" or "vocation," as they are held to be by the great weight of authority. (See in addition to the cases above cited, *Attorney Gen.* v. *McCaughey* (R. I.), 43 Atl., 646; *Dean* v. *Healy*, 66 Ga., 503; *State* v. *Jones*, 16 Fla., 306; *Petterson* v. *State* (Tex.), 58 S. W., 100; *U. S.* v. *Forbes*, Fed. Cas. No. 15,129, holding a pilot to be an "officer of the ship"; *Yates* v. *Brown*, 25 Mass. (8 Pick), 23, holding a pilot to be the agent of the owner.)

The phraseology of another provision of the Massachusetts statutes tends to support this view. Thus section 1 of chapter 102, General Laws, Massachusetts, 1921, provides:

> Whoever, not being a pilot *or* public officer, shall board or attempt to board a vessel arriving in the harbor of Boston, etc.

The word "or" is ordinarily employed to indicate an alternative, as one thing or the other, and corresponds with "either." (*Kuehner* v. *City of Freeport*, 32 N. E., 372, 17 L. R. A., 774.) This section can, in fact, be read sensibly only by giving the word "or" the use of joining alternatives expressing unlike things. That is, to board a vessel under the restrictions of the section, one must be *either* a pilot *or* a public officer. If the framers of this section believed pilots to be public officers it would have been sufficient to have said merely "any person not a public officer." Certainly the word "other" can not be inserted to make it read "pilot or *other* public officer," for that would be to alter vitally the language of the legislature.

While, in thus deciding that the pilots of Boston Harbor are not officers of the State or a political subdivision thereof, the case is disposed of both under section 1211 of the 1926 Act and under article 88 of Regulations 69, there are added reasons why the compensation of these pilots should be held taxable under the regulations referred to. As pointed out in *Metcalf & Eddy* v. *Mitchell*, supra (see also S. O. 152, C. B. II–2, 93), the exemption with which the regulation is concerned "rests on the conviction that each government (State and Federal), in order that it may administer its affairs within its own sphere, must be left free from undue interference by the other." 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 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.) Although the regulation of pilots and pilotage has been mainly exercised by the States, pursuant to an Act of Congress passed August 7, 1879 (R. S., 4235), it is a subject over which Congress has "*plenary* power," and belongs to the class of powers "which may be exercised by the States, but only until Congress shall see fit to act upon the subject." Ex parte McNeill (13 Wall., 236); *Cooley* v. *Board of Wardens* (12 How., 299); *Spraigue* v. *Thompson* (118 U. S., 90); *Anderson* v. *Pacific Coast Steamship Co.* (225 U. S., 187); and in *Wilson* v. *McNamee* (102 U. S., 572) the court used the language of Mr. Justice Story, who said, regarding the pilot laws of the several States, "They have been *adopted* by Congress, and without question are controllable by it." (2 Story, Const., sec. 1070.) In a case decided January 6, 1926, the Supreme Judicial Court of Massachusetts, when applying this doctrine of the paramount authority of Congress over pilotage, said: "Those laws (the Federal pilotage laws) were enacted pursuant to a *power* expressly enumerated as *conferred upon Congress* by the Constitution of the United States." (*Commonwealth* v. *Kemp*, 150 N. E., 172.) [Italics supplied.] 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 (even assuming this term to be applicable) may not be denied the Federal Government, for that would be to deny the "plenary power" of Congress over the subject.

That the pilots are not "employees" of the State seems clear. Their compensation is held to be received by virtue of a contract with the shipowner. (*Steamship Co.* v. *Joliffe*, 2 Wall., 450; Ex parte McNeill, supra; *Newton* v. *The Carrie L. Tyler*, supra; and this principle has also been recognized by the Massachusetts courts, *Commonwealth* v. *Kemp*, supra.) So far as they have been treated as employees at all, they are said to be "servants" of the shipowner (*Sherlock* v. *Alling*, 93 U. S., 99); though in cases involving compulsory pilotage, it is said that pilots could not have the status of employee because, for the time being, a pilot is master of the vessel. Hence the prime characteristic of the relationship of employer and employee—control by the employer—could not be present. (*Metcalf & Eddy* v. *Mitchell*, supra; *Guy* v. *Donald*, 203 U. S., 399; *Homer*

Ramsdell Co. v. *La Compagnie Gen. Trans.*, 182 U. S., 406; see also *Ducktown Sulphur, etc., Co.* v. *Galloway*, 262 Fed., 669.)

In this connection it should also be pointed out that the principle that a pilot's compensation is received by virtue of a contract argues strongly against an official status, for 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., 548), except that an implied contract may arise *after* the services are performed (*Fisk* v. *Police Jury*, 116 U. S., 131). Pilotage is not within this exception because the contract arises *before* performance. (*Steamship Co.* v. *Joliffe* and Ex parte McNeill, supra.)

For the reasons stated, it is held that the compensation of pilots of Boston Harbor is not exempt from income tax under the Revenue Acts of 1918, 1921, 1924, and 1926.

A. W. GREGG,
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ARTICLE 88: Compensation of State officers and employees. (Also Section 1211.)

VI–33–3364
G. C. M. 211A

REVENUE ACT OF 1926 AND PRIOR ACTS.

The compensation received by bar pilots of New Orleans for services as such is subject to the income tax imposed by the Revenue Act of 1926; but taxes imposed by the Revenue Act of 1924 and prior Revenue Acts in respect to such compensation may be abated, credited, or refunded.

An opinion is requested as to whether or not the compensation of the branch pilots appointed under the laws of Louisiana is exempt from income tax.

Section 1211 of the Revenue Act of 1926, which governs this case so far as the compensation for the year 1924 and prior years is concerned, reads as follows:

Any taxes imposed by the Revenue Act of 1924 or prior Revenue Acts upon any individual in respect of amounts received by him as compensation for personal services as an officer or employee of any State or political subdivision thereof (except to the extent that such compensation is paid by the United States Government directly or indirectly), shall, subject to the statutory period of limitations properly applicable thereto, be abated, credited, or refunded.

Article 88 of Regulations 69, which governs with respect to the implied exemption under the Revenue Act of 1926, 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. * * *

In *Metcalf & Eddy* v. *Mitchell* (269 U. S., 517, published as T. D. 3824, C. B. V–1, 218), the terms "office" and "officer" are defined as follows:

* * * 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; * * *.

The pilotage statutes of Louisiana are contained in sections 5429, et seq., Marrs Annotated Revised Statutes of Louisiana, and are epitomized in *State* v. *Leech* (119 La., 515, 43 So., 283), as follows:

A bar (or "branch") pilot must be a qualified elector of the State; he must have served in a pilot boat, at the mouth of the river, for 12 months next preceding his appointment by the governor, and he must be recommended for the appointment by a State board of examiners consisting of three branch pilots; he must give a bond of $2,000, approved by the master and wardens of the port of New Orleans; he must not absent himself from his station for more than 7 days without leave, granted by the governor upon the written recommendation of the board of examiners; he may be suspended or removed by the governor; he must be owner or part owner of at least one decked pilot boat, of not less than 50 tons burden, which must be kept employed as a pilot boat; he is liable to suspension, fine, and imprisonment if he refuses or neglects to board a ship when called.

Section 5431 fixes the rates of pilotage.

It would seem that these pilots occupy a station "conferred by the appointment of government," and that the position has "tenure," "duration," and "emolument," prescribed by law. As pointed out in a recent memorandum of this office with regard to the Sandy Hook pilots of New York and New Jersey (see G. C. M. 1867, on page 39), the opinions cited by the Supreme Court under the definition above quoted require that the "duties fixed by law," mentioned as one of the characteristics of an office, pertain to the "making, administering, or executing" of some of the laws of the State. It is not clear from the terms of the Louisiana statute that duties of this character are specifically imposed upon pilots. However, in the case of *State* v. *Follett* (33 La. An., 228) the court appears to have construed the language of the Louisiana statute as requiring duties of an official nature of them, and in *Levine* v. *Michel* (35 La. An., 1121) the court said:

Branch pilots of the port of New Orleans have been held by this court to be State officers—

citing the cases of *Williams* v. *Shepard* (14 La. An., 7) and *State* v. *Follett*, supra.

Section 1211 does not provide for an *exemption* from tax, but for the remission 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); and it is believed that the view taken by the Louisiana courts may be accepted for the purposes of this section.

For years not affected by this section an entirely different situation is presented. Article 88 of Regulations 69 embodies a principle of implied exemption (see *Metcalf & Eddy* v. *Mitchell*, supra, and S. O. 152, C. B. II–2, 93), and the general rule of strict construction must be applied. (See S. M. 2232, C. B. III–2, 83.) As was pointed out

in a recent memorandum of this office concerning the pilots of Boston Harbor [see G. C. M. 1832, on page 44], pilotage is a subject over which Congress has paramount power—a principle very clearly set forth by the Louisiana Supreme Court in *State* v. *Leech*, supra. Hence, the reason for the implied exemption recognized in article 88 of Regulations 69 does not obtain with respect to State pilots, regardless of the question of official status.

This office concludes, therefore, that, although any taxes imposed by the Revenue Acts of 1924 and prior Revenue Acts in respect to compensation received by the bar pilots of New Orleans for their services as such pilots may properly be abated, credited, or refunded, such compensation is subject to the income tax imposed by the Revenue Act of 1926.

It appears that these pilots are members of a certain pilot association. The association is the owner of pilot and salvage equipment and supplies. Each member is the owner of one share. It appears that the association is not only engaged in piloting, but also in the business of salvaging vessels in danger of loss or damage from maritime causes. The president receives a salary. There are provisions for the care of sick or disabled members. There are other incidental expenses. All members pay their earnings as pilots into a common fund, in the surplus of which, after all deductions are made, they share equally.

The only income which is subject to the provisions of section 1211 of the 1926 Act is that which each pilot himself earns. Since the earnings of each pilot, as pilot, are paid into and become mingled with the pilot fees of all the other members and with the earnings of the association from other sources, and since all members receive equal shares out of such funds after all expenses have been paid and all deductions have been made, it follows that each taxpayer must, in order to secure relief, trace his own pilot fees into and out of the common fund. The tax upon compensation received by each pilot from the association may be refunded, abated, or credited to the extent that it represents a tax imposed by the Revenue Act of 1924 or prior Revenue Acts in respect of amounts received by him as compensation for personal services rendered as a branch pilot under the laws of Louisiana, subject, however, to the statutory period of limitations applicable thereto. Any amount received by such pilot in excess of the amount which represents compensation for personal services is income by reason of his membership in the association and any tax thereon may not be refunded, as section 1211 is inapplicable.

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

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

VI–34–3377
G. C. M. 1833

REVENUE ACTS OF 1921, 1924, AND 1926.

The compensation received for services rendered as a pilot licensed under the laws of Pennsylvania is not exempt from income tax.

An opinion is requested as to whether amounts received in 1922 by a pilot licensed under the laws of the State of Pennsylvania are exempt from income tax as compensation for personal services paid to an officer or employee of a State.

A claim for refund of the taxes paid with respect to such income has been filed. The case is governed by section 1211 of the Revenue Act of 1926, which reads as follows:

> Any taxes imposed by the Revenue Act of 1924 or prior Revenue Acts upon any individual in respect of amounts received by him as compensation for personal services as an officer or employee of any State or political subdivision thereof (except to the extent that such compensation is paid by the United States Government directly or indirectly), shall, subject to the statutory period of limitations properly applicable thereto, be abated, credited, or refunded.

In the case of *Metcalf & Eddy* v. *Mitchell* (269 U. S., 514, T. D. 3824, C. B. V–1, 218), an office was defined as follows:

> * * * 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; * * *.

It is clear that the pilots licensed under the laws of Pennsylvania are not employees of the State. They are neither paid nor employed by the State, but by the shipowner, and the statutes of Pennsylvania so wholly fail to provide for the essentials necessary to create an office that an extended discussion is not deemed necessary.

Section 21676, Pennsylvania Statutes, 1920, gives to the board of commissioners of navigation for the river Delaware and its navigable tributaries power and authority "to grant licenses to persons to act as pilots in the bay and river Delaware, and to make rules for their government while employed in that service; * * *." Section 21679 relates to pilots holding licenses at the time of the passage of the statute of May 9, 1913, and to the number of pilots. Section 21680 provides that "Every person not now a licensed pilot, and who desires to exercise the *profession* of pilot * * * may apply for a license to entitle him to follow that occupation"; for the classification of pilots, and that the licenses shall be in force for one year from the date thereof. Section 21682 prescribes the qualifications of pilots and apprentices, and that "the person shall give bond * * * conditioned for the true and faithful performance of the duties and services required by this act, and that he shall not aid or assist in defrauding the revenues of the United States," and that he will deliver up his license when required according to the provisions of the act. Section 21683, which was included in an act passed May 14, 1861, requires that "Every person exercising the profession of a pilot * * * shall immediately after the passage of this act" take an oath to support the Constitution of the United States, and the laws and constitution of the State, and to "well and faithfully perform his duties as a pilot." Other sections of the statute provide penalties for "offenses" of pilots; for suspension in case of intoxication; or the revocation of licenses in certain cases. A report of vessels piloted to the port of Philadelphia is required under penalty of a fine. Section 21699 prescribes the rates of pilotage and subsequent sections refer to pilotage in special cases. Section 21709 requires certain vessels to take on a pilot.

Nowhere throughout the statute is there any intimation of an intention to create the "office" of pilot. On the contrary, language is used calculated to negative any such impression. The authority of a pilot is termed a "license," and this, when used with reference to governmental regulations, means the authority to do some act or to carry on a *trade* or *business*. (Bouv. Law Dict.) Even the language of section 21683, requiring an oath, guards against any misconception in this regard, for it uses the words "*profession*" and "duties *as a pilot*," i. e., "the duty to navigate the ship" (*Hobart* v. *Drogan*, 10 Pet., 108, 123), and not "duties as an officer." He is not charged with making, administering, or executing any of the laws of the State. No tenure of office is prescribed—the life of the licenses being merely limited as licenses usually are. These provisions are not unlike the statutes governing such businesses as peddlers, liquor dealers, loanbrokers, etc. For instance, a license limited to one year is required of a loanbroker; an applicant must put up a bond to obey the provisions of the act; his fees are fixed; duties to give receipts to borrowers and duties as to "loan on assignment," etc., are prescribed. (Sec. 14099 et seq., Penn. Stats., 1920.)

It is the opinion of this office that the pilot in question is not entitled to the relief provided for by section 1211 of the Revenue Act of 1926, because the compensation in question was not received as compensation for personal services as an officer or employee of any State or political subdivision thereof, and, accordingly, the claim for refund should be denied.

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

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

VI-34-3378
I. T. 2372

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

The compensation received for services rendered as a pilot licensed under the laws of Delaware is not exempt from income tax under the Revenue Acts of 1918, 1921, 1924, and 1926.

An opinion is requested as to whether the compensation received by certain pilots licensed under the laws of Delaware for services rendered as pilots is exempt from income tax.

Section 953, Revised Code of Delaware, 1915, provides for the establishment of a board of pilot commissioners consisting of five members appointed by the governor. The board is empowered to grant licenses to properly qualified persons as pilots in the bay and river Delaware. Section 954 provides in part as follows:

Any person desiring to exercise the profession of a pilot in the bay and river Delaware shall apply in person to the board of pilot commissioners for a license to entitle him to follow that occupation, and it shall be the duty of at least three of the said board to examine every person so applying as to his fitness in all respects to perform the duties of a pilot and to grant licenses to all such as they shall deem qualified according to their respective abilities. * * * Said licenses shall be in force for one year from the date thereof and until pilots respectively shall next after the expiration of the year arrive with any ship or vessel at any port on the bay or river Delaware and no longer, but every pilot delivering up his license shall be entitled to receive a new one in

lieu thereof, giving like security, as hereinafter directed, unless it shall appear to said board that the person applying is disqualified from exercising the duties of a pilot; * * *. Each applicant under this section shall pay to the board of pilot commissioners the sum of $10.

It is provided by section 956 that a pilot's license may be forfeited on account of neglect of duty. Section 963 provides that every pilot obtaining a license or branch to authorize him to act as a pilot for the bay and river Delaware shall pay the sum of 50 cents, to be applied for the support of the board's office. Section 971 prescribes the rates of pilotage.

The compensation received for services rendered as a pilot licensed under the laws of Delaware is not exempt unless the pilot as such is an officer or employee of the State of Delaware or a political subdivision thereof.

In the case of *Metcalf & Eddy* v. *Mitchell* (269 U. S., 514, published as T. D. 3824, C. B. V–1, 218), the court stated that "An office is 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." In order that a taxpayer may be treated as an employee of a State or a political subdivision thereof, it must be shown that the relationship of master and servant exists between the State or political subdivision and the taxpayer. In *Vane* v. *Newcomb* (132 U. S., 220) it was held:

To be an employee within the meaning of the statute Vane "must have been a servant, bound in some degree at least to the duty of a servant" * * *.

The provisions of the laws of Delaware above referred to do not pretend to create the office of "pilot." They merely provide for the licensing of persons "desiring to exercise the profession of a pilot" in a manner analogous to the licensing of physicians to practice medicine. This, also, is the attitude taken by the courts of Delaware, for in *Virden* v. *Board of Pilot Commissioners* (8 Del., ch. 1, 67 A., 975), it was held that "a pilot's license, duly granted under the pilotage act, is property, which can not be forfeited except by direct legislative authority, * * *." It is a general rule that no one has any private right of property in a public office. (*Taylor* v. *Beckham*, 178 U. S., 548.) It does not appear that any contention was made, in the Delaware case above cited, that the pilots were State officers, but the court's decision that the license was property is totally inconsistent with the idea of an office.

It is not seriously contended that these pilots are employees of the State, and it is clear that they are not. They are not employed by the State, for a pilot's compensation is received by virtue of a contract with the shipowner. (*Steamship Co.* v *Joliffe*, 2 Wall., 450; *Ex parte McNeill*, 13 Wall., 236.) So far as pilots have been treated as employees at all, they are said to be "servants" of the shipowner (*Sherlock* v. *Alling*, 93 U. S., 99), though in cases involving compulsory pilotage it is said that pilots could not have the status of employee because, for the time being, a pilot is master of the vessel. (*Guy* v. *Donald*, 203 U. S., 399; *Homer Ramsdell Co.* v. *La Compagnie Gen. Trans.*, 182 U. S., 406.) Hence, the prime characteristic of the relationship of employer and employee—control by the em-

ployer—exists either on the part of the shipowner or does not exist at all. (See *Metcalf & Eddy* v. *Mitchell*, supra.)

For the reasons stated. it is held that the compensation received for services rendered as a pilot licensed under the laws of Delaware is not exempt from income tax under the Revenue Acts of 1918, 1921, 1924, and 1926.

ARTICLE 88: Compensation of State officers and employees. VI-36-3408 I. T. 2376

REVENUE ACT OF 1926.

The taxpayer is an employee of a freight traffic commission, a bureau created by a certain city council. His work, as well as that of the bureau in which he is employed, is "to endeavor to secure and maintain just, reasonable, and nondiscriminatory freight rates applying to and from the ports of M and O, thereby fostering and encouraging the commerce of the ports."

Held, that the taxpayer is not rendering service in connection with the exercise of an essential governmental function and therefore his salary derived from the source mentioned must be included in his gross income.

An opinion is requested as to the taxability of the salary received by one acting as assistant traffic commissioner of the M Freight Traffic Commission.

The M Freight Traffic Commission is a municipal nonstock, nonprofit bureau created by an act of the M City Council and consists of — commissioners serving without compensation. The purpose of the commission is to secure and maintain just, reasonable, and nondiscriminatory freight rates applying to and from the ports of M and O, thereby fostering and encouraging the commerce of the ports. The commission has authority, subject to the approval of the council, to employ an assistant traffic commissioner. The taxpayer was appointed as assistant traffic commissioner by the commission with the approval of the city council and served in that capacity throughout the taxable year 1925. In that capacity he is subject to the orders of the commission. It is his contention that, inasmuch as he receives his salary from the city of M, he is an employee of a political subdivision of a State and that his income is not subject to Federal income tax.

Article 88, Regulations 69, provides in part as follows:

Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function.

In a sworn statement dated September —, 1926, the taxpayer advises that his work, as well as that of the municipal department in which he is employed, is—

To endeavor to secure and maintain just, reasonable, and nondiscriminatory freight rates applying to and from the ports of M and O, thereby fostering and encouraging the commerce of the ports.

Even though the taxpayer's contention that he is an officer or employee of a municipal commission be conceded, it is evident, from the nature and purpose of the M Freight Traffic Commission, that

the taxpayer is not rendering services in connection with the exercise of an essential governmental function. It is held, therefore, that the taxpayer's salary derived from this source must be included in his gross income for the year 1925.

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

VI–41–3460
G. C. M. 2286

REVENUE ACT OF 1926.

The river port pilots of New Orleans are entitled to the relief provided for by section 1211 of the Revenue Act of 1926, but are not exempt from the income tax imposed by the Revenue Act of 1926.

Advice is requested as to whether the memorandum of this office (G. C. M. 211A, on page 49), relative to the compensation received by bar pilots of New Orleans, is applicable to the compensation received by river port pilots of New Orleans. In that memorandum the opinion was expressed that:

The compensation received by bar pilots of New Orleans for services as such is subject to the income tax imposed by the Revenue Act of 1926; but taxes imposed by the Revenue Act of 1924 and prior Revenue Acts in respect to such compensation may be abated, credited, or refunded.

The statutes of Louisiana contain a number of provisions governing pilots in general. (Sections 5418 to 5428, inclusive, Marr's Annotated Stats.) Then follow sections 5429 to 5446, inclusive, "Relative to the pilots of New Orleans," and sections 5447 to 5455, inclusive, "River port pilots, New Orleans."

The memorandum of this office was written with reference to the bar pilots of New Orleans, who are subject to the special provisions contained in sections 5429 to 5446, supra. However, there were also considered the provisions as to pilots generally, which apply to both classes of pilots. This office has now given attention to the sections pertaining to "River port pilots, New Orleans." These provisions, so far as the question of the official status of the pilots is concerned, are not materially different from those governing the bar pilots.

Therefore, the memorandum above referred to may be taken as deciding that the river port pilots of New Orleans are entitled to the relief provided for by section 1211 of the Revenue Act of 1926, but are not exempt from the income tax imposed by the Revenue Act of 1926.

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

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

VI–46–3500
I. T. 2387

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

The compensation received for services rendered as a pilot licensed under the laws of Georgia is not exempt from income tax under the Revenue Acts of 1918, 1921, 1924, and 1926.

A question is raised as to the proper treatment of compensation received by A for services rendered as a pilot at the port of Savannah during the year 1925.

The basis of the claim for refund filed by the above-mentioned taxpayer is as follows:

During the period for which the tax was paid taxpayer was a pilot at the port of Savannah, in the State of Georgia, and as such pilot acted in behalf of and under authority and as a representative of the State of Georgia; and the income upon which this tax was paid was compensation which he received for his services as pilot, and is for that reason exempt from income tax. Taxpayer asks that under this claim for refund the entire amount of income tax paid by him for the period involved on his compensation as pilot be refunded.

Section 1899 of the Political Code of Georgia, 1910, which provides for the licensing of pilots, as amended by an act of the General Assembly of Georgia approved August 8, 1921, provides that—

The commissioners of pilotage at each of the ports of this State are empowered to license such persons (being citizens of the United States) of good character as they shall think most fit to act as pilots, for the purpose of conducting vessels inward to and outward from the several ports and rivers for which they shall be licensed during their good behavior. Pilots already licensed for any of said ports or rivers shall continue to act until removed for cause. * * * No person, other than a duly licensed pilot, shall be entitled to receive any fee, gratuity, or reward for conducting or piloting any vessel inward to or outward from any of the ports, rivers, or harbors for which a pilot shall be licensed. If any person, having no authority or license to act as a pilot, or who, having had any authority, has had it suspended or revoked by the commissioners, shall, while his license is suspended, pilot or conduct any vessel inward to or outward from any of the ports, rivers, or harbors of this State, * * * such person may, on conviction, be fined and imprisoned at the discretion of any court having jurisdiction; * * *.

Section 1908 of the code of Georgia, adopted August 15, 1910, as amended by an act of the General Assembly of the State of Georgia approved August 15, 1921, provides:

The pilot must make and deliver to the commissioners a bond, payable to the chairman of the board, and his successor in office, in the penal sum of $2,000, with security to be approved by the commissioners, and with the condition satisfactorily to perform his duties as pilot, which bond shall be renewable at the discretion of the commissioners with such security or additional securities as they may require. * * *.

Article 88 of Regulations 69, which governs this case in so far as the compensation for the years covered by the Revenue Act of 1926 is concerned, 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. * * *.

In General Counsel's Memorandum 1867 (see page 39), and several other memoranda lately issued by the General Counsel, the opinion was expressed that unless there is imposed upon pilots of a State the duty of making, executing, or enforcing some of the laws of the State, in addition to the ordinary duties of a pilot, a pilot can not be considered as an officer of the State. These memo-

randa also point out that a pilot can not be treated as an employee of the State.

The statutes of the State of Georgia do not appear to require of the licensed pilots any duties of the nature mentioned. Furthermore, the courts of Georgia in two reported cases have decided that a pilot is not an officer of the State. (*Dean* v. *Healy*, 66 Ga., 503; *Low* v. *Pilotage Commissioners*, R. M. Charlt., 302.)

For the reasons indicated herein, it is concluded that the compensation received for services rendered as a pilot licensed under the laws of Georgia is not exempt from income tax under the Revenue Act of 1926.

The same conclusion is reached under the Revenue Acts of 1918, 1921, and 1924.

ARTICLE 89: Additional exclusions from gross income. VI-43-3484 T. D. 4098

INCOME TAX.

Exemption from taxation of earnings of ships documented under the laws of France.

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.

France 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] and Treasury Decision 4013 [C. B. VI-1, 59], article 89 of Regulations 65 as amended by Treasury Decision 3812 [C. B. V-1, 47] and Treasury Decision 4013, and article 89 of Regulations 69, as amended by Treasury Decision 4013 are hereby further amended so as to include France 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 France from the list of countries which do not grant such exemption.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved October 18, 1927.

A. W. MELLON,
Secretary of the Treasury.

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

ARTICLE 101: Business expenses.

REVENUE ACT OF 1926.

Contributions to a chamber of commerce fund to be used in the furtherance of building up a city. (See I. T. 2375, page 76.)

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

ARTICLE 131: Taxes. VI–36–3409
(Also Section 212, Article 23.) I. T. 2377

REVENUE ACT OF 1926.

Taxpayers in the States of Washington and Oregon who maintain books of account on the accrual basis may, in the computation of net income, take a deduction because of accrued property taxes only for the year within which such taxes become a fixed liability, which is the date when the tax rolls or lists are delivered to the treasurer or collector of taxes. Taxpayers who are on the cash receipts and disbursements basis may deduct such taxes only for the year in which paid.

In General Counsel's Memorandum 1240 (C. B. VI–1, 65) it is stated generally with respect to property taxes that not until a 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 taxes, have all events occurred which fix the amount of tax and determine the liability of the taxpayer to pay it. It is further stated in the ruling referred to that not until the officers designated by law have completed their computation and the tax roll or tax book is made up does a liability for any particular sum become fixed.

In the State of Washington, the date specified for delivery of the certified tax rolls is the first Monday of January and in the State of Oregon it is not later than 45 days before May 5, a date which usually falls in March. (See sec. 11241, Remington's Compiled Statutes of Washington, 1922; sec. 3669, Lord's Oregon Laws, as amended February 24, 1915; and section 4323, Oregon Laws, as amended March 3, 1927.) Taxpayers in these two States who maintain books of account on the accrual basis may, therefore, in the computation of net income, take a deduction because of accrued property taxes only for the year within which such taxes become a fixed liability, which is the date when the tax rolls or lists are delivered to the treasurer or collector of taxes. Taxpayers who are on the cash receipts and disbursements basis may deduct such taxes only for the year in which paid.

SECTION 214(a)4, 5, 6.—DEDUCTIONS ALLOWED INDIVIDUALS: LOSSES.

ARTICLE 146: Losses from the sale and repurchase of securities. (Also Section 204, Article 1601.)

VI-27-3293
G. C. M. 1210

REVENUE ACTS OF 1924 AND 1926.

Interpretation of the "wash sales" provisions of sections 214(a)5 and 204(a)11 of the Revenue Acts of 1924 and 1926.

An opinion has been requested relative to the interpretation of sections 214(a)5 and 204(a)11 of the Revenue Acts of 1924 and 1926, which read as follows:

SEC. 214(a)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; but in the case of a nonresident alien individual only if the profit, if such transaction had resulted in a profit, would be taxable under this title. No deduction shall be allowed under this paragraph for any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities where it appears that within 30 days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) or has entered into a contract or option to acquire substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition. If such acquisition or the contract or option to acquire is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed; * * *.

SEC. 204(a)11. If substantially identical property was acquired after December 31, 1920, in place of stock or securities which were sold or disposed of and in respect to which loss was not allowed as a deduction under paragraph (5) of subdivision (a) of section 214 or paragraph (4) of subdivision (a) of section 234 of this Act, the Revenue Act of 1921, or the Revenue Act of 1924, the basis in the case of the property so acquired shall be the basis in the case of the stock or securities so sold or disposed of, except that if the repurchase price was in excess of the sale price such basis shall be increased in the amount of the difference, or if the repurchase price was less than the sale price such basis shall be decreased in the amount of the difference.

Under the terms of section 214(a)5 no deduction for any loss claimed to have been sustained in any sale of securities is allowable, where it appears that within the 30 days *before* or *after* the date of such sale the taxpayer purchased substantially identical property, and the property so acquired was held by the taxpayer for any period after such sale. The fact, on account of which a loss from the sale of securities is disallowed, is the purchase by the taxpayer within 30 days before or after the sale of substantially identical property to that sold. One such purchase within the proscribed 60-day period is sufficient to result in the disallowance of the loss, whether such purchase takes place in the first half of the proscribed period or in the second half—that is, whether within 30 days before the sale or within 30 days after the sale. The making of other such purchases in addition to the first purchase of substantially identical property within the 60-day period is therefore immaterial.

Where there are numerous purchases within the proscribed period it seems natural and logical to consider the first as the purchase on account of the making of which the loss on the sale is not allowable. Such a rule is analogous to the principle stated in article 39 of

Regulations 65 and 69 that when "shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots can not be determined, the stock sold shall be charged against the earliest purchases of such stock." This rule becomes important in the application of the provisions of section 204(a)11, which are to the effect that if substantially identical property was acquired after December 31, 1920, "in place of stock or securities which were sold or disposed of and in respect of which loss was not allowed as a deduction" under section 214(a)5, the basis in the case of the property so acquired shall be the basis in the case of the securities so sold or disposed of, except that if the repurchase price was in excess of the sale price such basis shall be increased in the amount of the difference, or if the repurchase price was less than the sale price such basis shall be decreased in the amount of the difference. In line with the rule above suggested, the first purchase of securities (provided the purchased securities are substantially identical with those sold) within the proscribed period should be regarded as made up of the substantially identical property which was acquired in place of the securities, the loss upon the sale of which is disallowed, regardless of whether such first purchase was made within the 30-day period before the sale or within the 30-day period after the sale. To hold that securities purchased within the proscribed period but before the sale are not securities acquired in place of the securities sold would necessitate the disallowance of the loss sustained in making the sale, and in addition (except in cases where there is also a purchase after the sale) would result in depriving the taxpayer of the right, which Congress intended he should have, to carry the new securities at a basis which ultimately will result in the return to him of his entire investment tax free.

Stated simply, the "wash sales" provisions operate as follows: A taxpayer who has purchased securities which have decreased in value is prevented from taking a loss for income tax purposes by selling the securities if, within 30 days prior to the sale or 30 days afterwards, he purchases other similar securities. In such a case the indicated loss is not an allowable deduction, but the amount thereof may be added to the purchase price of the new securities in arriving at the basis to be used in determining gain or loss upon the subsequent sale of those securities. Thus, while the taxpayer can not prematurely claim losses, he is allowed eventually to receive the return of his entire investment tax free.

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

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

ARTICLE 155: Reserve for bad debts. VI–29–3309
G. C. M. 1887

REVENUE ACTS OF 1921, 1924, AND 1926.

A reasonable addition to a reserve for bad debts may be recognized in the case of debts represented by bonds.

An opinion is requested as to whether an amount credited to a reserve set up for depreciation of bonds may be treated as an addition to a reserve for bad debts and as such deducted from gross income.

Section 214(a) of the Revenue Act of 1921 provides that in computing net income there shall be allowed as a deduction:

(7) Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part; * * *.

Section 214(a)7 of the Revenue Act of 1924 and section 214(a)7 of the Revenue Act of 1926 are identical with the above provisions of the Revenue Act of 1921.

Articles 154 and 155 of Regulations 62, 65, and 69 interpret the provisions above quoted in relation to bonds, and are substantially identical in so far as their relation to the instant question is concerned.

In article 154 provision is specifically made for the treatment of bonds as debts within the meaning of section 214(a)7. The article provides that where a taxpayer ascertains that owing to the financial condition of the debtor, or conditions other than market fluctuation, he will recover upon maturity none or only a part of the debt evidenced by bonds, and is able to so demonstrate to the satisfaction of the Commissioner, he may deduct in computing net income the uncollectible part of the debt so evidenced by bonds. It is provided, however, that a taxpayer (other than a dealer in securities) possessing debts evidenced by bonds can not deduct from gross income any amount merely on account of market fluctuation. Article 155 provides that taxpayers who establish the reserve method of treating bad debts and maintain proper reserve accounts therefor may deduct from gross income a reasonable addition to a reserve for bad debts in lieu of a deduction for specific bad debt items. No exception is made in such article of debts represented by bonds. Furthermore, it appears that taxpayers are required to adhere consistently to one method of treating bad debts or the other. It follows that a taxpayer who has established the reserve method can secure his allowance on account of debts evidenced by bonds only by way of an addition to a reserve for bad debts.

In view of the above, it is believed that a reasonable addition to a reserve for bad debts may be recognized in the case of debts represented by bonds; provided, however, that no deduction be allowed from gross income merely on account of market fluctuation. What constitutes a reasonable addition to a reserve for bad debts on this account must be determined in the light of the facts in each case. It is possible, of course, that the reserve accounts set up by banks for depreciation of bonds reflect mainly market fluctuations, in which case no addition to a reserve for bad debts can be recognized.

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

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

ARTICLE 163: Depreciation of intangible property. VI-33-3365
T. D. 4055

INCOME AND PROFITS TAXES—REVENUE ACTS OF 1918, 1921, 1924, AND 1926.

Amendment of article 163, Regulations 45 (1920 edition), 62, 65, and 69.

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

To Collectors of Internal Revenue and Others Concerned:

In view of the decision of the Circuit Court of Appeals for the Eighth Circuit, in *Red Wing Malting Co.* v. *Willcuts, Collector*, dated November 5, 1926 [C. B. VI-1, 225], articles 163 of Regulations 45 (1920 edition), 62, 65, and 69 are hereby amended by the addition thereto of the provision that: "No deduction for depreciation, including obsolescence, is allowable in respect of good will." Said articles, as amended, read as follows:

ART. 163. *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. No deduction for depreciation, including obsolescence, is allowable in respect of good will.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 4, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

ARTICLE 165: Method of computing depreciation allowance. VI-31-3341
I. T. 2369

REVENUE ACT OF 1926.

The Bureau will neither approve nor disapprove the use of the declining balance method of computing depreciation in advance of the audit of taxpayer's return.

The M Company has requested approval, effective from January 1, 1927, of the use of the declining balance method for computing the allowance for depreciation.

It is stated that the company since its organization in 1919 has used the straight line method for computing depreciation allowances, but that such method has resulted in the allowances for depreciation being disproportionate to the income realized from the property in respect of which the depreciation was claimed. In other words, the claim is that the depreciation charges have not been prop-

erly distributed in proportion to the income derived from the property. The company desires to compute the allowance for depreciation at a certain percentage of the net book value (proper adjustment being made for the depreciation reserve), instead of a certain percentage of the cost of the depreciable property. It is proposed to use this method only with respect to property from which, due to the nature of the business, income is the greatest in the first years of the property's use, with a steady decline with the lapse of time. The property in respect of which the suggested method is to be used includes all production equipment, pipe lines and storage tanks serving individual fields, casinghead gasoline plants, and refineries. Marketing stations and tank cars, the income from which is not subject to decline as in the case of production equipment, would not be depreciated upon the declining balance method. It is asserted that the true net income of the company would be more clearly reflected through the use of the declining balance method for computing depreciation allowances on the property above mentioned. It is claimed that the use of the production unit method for computing depreciation is impracticable.

Section 234(a)7 of the Revenue Act of 1926 provides in the case of corporations for the reduction of a reasonable allowance for exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

Article 165, Regulations 69, reads in part as follows:

> The capital sum to be replaced should be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. While the burden of proof must rest upon the taxpayer to sustain the deduction taken by him, such deductions must not be disallowed unless shown by clear and convincing evidence to be unreasonable. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made.

Article 225, Regulations 69, provides in part as follows:

> Both owners and lessees operating oil and/or gas properties will, in addition to and apart from the deduction allowable for depletion as hereinbefore provided, be permitted to deduct a reasonable allowance for depreciation of physical property, such as machinery, tools, equipment, pipes, etc., so far as not in conflict with the option exercised by the taxpayer under article 223. The amount deductible on this account shall be such an amount based upon its cost or other basis equitably distributed over its useful life as will bring such property to its true salvage value when no longer useful for the purpose for which such property was acquired.

It will be seen from the provisions of the statute and regulations referred to above that the allowance for depreciation must be reasonable in order to constitute an allowable deduction. The deduction of an allowance for depreciation is not in any way dependent upon the amount of income derived from the property during the taxable year. Depreciation may be deducted even though no income is realized from the property in respect of which the depreciation is claimed. It is believed that the methods prescribed by articles 165 and 225, Regulations 69, for the computation of an allowance for depreciation represent a reasonable construction of the statute, and that the net income of the corporation would be reflected by the use

of such methods. However, inasmuch as the burden of sustaining a deduction for depreciation rests upon the taxpayer, and in view of the fact that the reasonableness of any such deduction must be determined upon the conditions known to exist as at the end of the period for which the return is made, the Bureau will neither approve nor disapprove the use of the declining balance method of computing depreciation, as suggested, in advance of the audit of the return. If in its return for 1927 the company deducts an allowance for depreciation computed in accordance with the declining balance method, the deduction will not be disallowed if, after due consideration of all the facts disclosed in the audit of the return, the allowance is determined to be reasonable.

In this connection it should be borne in mind that a taxpayer's plan for taking deductions for depreciation should be reasonably consistent and that a taxpayer will not be permitted, by a revision of such plan, to take deductions in a given taxable year which should have been taken in prior taxable years. (Article 161, Regulations 69; Appeal of Atlantic Carton Corporation, 2 B. T. A., 380.)

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

ARTICLE 201: Depletion of mines, oil and gas wells; depreciation of improvements. VI–31–3342 G. C. M. 2056

REVENUE ACTS OF 1921, 1924, AND 1926.

Opinion of Attorney General, Treasury Decision 3754 (C. B. IV–2, 37), in which it was held that the income from allotted lands of the Quapaw Indians subject to restrictions on alienation imposed by the Federal Government is exempt from taxation during the continuance of such restrictions, and the decision of the Board of Tax Appeals in the appeal of Leah Brunt, administratrix (5 B. T. A., 134), in which it was held that payments made to the members of the Osage Tribe out of royalties derived from mineral rights held in trust by the United States are not exempt from taxation, distinguished.

The fact that income received by allottees of Quapaw Indian lands was not taxable prior to the removal of restrictions in 1921 does not afford any ground for fixing a different basis for depletion than that specified by statute.

The opinion of this office is requested on the following questions:

1. Is the decision of the Board of Tax Appeals in the appeal of Leah Brunt, administratrix, in regard to the taxability of the income of the Osage Indians inconsistent with the opinion of the Attorney General, published as Treasury Decision 3754, which holds that income received by the Quapaw Indians from restricted land is not taxable?

2. What is the basis for depletion available to A, a Quapaw Indian, whose income subsequent to September 26, 1921, is taxable owing to the removal of restrictions?

In the opinion of the Attorney General, published as Treasury Decision 3754, it was held that the income from allotted lands of the Quapaw Indians subject to restrictions on alienation imposed by the Federal Government is exempt from taxation during the continuance

of such restrictions, though there is no provision in any Act of Congress providing in direct terms for such exemption. The opinion was based primarily upon the ground that to hold the income from such land to be taxable would require it to be held also that the land might be sold to satisfy the tax on such income, which would be inconsistent with the restrictions. To give proper effect to the restrictions it was held that they include an exemption from taxation.

The appeal of Leah Brunt, administratrix, supra, had to do with the payments made to the members of the Osage Tribe out of royalties derived from mineral rights held in trust by the United States. The Osage lands have been allotted in severalty under the authority of the Act of Congress of June 28, 1906 (34 Stat., 589), but the mineral rights have been reserved for a period of years for the benefit of all the members of the tribe, at the expiration of which period the absolute title to such mineral rights will pass to the respective allottees of the lands. The interest held in trust by the United States is, therefore, an estate for years in such mineral rights for the benefit of the members of the tribe as the beneficiaries of the income therefrom. Each member of the tribe shares in such income by reason of his membership in the tribe and not by reason of any specific interest or ownership in any portion of the Osage mineral property. During the taxable years involved in the Brunt case the entire income derived from this source was distributed by the United States to the members of the tribe without any limitations or conditions upon the use thereof after payment. It was this income in the hands of the distributees that the Bureau taxed in the Brunt case on the ground that there was no exemption thereof (either in specific terms or to be deduced by necessary implication) in any Act of Congress. The Board upheld the tax thus asserted.

The Quapaw matter is, therefore, to be distinguished from the Osage case dealt with in the Brunt decision of the Board. The latter case did not involve a construction of restrictions on alienation. Exemption was there claimed on the ground that the beneficiaries of the trust indicated were wards of the Government, and that such wards should not be held to be taxable persons under general Revenue Acts of the United States unless included within the class of taxable persons by specific mention. The Board overruled this contention, holding in effect that wardship of the Indians does not in itself create an exemption from Federal taxation, in the absence of a specific provision by Congress which can be construed to grant an exemption. Inasmuch as the Quapaw matter is thus distinguishable from the Osage case, there is nothing in the decision of the Board referred to which is necessarily inconsistent with the principle in the opinion of the Attorney General, published as Treasury Decision 3754, that restrictions on alienation of land include by necessary implication an exemption from taxation during the continuance of such restrictions.

With respect to the second question: The basis for depletion is set forth in section 214(a)10 of the Revenue Act of 1921, which provides as follows:

> In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the

property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within 30 days thereafter: * * *.

The basis for the determination of depletion deductions in the case of mines under the Revenue Acts of 1924 and 1926 is, except in the case of discovery, the same as is provided for determining gain or loss upon a sale. See section 204(c) of each of the Revenue Acts of 1924 and 1926.

The case of A was considered by this office in Law Opinion 1098, dated May 28, 1922 (C. B. I–1, 64). It appears that the taxpayer acquired her allotment of Quapaw Indian lands by a patent from the United States dated September 26, 1896, the previous allotment thereof having been ratified and confirmed by the Act of Congress approved March 2, 1895 (28 Stat., 907). Lead and zinc deposits were discovered thereon at various times from August, 1915, to October, 1917. Said patent provides in part as follows:

That the United States of America, in consideration of the premises, and in conformity with the provisions of said Act of Congress approved March 2, 1895, the order and schedule of allotments aforesaid, has given and granted and by these presents DOES GIVE AND GRANT unto the said A and to her heirs, the said tract above described; but with the stipulation and limitation contained in the aforesaid Act, that the land embraced in this patent shall be inalienable for the period of 25 years from and after the date hereof; TO HAVE AND TO HOLD the same, together with all the rights, privileges, immunities and appurtenances, of whatsoever nature thereunto belonging, unto the said A and to her heirs forever, provided as aforesaid, that said tract shall be inalienable for the said period of 25 years.

It will be seen that said lands were granted to the taxpayer and to her heirs forever, to have and to hold the same together with all the rights, privileges, immunities and appurtenances, *of whatsoever nature thereunto belonging.* The entire interest in said lands passed to the taxpayer and her heirs in fee simple. As a condition to the vesting of such title the allottee and her heirs were denied the power of alienation for 25 years. This condition did not affect the vesting of title but affected only the power of disposing of the title which vested by the deed. The taxpayer, therefore, acquired the entire substantial interest in the lands on September 26, 1896.

The 1921 Act fixes as the basis for depletion in the case of property acquired before March 1, 1913, the fair market value of such property on that date. The 1924 and 1926 Acts fix as the basis for depletion in the case of property acquired *by gift* prior to March 1, 1913, the fair market value of such property as of the date of acquisition or the fair market value as of March 1, 1913, whichever is greater. The several Acts provide further that in case of the discovery of a mine made after March 1, 1913, depletion may be computed upon the basis of the fair market value of the property so proven at the time of the discovery or within 30 days thereafter.

It has been contended on behalf of allottees of Quapaw Indian lands that they are entitled to place a value on their royalty equities in such lands as of the date of the removal of restrictions, and that this value must be used in computing depletion deductions after the removal of restrictions. This claim is presented on the following

grounds: Under the opinion of the Attorney General, published as Treasury Decision 3754, it was held that income from restricted lands of the Quapaw Indians is not subject to the Federal income tax laws; consequently, the Federal income tax laws did not apply to the Quapaw Indians prior to the removal of restrictions; therefore, at the date of the removal of restrictions the market value of the royalty equities of such Indians constituted capital to them which should be realized free from taxation; to adopt any lower value as the basis for depletion amounts to a taxation of capital.

It is enough to say in respect of such claim made on behalf of the Quapaw allottees that the Revenue Acts of 1921, 1924, and 1926 fix the basis of depletion in the case of mines as indicated in the provisions of law referred to above. The Quapaw allottees acquired the fee simple interest in their allotments at the date of the issuance of the patents therefor by the United States, and the fact that income therefrom was not taxable prior to the removal of restrictions in 1921 does not afford any ground for fixing a different basis for depletion than that specified by statute.

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

ARTICLE 216: Depletion—Adjustments of accounts based on bonus or advanced royalty.

REVENUE ACT OF 1926.

Leases covering properties on which no oil or gas well is in existence. (See I. T. 2384, page 22.)

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells. VI–52–3550 I. T. 2393

REVENUE ACT OF 1926.

The election by a taxpayer, under the provisions of Treasury Decision 4025 (C. B. VI–1, 75), to charge off as expenses for 1925 and subsequent taxable years the items specified in article 223, Regulations 69, will not preclude him from claiming as depletion and depreciation deductions for 1925 or any subsequent taxable year affected the proper proportionate amounts of the expenditures previously capitalized in accordance with an election made with respect to the years prior to 1925.

Taxable years which are not governed by the provisions of the Revenue Act of 1926 do not fall within the scope of Treasury Decision 4025.

An opinion is requested as to the application of the provisions of article 223, Income Tax Regulations 69, in the case of the M Company.

From the information furnished it appears that the above-mentioned company expended during the years 1923 to 1926, inclusive, certain amounts for exploration of oil properties and for drilling nonproductive wells. It is stated that these amounts were capitalized during those years and are being written off through depreciation and depletion. Inasmuch as the company contemplates electing to charge the cost of exploration of property and the cost of drilling nonproductive wells to expense in the year of expenditure, an opinion

is requested as to whether by so doing the taxpayer will be deprived of the annual deduction through depreciation and depletion allowances with respect to expenditures made prior to the passage of the Revenue Act of 1926.

Information is also requested as to whether it is possible to have Treasury Decision 4025 made applicable to the year 1924.

It is the opinion of this office that the election by the M Company, under the provisions of Treasury Decision 4025, to charge off as expenses for 1925 and subsequent taxable years the items specified in article 223 of Regulations 69 will not preclude the company from claiming as depletion and depreciation deductions for 1925, or any subsequent taxable year affected, the proper proportionate amounts of the expenditures previously capitalized by the company in accordance with its election made with respect to the years prior to 1925.

With respect to the inquiry as to whether the provisions of Treasury Decision 4025 can be made applicable to the year 1924 as well as to the years 1925 and 1926, attention is invited to the second paragraph of that decision. As will be noted, the new election granted therein is permitted because of the change in the basis for depletion in the case of oil and gas wells provided by section 204(c)2 of the Revenue Act of 1926. Therefore, taxable years which are not governed by the provisions of the Revenue Act of 1926 do not fall within the scope of Treasury Decision 4025.

SECTION 218.—PARTNERSHIPS.

ARTICLE 335: Partnerships. VI-43-3479
G. C. M. 2448

REVENUE ACT OF 1926.

Under the provisions of the constitution of the State of Florida a married woman can not become a partner with either her husband or any other person, but she can possess and acquire property or property rights, the income from which is recognized as her property. However, if she has become a "free dealer" in the manner specified by the Florida statutes, she may become a partner with her husband.

An opinion is requested as to whether husband and wife domiciled in the State of Florida may become partners, and, in the event that they may not, whether any of the profits of an attempted partnership between A and her husband may be treated as the separate income of A.

Both the constitution of Florida and the statutes of the State contain provisions relative to married women's property. For the purpose of clarity a married woman's constitutional rights and her statutory rights respecting her separate property will be treated separately.

DIVISION 1.

Article 11 of the constitution of Florida provides as follows:

SECTION 1. All property, real and personal, of a wife owned by her before marriage, or lawfully acquired afterwards by gift, devise, bequest, descent or purchase, shall be her separate property, and the same shall not be liable for the debts of her husband without her consent given by some instrument in

writing, executed according to the law respecting conveyances by married women.

SEC. 2. A married woman's separate real or personal property may be charged in equity and sold, or the uses, rents and profits thereof sequestrated for the purchase money thereof; or for money or thing due upon any agreement made by her in writing for the benefit of her separate property; or for the price of any property purchased by her, or for labor and material used with her knowledge or assent in the construction of buildings, or repairs, or improvements upon her property, or for agricultural or other labor bestowed thereon, with her knowledge and consent.

SEC. 3. The legislature shall enact such laws as shall be necessary to carry into effect this article.

Under the above constitutional provisions the courts of Florida have held that a married woman's disability of coverture has been removed to the extent that she may own and possess property in her own name in regard to which she may assume obligations, but such obligations become a charge against her property and not a personal obligation; and that the rents, profits, and income from such property become the property of the married woman for which she has an enforcible right in a court of equity. However, her common law disability of coverture has not been removed by the above constitutional provisions so far that she has acquired the capacity to enter into a contract of partnership. (*De Graum* v. *Jones*, 23 Fla., 83, 6 So., 925; *Virginia-Chemical Co.* v. *Fisher*, 58 Fla.. 377, 50 So., 504; *Porter* v. *Taylor*, 64 Fla., 100, 59 So., 400; *Nadel* v. *Weber Bros. Shoe Co.*, 70 Fla., 218, 70 So., 20; *Le Noir* v. *McDaniel*, 80 Fla., 500, 86 So., 435; *Clark* v. *Andrew*, 11 F. (2d), 958; *Micou* v. *McDonald*, 55 Fla., 776, 46 So., 291; *Halle* v. *Einstein*, 39 Fla., 589, 16 So., 544.)

Although a married woman may not enter into a contract of partnership, it was held in the case of *Nadel* v. *Weber Bros. Shoe Co.*, supra, that a married woman could acquire a property interest in a partnership for which her separate property will be charged in equity for any obligations arising from the conduct of the business but for which she is not individually liable as a partner. In the case of *Le Noir* v. *McDaniel*, supra, a married woman made an agreement to take charge of and manage a business, it being agreed that she would be entitled to a half interest when the net profits of the business reached a specified amount. Upon failure of the owner of the business to live up to the agreement the court held that although a married woman could not make a contract of partnership she could, by her personal efforts, create property rights which would be recognized as belonging to her and to which she could enforce her rights.

Therefore, it is the opinion of this office that under the provisions of the constitution of the State of Florida A, except as hereinafter pointed out, could not become a partner with either her husband or any other person but that she could possess and acquire property or property rights, the income from which is recognized as her property.

DIVISION 2.

The statutes in the State of Florida apparently have broadened the rights of a married woman by permitting her to become a free dealer by complying with certain provisions of the Revised General Statutes of Florida, 1920, which are in part as follows:

3218. *Right to and manner of application.*—Any married woman who resides in the State of Florida, and who may wish to take charge of and manage her

estate and to become a free dealer in every respect, may apply by petition in chancery to the judge of the circuit court for the circuit in which said married woman may reside, for a license to take charge of and manage her own estate and property, and to become a free dealer.

3221. *Decree.*—Upon the coming in and filing of said report and testimony, and upon the hearing thereof, if the judge shall be satisfied as to the capacity and qualifications of such married woman to take charge of and manage her own estate and property, and to become a free dealer in every respect, it shall be lawful for the judge to make an order confirming the report of the master, and to grant to the applicant a license in accordance with the prayer of the petition; and thereupon such applicant, after she shall have published a copy of the order or decree granting the license in the manner and for the time prescribed for publication of the notice of application, shall be authorized to take charge of and control her estate, to contract and be contracted with, to sue and be sued, and to bind herself in all respects as fully as if she were unmarried.

The courts of Florida in interpreting the above statutes have never had the question directly before them as to whether a married woman who has become a free dealer may enter into a partnership agreement. In the case of *Porter* v. *Taylor*, supra, the court considering the question whether a married woman may become a member of a partnership, said in part as follows:

> Under the constitution and laws of Florida, a married woman, who has not been declared a free dealer as authorized by statute, can not become a member of a partnership so as to make herself liable personally for the partnership debts or obligations.

It would seem from the above quotation that the court inferred that had the married woman been a free dealer she could have become a member of a partnership.

In the case of *Lerch* v. *Barnes* (61 Fla., 672, 54 So., 763), the question as to whether a married woman who has been made a free dealer may convey her separate property by her sole deed, the husband in such case not being required by law to join in the conveyance, was before the court, and the opinion of the court is in part as follows:

> If a married woman who has been made a free dealer must still secure the husband to join in her conveyances, how can it be said that she has authority to contract and be contracted with, and to bind herself in all respects as if she were an unmarried woman? If she must secure her husband to join with her in selling and conveying her real estate, to that extent she can not contract, and can not bind herself in all respects as fully as if she were unmarried. There is no language in the statute which limits her authority and power as a free dealer to personal property, or to property which she uses in trade. The statute names the property to which it refers as "her own estate and property," without qualifications or limitations of any sort. These words it would seem mean all her estate and all her property, not some particular parts thereof. * * * If she can not carry out her executory contracts as if unmarried, she is left, in the anomalous position of being sued on such a contract to convey her real estate, if her husband declines to unite with her in the deed of conveyance.
>
> It must be observed that our statutes, unlike those of some other States, do not undertake to take away the common-law disabilities of all married women. It applies only to those who shall be able to satisfy the circuit judge, after testimony has been taken and inquiry has been made, that they have the capacity and qualifications to take charge of and manage their separate estates and property. Undoubtedly this statute is based on the well-known fact that too often a married woman is the breadwinner and stay of the family; and owing to the incapacity of the husband to make proper provision for his family, and his inability to educate his children, the burden falls upon the wife. Why should a narrow construction be given to the statute, putting her at the mercy of an incompetent husband, thus hampering her in the use of her separate

estate, in a way that she could not be "if she were unmarried"? We can see no good reason for giving such a narrow and restricted construction to this statute.

This case was decided February 21, 1911, and an examination of the statutes and of the decisions of the courts of Florida fails to disclose that the rule established therein has been abrogated. Thus it appears that the courts of Florida place a married woman who has been made a free dealer on the plane of a feme sole in transactions pertaining to her property and as such free dealer the disabilities of a feme covert have been removed.

Therefore, it is the opinion of this office that if A has become a free dealer under the Florida statutes she may become a partner with her husband.

SECTION 219.—ESTATES AND TRUSTS.

ARTICLE 345: Credits to trust or beneficiary. VI-50-3533
Mim. 3584

Instructions relative to distributing dividends reported on return of fiduciary where amount received exceeds net income.

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

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

Reference is made to section 219(d) of the Revenue Acts of 1924 and 1926, which provides in part as follows:

> If any part of the income of an estate or trust is included in computing the net income of any legatee, heir, or beneficiary, such legatee, heir, or beneficiary shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are, under this section, required to be included in computing his net income. * * *

Under the above-quoted provision it is held that where the amount of dividends reported in item 6 of the fiduciary return on Form 1041 is in excess of the net income of the estate or trust as shown in item 16 on this return by reason of a deduction claimed on account of trustees' commissions or other allowable deductions, the amount of such net income shall be apportioned among the beneficiaries in column 3 of item 17 on the fiduciary return. In such case, each beneficiary shall include the distributive share of such income received by him from the estate or trust in item 7 of his individual return on Form 1040, to be claimed as a credit in item 32 for normal tax purposes.

Queries regarding this mimeograph will refer to the number of the mimeograph and the symbols IT:E:RR.

D. H. BLAIR, *Commissioner.*

ARTICLE 346: Stock bonus, pension, or profit-sharing trust.

REVENUE ACT OF 1926.

Amounts to be treated as earned income. (See I. T. 2370, page 28.)

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

ARTICLE 361: Withholding tax at source. VI-51-3540
G. C. M. 2699

REVENUE ACT OF 1926.

Example of a provision in a deed of trust which is held to be a tax-free covenant clause.

An opinion is requested as to whether the covenant contained in the deed of trust securing the first mortgage 5½ per cent 30-year gold bonds due January 1, 19—, of the M Company is a tax-free covenant clause. A portion of the covenant reads as follows:

* * * the company hereby further covenants and agrees that it will, *except as to any income tax payable under the provisions of the Act of Congress of the United States of America approved September 8, 1916*, duly and punctually pay both the principal of the said bonds and the interest coupons without any deduction from either principal or interest for any tax or taxes which the company may be required to pay thereon, or to retain therefrom under any present or future law of the United States of America, or of any State, county, municipality, or other governmental subdivision thereof.

Inquiry is made as to whether the fact that, according to the language of the covenant, tax is payable except under the Revenue Act of 1916 nullifies the force of the italicized phrase as to later Acts so that the quoted covenant comes within the class of covenants specified in section 221(b) of the Revenue Act of 1926. It is contended that it was probably not the intention of the obligor to treat the bonds as nontax-free for one year only, 1916, the year in which the bonds were issued, and to treat them as tax-free bonds for the remaining 29 years.

It is the opinion of this office that the covenant quoted is a tax-free covenant within the meaning of section 221(b) of the Revenue Act of 1926. The language used is clear and the exception applies only to the taxes payable under the 1916 Act.

A question naturally arises upon reading the covenant as to the intention of the obligor in inserting such an exception, but as the language is clear it is not necessary to inquire further into the motives which prompted the insertion of the exception.

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

SECTION 223.—INDIVIDUAL RETURNS.

ARTICLE 401: Individual returns. VI-27-3294
I. T. 2367

REVENUE ACT OF 1926.

The filing of a joint return by husband and wife constitutes an election as to the basis to be used for that year, and they are precluded from subsequently filing separate returns even though they propose to do so prior to the expiration of the period specified for the filing of returns.

A and wife filed a joint return for 1926 on February 9, 1927. On March 2, 1927, the taxpayers decided it was advantageous to file sepa-

rate returns; therefore, separate amended returns were submitted to the collector of internal revenue, which he declined to accept.

I. T. 2192 (C. B. IV–2, 68) provides in part as follows:

Held, that where a husband and wife for 1921 filed a joint return or separate returns prior to the publication of Office Decision 1372 [C. B. I–1, 238] on June 26, 1922, they are not precluded from filing amended returns for that year on the other basis; that where a husband and wife filed a joint return or separate returns subsequent to the date of publication of Office Decision 1372, they will be deemed to have made an election and therefore be barred from filing amended returns on the other basis.

The taxpayers contend that this ruling is not applicable to them, inasmuch as the amended returns were filed prior to March 15, 1927, and that prior to that date a definite election has not been made. A ruling is requested on the point involved.

Section 227(a) of the Revenue Act of 1926 provides in part as follows:

(a) Returns * * * shall be made on *or before* the 15th day of the third month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall be made *on or before* the 15th day of March * * *. [Italics supplied.]

It is, therefore, held that the filing of a joint return at any time within the period specified for the filing of returns, as above set forth, constitutes an election as to the basis to be used for that year. Accordingly, in the instant case the taxpayers are precluded from filing separate returns.

PART III.—CORPORATIONS.

SECTION 231.—CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

ARTICLE 518: Business leagues, chambers of commerce, and boards of trade. VI–38–3439 T. D. 4089

INCOME TAX—REVENUE ACTS OF 1918, 1921, 1924, AND 1926.

Exemptions—Business leagues, etc. Article 518, Regulations 69, 65, 62 (1922 edition), and 45 (1920 edition), amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 518, Regulations 69, 65, 62 (1922 edition), and 45 (1920 edition), is hereby amended to read as follows:

ART. 518. *Business leagues, chambers of commerce, and boards of trade.*—A business league is an association of persons having some common business interest, not organized for profit and no part of the earnings of which inure to the benefit of any private shareholder or individual, which limits its activities to work for such common interest. Its work need not be similar to that of a chamber of commerce or board of trade. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not exempt, since its members have no common business interest, even though all of its income is devoted to the purpose stated. A clearing house association, not organized for profit, no part of the net income of which

inures to any private shareholder or individual, is exempt provided its activities are limited to the exchange of checks and similar work for the common benefit of its members. An association of persons who are engaged in the business of carrying freight and passengers by boats propelled by steam, which is designed to promote the legitimate objects of such business, and all of the income of which is derived from membership dues and is expended for office expenses and the salary of a secretary-treasurer is exempt from tax. An incorporated cotton exchange whose shares carry the right to dividends is organized for profit and is not exempt. A stock exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of the law and is not exempt from tax.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 10, 1927.

A. W. MELLON,
Secretary of the Treasury.

SECTION 233.—GROSS INCOME OF CORPORATIONS DEFINED.

ARTICLE 541: Gross income. VI-38-3437
G. C. M. 2185

REVENUE ACT OF 1926 AND PRIOR ACTS.

Because of the provisions of section 605 of the code of the District of Columbia, which prohibit the organization of corporations to buy, sell, or deal in real estate, except corporations to transact the business ordinarily carried on by real estate agents or brokers, the M Company conveyed its real properties to an individual in trust for the sole use of its stockholders.

Held, that the trust for income tax purposes should be treated merely as an agent, and the income derived from real estate operations should be considered as having been received directly by the corporation and should be accounted for in its corporation return.

An opinion is requested in regard to the income tax liability of the M Company, a corporation organized and existing under the laws of the District of Columbia.

A and five other individuals organized the M Company under date of December —, 190–, to conduct a general real estate and insurance business, and to buy, sell, improve, lease, rent, assign, mortgage, pledge, or otherwise dispose of or deal in real estate or real estate securities, etc., in the District of Columbia and elsewhere.

Section 605 of the code of the District of Columbia, amended to June 7, 1924, provides as follows:

Any three or more persons who desire to form a company for the purpose of carrying on any enterprise or business which may be lawfully conducted by an individual, excepting banks of circulation or discount, railroads, and such other enterprise or business as may be otherwise specially provided for in this code, may make, sign, and acknowledge, before some officer competent to take the acknowledgment of deeds, and file in the office of the recorder of deeds, a certificate in writing: *Provided, That nothing herein contained shall be held to authorize the organization of corporations to buy, sell, or deal in real estate, except corporations to transact the business ordinarily carried on by real estate agents or brokers.* [Italics supplied.]

At the suggestion of various title companies, fee simple title to all properties purchased by the M Company was conveyed to A in trust for the sole use of the stockholders of the M Company. This

action was evidently taken because of the provisions of section 605 of the code of the District of Columbia, supra, to the effect that nothing contained therein shall be held to authorize the organization of corporations to buy, sell, or deal in real estate, except corporations to transact the business ordinarily carried on by real estate agents or brokers.

The profits from the real estate operations undertaken, which were derived mainly from the buying and selling of improved real property and the building and selling of apartments and dwelling houses, were treated as profits of the corporation and were reported on the return, Form 1120, filed by the corporation.

Under the facts and circumstances shown, it is the opinion of this office that the trust for income tax purposes should be treated merely as an agent for the purpose of dealing in real estate to meet the inhibition contained in the code of the District of Columbia, and that the trustee should not be considered a fiduciary within the meaning of the income tax law and the regulations. Inasmuch as the profits and income derived from the real estate operations were received or held in trust for the benefit of the stockholders of the corporation, for income tax purposes such income should be considered as having been received directly by the corporation and should be accounted for in its corporation return. No return by A, as trustee, should be required.

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

SECTION 234.—DEDUCTIONS ALLOWED CORPORATIONS.

ARTICLE 562: Donations VI–35–3398
(Also Section 214(a)1, Article 101.) I. T. 2375

REVENUE ACT OF 1926.

Contributions to a chamber of commerce fund to be raised for "industrial and publicity purposes" in the furtherance of building up a city are not allowable deductions from gross income. Amounts included therein, or paid, as membership dues or fees to the chamber of commerce by individuals and corporations are allowable deductions from gross income, provided the membership is employed as a means of advancing the business interests of the individual or corporation making such payments.

An opinion is requested regarding the deductibility for income tax purposes by subscribers of amounts contributed to what is known as the "development fund," to be used by the M Chamber of Commerce for certain purposes.

It appears that the chamber of commerce of the city of R has undertaken a five-year program which it states is to help all lines of business in that community. It is planned to raise and expend through the chamber of commerce of the city of R the sum of x dollars a year for five years for what is stated to be industrial and publicity purposes. Contributions to the fund are to include membership fees in the chamber of commerce of the city of R.

The plan proposes that the chamber of commerce, composed of representatives of every business interest, shall be reorganized, that

steps shall be taken for the further building up of a greater city of R and of its industries, and that efforts will be made to secure new industries for the city. The plan will be under the direction of an executive manager accountable to the board of directors of the chamber of commerce of the city of R. To secure a basis for the working out of the plan, industrial engineers will be employed to make a survey of the city's industrial and commercial possibilities so that the result may be presented to the various industries of the city and to those industries which it is determined can profitably locate in the city of R. The city of R's business interests and individuals interested in the growth of the city of R territory are invited to contribute to the fund.

In computing net income there may be deducted, under the provisions of sections 214(a)1 and 234(a)1 of the Revenue Act of 1926, all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Article 562 of Regulations 69 provides in the case of corporations for the deduction of donations as a business expense to the extent that such donations may legitimately represent a consideration for a benefit flowing directly to the corporation as an incident to the business. The business expenses which are deductible under the sections of the statute above referred to are those incurred directly in the maintenance and operation of the taxpayer's business and not those expenses which may be beneficial or even necessary in a broader sense. That likewise is the effect of article 562 of the regulations.

In order that a contribution of the character referred to in the inquiry may be deductible by a subscriber in the computation of his income tax liability, such contribution must have, in a direct sense, a reasonable relationship to such subscriber's business. In a case in which the question of freight rates was a matter of great importance to a corporation engaged in a business which required the shipping of its products by freight, and in which the corporation faced keen competition with shippers of similar products operating in localities enjoying more favorable rates, a contribution was made by the corporation to a chamber of commerce for the purpose of securing lower freight rates with respect to the products of the corporation. It was held that this contribution was in fact a business expense incurred in exchange for a benefit sought by the contributing corporation, a benefit which was direct and immediately applicable to the particular business of the corporation and, therefore, that the contribution might be made the basis of an allowable deduction. (G. C. M. 1627, C. B. VI–1, 59.)

The benefits flowing to the subscribers to the fund raised and expended by the chamber of commerce of the city of R are most general and indirect, and can not be said to have a direct or immediate relationship to any particular subscriber's business. The contributions of a subscriber do not represent a consideration for a benefit flowing directly to the contributor as an incident of his business.

It is held, therefore, that the contributions made to the fund established by the chamber of commerce of the city of R for the purposes stated, to the extent that such contributions exceed the amount of membership fees included therein, are not ordinary and necessary expenses incident to the carrying on of the business of the contributor, and, therefore, are not allowable deductions from gross

income for income tax purposes. However, amounts paid as membership dues or fees to the chamber of commerce by individuals and corporations are allowable deductions from gross income, provided the membership is employed as a means of advancing the business interests of the individual or corporation making such payments.

SECTION 236.—CREDITS ALLOWED CORPORATIONS.

ARTICLE 591: Credits allowed. VI–37–3420
(Also Section 239, Article 625.) G. C. M. 2292

REVENUE ACT OF 1926.

The return of a corporation of the income received or accrued from the date of its incorporation to the end of its first accounting period, even though such period is less than 12 months, is a return for a period of 12 months and not a return for a fractional part of a year.

An opinion is requested as to when a return may be said to be a return for a fractional part of a year.

In *Bankers' Trust Co.* v. *Bowers* (295 Fed., 89) the court held that a return made for a decedent by his executors of the income received by the decedent during the calendar year in which he died and a return by them for his estate of the income received by the estate during the same calendar year are returns for the full calendar year. This case arose under the Revenue Act of 1921. In the course of its opinion the court used the following language:

The time of receipt of income or the ability to receive income has no bearing upon the accounting period. A taxpayer may receive his income for the year on the first day of the year. He may become a nonresident alien during the year, without property in or income from any source in the United States. As an alien, he may have come to this country during the first taxable year, and he may have attained his majority or become incompetent during the year. When during the year his status changes, and he becomes a taxpayer, or ceases to be one, is immaterial. If he received taxable income during any part of that year, and kept his books on a calendar-year basis, a return is required of all such income derived from or received within the 12 months of such calendar year, and the return is for a period of 12 months.

After the passage of the Revenue Act of 1924 the question arose as to the application of the Bankers' Trust Co. case, supra, to cases arising under that Act. After very careful consideration, the conclusion was reached that the Bankers' Trust Co. case, supra, should be followed in applying the provisions of the Revenue Act of 1924. (I. T. 2239, C. B. IV–2, 58.) This conclusion was based upon the ground that the Bankers' Trust Co. case rested upon the application of general principles and that the language of the Revenue Act of 1924 was not sufficient to warrant a different application of those principles. The provisions of section 226 of the Revenue Acts of 1924 and 1926 are practically identical and it follows that the same rule must be followed under both Acts. (See G. C. M. 2080, on page 288, and *United States* v. *Carroll Chain Co.*, 8 F. (2d), 529.)

Article 625 of Regulations 69 provides as follows:

Returns for fractional part of year.—If a corporation, with the approval of the Commissioner, changes its accounting period from calendar year to fiscal

year, from fiscal year to calendar year, or from one fiscal year to another fiscal year, a separate return shall be made for a fractional part of a year and the net income of such return shall be placed on an annual basis as provided in section 226(c). (See art. 431.) In all other cases the credit of $2 000 against net income allowed a domestic corporation having a net income not exceeding $25,000 shall be reduced to such proportion of the full credit as the number of months in the period for which the return is made bears to 12 months.

It is noted that the scope of the above article of Regulations 69 is expressly limited to cases where the return is for a fractional part of a year, whereas under the application of the principles laid down in *Bankers' Trust Co.* v. *Bowers*, supra, the return for a corporation which enters business during the course of its first calendar or fiscal year is a return for a period of 12 months and is not a return for a fractional part of a year. Consequently, the corporation return in such a case, not being a return for a fractional part of a year, is not one contemplated by article 625 of Regulations 69.

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

SECTION 239.—CORPORATION RETURNS.

ARTICLE 625: Returns for fractional part of year.

REVENUE ACT OF 1926.

Return of a corporation of the income received or accrued from the date of its incorporation to the end of its first accounting period. (See G. C. M. 2292, page 78.)

SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 633: When corporations are affiliated. VI–47–3512
T. D. 4100

INCOME TAX.

Consolidated returns of corporations.—Article 633 of * * * Regulations 69 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 633 of * * * Regulations 69 is hereby amended by omitting from * * * said article the last sentence thereof, having to do with the definition of the words "the same interests."

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved November 12, 1927.

A. W. MELLON,
Secretary of the Treasury.

SECTIONS 246 AND 247.

ARTICLE 693: Deductions allowed insurance companies. VI-49-3526 G. C. M. 2318

REVENUE ACTS OF 1921, 1924, AND 1926.

"Losses incurred but not reported" and "resisted losses" are not allowable as deductions under section 247(a)4 of the Revenue Acts of 1921, 1924, and 1926, but such items should be included in the computation of "losses incurred" under section 246(b) of the Acts mentioned.

An opinion is requested whether "losses incurred but not reported" and "resisted losses" should be allowed fire insurance companies as a deduction under section 247(a)4 of the Revenue Acts of 1921, 1924, and 1926, or whether these items are to be included as "losses incurred" under section 246(b)4 of the Acts mentioned.

In consideration of the question it should be borne in mind that Congress has, in the Revenue Act of 1921, as well as in the subsequent Revenue Acts, made special provision for the taxation of insurance companies. With respect to insurance companies, other than life or mutual insurance companies, the taxes imposed by section 246 of the Revenue Act of 1921 and subsequent Revenue Acts are in lieu of the taxes imposed on other corporations by section 230 of those Acts. By section 246(b), paragraphs 1 and 2, Congress has defined "gross income" and "net income" of insurance companies subject to tax under that section as follows:

(1) The term "gross income" means the combined gross amount, earned during the taxable year, from investment income and from underwriting income as provided in this subdivision, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners;

(2) The term "net income" means the gross income as defined in paragraph (1) of this subdivision less the deductions allowed by section 247.

The succeeding paragraphs of section 246(b) are devoted to the definition of various items entering into the computation of gross income as above defined. By section 246(b), paragraphs 4 and 6, respectively, it is provided that:

(b) In the case of an insurance company subject to the tax imposed by this section—

(4) The term "underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(6) The term "losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year.

This definition of the term "losses incurred" on the part of Congress is strongly indicative of an intention on its part to use the term in a sense different from that in which it is ordinarily used. Furthermore, a reference to the "Underwriting exhibit" (page 10) of the annual statement of fire insurance companies, convention edition,

will disclose that "losses incurred" for the purposes of that statement are determined by the following computation:

14. Losses paid, per item 13, page 3, * * *
15. Deduct salvage and reinsurance recoverable December 31, 1922, per items (a) 28, page 4, * * *
16. Balance, * * *
17. Add salvage and reinsurance recoverable December 31, 1921, per item 15, of last year's exhibit, * * *
18. Total, * * *
19. Deduct unpaid losses December 31, 1921, per item 21 of last year's exhibit, * * *
20. Balance, * * *
21. Add unpaid losses December 31, 1922, per item 14, page 5, * * *
22. Losses incurred during 1922, * * *

It will be noted that this computation follows exactly the computation provided by Congress (sec. 246(b)6, supra) for determining "losses incurred" under section 246(b)4. It will also be noted that in item 21, supra, entitled "Unpaid losses December 31, 1922," item 14, page 5, of the annual statement is incorporated by reference. A reference to this item will disclose that it carries the total of "net unpaid claims" as of the close of the year and includes in that total the total of the two items "losses incurred but not reported" and "resisted losses."

It thus becomes apparent that "losses incurred but not reported" and "resisted losses" are uniformly included under the head of "unpaid losses" in determining the total "losses incurred" in a given year for the purpose of the annual statement of fire companies as submitted to the insurance commissioners of the various States.

It is fundamental that in construing a statute dealing with a particular trade or business it is to be presumed that terms used in such a statute are used in the sense that those terms are understood in the trade or business with respect to which the statute was enacted when such terms have a meaning in that trade or business different from the commonly accepted meaning. In view of this rule of statutory construction and the intention of Congress, apparent from a reading of those paragraphs of section 246 hereinbefore quoted, as well as the uniform treatment among fire insurance companies of the items in question as shown by the annual statements of such companies, this office is of the opinion that "losses incurred but not reported" and "resisted losses" should be included in the computation of "losses incurred" under section 246(b)4 of the Revenue Act of 1921 and the corresponding sections of subsequent Revenue Acts.

The effect of this construction of the term "losses incurred" as used in section 246(b)4 is to exclude the items in question from the gross income of fire insurance companies subject to tax under section 246. Therefore, to permit these items to be deducted under section 247(a)4 in ascertaining the net income of such companies would be to permit the same item to be deducted twice contrary to the prohibition of section 247(c). It necessarily follows that "losses incurred but not reported" and "resisted losses" should not be allowed as deductions under section 247(a)4.

PART IV.—ADMINISTRATIVE PROVISIONS.

SECTION 257.—RETURNS TO BE PUBLIC RECORDS.

ARTICLE 1091: Furnishing of copies of income returns. VI–44–3486 G. C. M. 2454

REVENUE ACT OF 1926.

Under the statutes of Indiana corporations are continued in existence after dissolution as corporate bodies for three years for the purpose of winding up the affairs of the corporation. Where the 3-year period has not expired, a copy of a corporation return may be furnished upon request, in proper form, signed by a principal officer of the corporation. A request for such copy by the administrator of a former officer can not be recognized.

Request for a copy of the return filed by the M Company for 1922 has been made by the administrator of the estate of the former vice president and treasurer of the corporation at the date of dissolution.

By section 4050 of the Indiana statutes, revision of 1914, volume 2, page 550, it is provided that corporations are continued in existence after dissolution as corporate bodies for three years for the purpose of winding up the affairs of the corporation. The section reads:

4050 (3429). *Continuance after dissolution.*—6. All corporations whose charters shall expire by limitation, forfeiture, or otherwise, shall, nevertheless, be continued bodies corporate for three years after the time they would have been so dissolved, for the purpose of prosecuting and defending suits to which they are a party, and to enable them to settle, dispose of, and convey their property, and divide the capital stock, but not to continue the business for which such corporations were established.

During the three-year period the corporation may sue in its own name. (*Herron* v. *Vance*, 17 Ind., 595; *Muncie Tract. Co.* v. *Citizens Gas Co.*, 179 Ind., 322, 100 N. E., 65.) It would appear, therefore, that, if the three-year period referred to above has not expired, a copy of the corporation return may be furnished upon a request, in proper form, signed by a principal officer of the corporation. It is the opinion of this office, however, that the request which has been made by the administrator of a former officer of the corporation can not be recognized.

ARTICLE 1093: Examination of returns by shareholder. VI–33–3366 G. C. M. 1076

REVENUE ACT OF 1926.

A shareholder of a subsidiary corporation owning 1 per cent or more of the outstanding capital stock may inspect only that part of the return of the consolidated group which shows the income of the subsidiary in which the stock is held. If the income of the subsidiary can not be identified in the consolidated return, there is no authority in the law which would authorize an inspection of the consolidated return by a shareholder of a subsidiary.

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

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-29-3310
G. C. M. 2028

REVENUE ACT OF 1926.

Held, under the facts stated, that distraint proceedings may be instituted for the collection of a penalty and interest accrued, notwithstanding the fact that such penalty and interest have not been assessed. The collection of such penalty and interest, however, is subject to the statute of limitations applicable to the collection of the tax itself.

Advice is requested relative to the procedure to be followed in enforcing collection of penalty and interest asserted against the M Company under the following circumstances:

An additional tax for the year 1918 in the amount of $19x$ dollars was assessed against the M Company on the November, 1921, assessment list; on December 28, 1921, a first notice and demand was mailed to the taxpayer for the amount so assessed; on January 6, 1922, a claim for abatement, Form 47, was filed by the taxpayer, which was rejected by the Bureau under date of November 18, 1922; under dates of February 2, 1923, January 30, 1924, and January 5, 1925, further notices for the payment of the tax were issued; under date of June 1, 1925, a warrant of distraint was issued; and the tax was paid on July 7, 1925. At the time of payment of the tax, the taxpayer submitted an offer of $3x$ dollars in compromise of the 5 per cent penalty and interest of $8x$ dollars. On December 10, 1926, the offer in compromise was rejected, and on March 23, 1927, a warrant of distraint was issued covering the penalty and interest.

Based upon these facts, advice is requested as to—

(1) Whether in this case, where the tax liability itself has been fully satisfied, distraint proceedings can be legally instituted for the collection of penalty and interest accrued but not assessed.

(2) Whether the accrued interest is in the nature of a tax or a debt.

(3) Whether the penalty and interest must be officially assessed by the Commissioner before collection can be enforced by distraint proceedings.

(4) Whether the statute of limitations runs against the assessment and collection of penalty and interest, and, if so, how same applies in the case of the M Company.

The first and third questions make it necessary to consider whether penalty and interest accrued but not assessed may be legally collected by a distraint proceeding. A delinquent taxpayer is as much obligated under the law to pay unassessed penalty and interest imposed for failure to pay a tax within the statutory period following notice and demand as he is to pay the amount actually assessed by the Commissioner of Internal Revenue. (See section 3187, Revised Statutes.) In the opinion of this office, under the provisions of the cited section proceedings by distraint properly may be utilized to collect such unassessed penalty and interest.

With regard to the second question presented, it appears to be immaterial as to whether accrued interest may be regarded as a tax

or a debt for collection purposes. Under the provisions of the statute, interest for delinquency in making payment of a tax is added as a part of the tax and is collectible in the same manner as the tax.

With regard to the fourth question, it is the opinion of this office that where the statute provides for the collection of penalty and interest as a part of the tax, the collection of such penalty and interest is subject to the statute of limitations applicable to the collection of the tax itself. Unless a suit or proceeding by distraint is begun for the collection of the penalty and interest within the statutory period applicable to the collection of the tax, the collection thereof becomes barred. It is stated that it is evident that the decision of the Supreme Court in the case of *Bowers* v. *New York & Albany Lighterage Co.* (269 U. S., 514; T. D. 4009 [C. B. VI–1, 268]) applies to the collection of the penalty and interest asserted against the M Company. In the instant case the five-year period of limitation, as prescribed in the Revenue Act of 1921, upon assessment and collection of the tax assessed against the said company expired prior to June 2, 1924, the date of the enactment of the Revenue Act of 1924, and no collection waivers were filed by the taxpayer. The six-year period of limitation upon collection of the tax after assessment, as prescribed in the Revenue Acts of 1924 and 1926, is therefore not applicable. Under the decision of the Supreme Court referred to, collection of the tax, penalty, and interest became barred five years after the return was filed, unless a suit or distraint proceeding was begun for the collection thereof within such period.

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

Article 1205: Liens and enforcement of tax liens by bill in equity. VI–27–3295 G. C. M. 1089

REVENUE ACT OF 1926.

Notice of lien for taxes recorded in the proper office of record in the book of miscellaneous liens, even though in an abbreviated form and not indexed, held to be effective.

A tax was legally due from A; demand therefor was properly made; he either refused or neglected to pay the same, and, thereupon, the collector filed the lien authorized by section 3186 of the Revised Statutes. The representatives of certain interested parties contend that under the State law, in order to be effective against any mortgagee, purchaser, or judgment creditor, the Federal tax lien must not only be filed but must also be recorded and indexed. They state that in the instant case the register of deeds entered the notice of lien in a book entitled "Miscellaneous liens," to which there is no index; that the data so entered are incomplete; and that the procedure taken was inadequate to constitute constructive notice of a lien against the particular property in question.

With regard to these matters, it seems to be clear that the collector complied with the terms of the Federal law. Evidently he filed the notice of lien for taxes in the proper office of record. A record of the notice was duly made. The data relating to the notice recorded in the book of miscellaneous liens, even though in an abbreviated form,

afforded sufficient information to indicate to an experienced searcher of records that the Federal Government had filed a lien for taxes against the said A and to cause the searcher to make further inquiry in case he was uncertain of the precise significance of the entries.

If the bank, an interested party, was a mortgagee, as alleged, and if the mortgage was executed and recorded prior to the registration of the Federal tax lien under section 3186, as amended, and if there is no question about the validity or *bona fides* of the mortgage, the mortgage indebtedness would be and is entitled to priority over the taxes. (In re Fahnestock Manufacturing Co., 7 Fed. (2d), 777.) If, however, the tax lien was filed and recorded first, the claim for taxes is entitled to priority over any mortgage that was never recorded or one that was recorded after the notice of the tax lien was entered.

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

ARTICLE 1205: Liens and enforcement of tax liens by bill in equity — VI-30-3327, I. T. 2368

REVENUE ACT OF 1926.

The act of February 28, 1927, passed by the Legislature of Utah, effective July 1, 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 (45 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 1235: Interest on a deficiency. — VI-30-3328, G. C. M. 2010

REVENUE ACT OF 1926.

A notice in writing consenting to the immediate assessment and collection of a proposed deficiency in tax, in which notice the taxpayer expressly reserves the right to appeal to the United States Board of Tax Appeals for a review and determination of the entire deficiency, is a sufficient compliance with section 274(d) of the Revenue Act of 1926 to curtail the interest period provided for in section 283(d) of said Act; likewise the filing of such a notice consenting to the immediate assessment and collection of a portion of the proposed deficiency in tax (without waiving the right to file a petition with the Board of Tax Appeals in connection with the entire deficiency) would curtail the interest period provided for in section 283(d) upon such portion of the deficiency.

An opinion is requested relative to claims for refund filed in the case of the M Company covering a portion of the interest paid on deficiencies in tax assessed for the taxable years 1917 and 1918.

The facts in the case appear to be substantially as follows: Under date of March —, 1926, the taxpayer was notified by registered letter of deficiencies in tax due for the taxable years 1917, 1918, and 1919 in the respective amounts of $45x$ dollars, $128x$ dollars, and $69x$

dollars. On March —, 1926, the taxpayer filed with the Commissioner a written notice reading as follows:

In accordance with the provisions of subdivision (d) of section 274 of the Revenue Act of 1926, the undersigned taxpayer hereby consents to the immediate assessment and collection of a portion of a total deficiency of 242x dollars, alleged income and profits taxes for the years 1917 and 1918, as set forth in a registered letter from the Commissioner of Internal Revenue addressed to the taxpayer under date of March —, 1926. The portions of said deficiencies, to the immediate assessment and collection of which the taxpayer hereby consents, are as follows:

	Dollars.
For the year 1917	45x
For the year 1918	128x
Total	173x

This is not an agreement under the provisions of section 1106, and is not to be construed as an admission by the taxpayer of the legality or correctness of any part of said total deficiency; and the taxpayer hereby expressly reserves the right to appeal to the United States Board of Tax Appeals for a review and determination of the entire deficiency for each of said years 1917 and 1918, and/or to file any claims for refund and sue for recovery of any taxes overpaid for any of said years as though this agreement had not been executed.

No petition having been filed with the United States Board of Tax Appeals for a redetermination of the deficiencies in tax due for the taxable years 1917 and 1918, the deficiencies due for those years were assessed on June 12, 1926. Interest upon the deficiencies was computed up to the date the assessments were made rather than up to the thirtieth day after the filing of the above notice with the Commissioner.

Advice is requested as to (*a*) "whether a notice in writing consenting to the immediate assessment and collection of a proposed deficiency in tax, in which notice the taxpayer expressly reserves the right to appeal to the United States Board of Tax Appeals for a review and redetermination of the entire deficiency, is a sufficient compliance with section 274(d) of the Revenue Act of 1926 to curtail the interest period provided for in section 283(d) of the 1926 Act," and (*b*) whether the filing of such a notice "consenting to the immediate assessment and collection of a portion of the proposed deficiency in tax (without waiving the right to file a petition with the Board of Tax Appeals in connection with the entire deficiency) would curtail the interest period provided for in section 283(d) upon such portion of the deficiency."

Section 283(d) of the Revenue Act of 1926 provides as follows:

(d) In the case of any assessment made after the enactment of this Act in respect of a tax imposed by any Act of Congress prior to November 23, 1921, interest upon the tax proposed to be assessed shall be assessed at the same time as such tax, shall be paid upon notice and demand from the collector, and shall be collected as part of such tax, at the rate of 6 per centum per annum, from the date of the enactment of this Act to the date such tax is assessed, or, in the case of a waiver under subdivision (d) of section 274, to the thirtieth day after the filing of such waiver or to the date the deficiency is assessed whichever is the earlier.

Section 274(d) provides as follows:

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.

The plain words of the statute appear to be decisive of both of the questions presented. The taxpayer shall have the right by a signed notice in writing filed with the Commissioner to *waive the restrictions* provided in subdivision (a) of section 274 on the assessment and collection of the whole or any part of the deficiency. The restrictions prescribed in subdivision (a) are that no assessment of a deficiency and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until a notice of such deficiency has been sent to the taxpayer by registered mail, nor until the expiration of 60 days after the mailing of such notice, nor, if a petition has been filed with the Board until the decision of the Board has become final. These restrictions may be waived by the taxpayer "at any time," and that may be either before or after a petition has been filed with the Board, or even after the Board has rendered its decision. Obviously, therefore, the taxpayer may file a waiver under subdivision (d) without waiving, or without having waived, his right to file a petition with the Board. There is nothing in the statute to show that the jurisdiction of the Board is in any wise restricted by the filing of a waiver under subdivision (d) of section 274. If the taxpayer files a waiver of the restrictions on the assessment and collection of "any part of the deficiency," which concededly he has the right to do, and files a petition with the Board for a redetermination of the balance of the deficiency, the Board not only has jurisdiction to redetermine the true deficiency but may also determine that an overpayment has been made. See section 284(d).

There is nothing in section 274(d) to the effect that the taxpayer must file a waiver of his right to file a petition with the Board. Its provisions are satisfied upon the filing of a waiver of the restrictions upon the assessment and collection of the deficiency. While in the opinion of this office the provisions of the statute are clear with respect to the questions presented and leave little room for interpretation, attention may be called to the legislative history of section 274(d), which indicates that it was not the intention of Congress that the taxpayer must waive his right to file an appeal with the Board in order to take advantage of the provisions of that section. In the report of the Committee on Finance, dated January 22, 1926, on the revenue bill of 1926, the following recommendation was made:

> The law provides that where a deficiency is assessed there shall be assessed at the same time interest at the rate of 6 per cent from the time the deficiency should have been paid to the date of the assessment. In order to permit the taxpayer to pay the tax and stop the running of interest, the committee recommends in section 274(d) of the bill that the taxpayer at any time be permitted to waive in writing the restrictions on the Commissioner against assessing and collecting the tax, but without taking away the right of the taxpayer to take the case to the Board. It is provided in such cases that the 6 per cent interest stops running on the thirtieth day after the filing of such waiver unless assessment is made before such time.

Subdivision (d) of section 274, as originally drafted in the Senate, provided as follows:

> 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. Such waiver shall not bar the taxpayer from receiving a

credit or refund under subdivision (c) of section 284 if the decision of the Board, which has become final, determines an overpayment of tax in respect of the year to which the waiver relates.

When the conference committees of the House and Senate met the last sentence of the Senate draft was stricken. Mr. Green, in his conference report of February 22, 1926, report No. 356, at page 40, said:

Subdivision (d): This subdivision of the House bill provided for the making of jeopardy assessments. The Senate amendment strikes out this subdivision for reasons explained in connection with amendment numbered 86, and inserts a provision authorizing the taxpayer, by a signed notice in writing, to waive the restrictions placed upon the Commissioner by subdivision (a) on assessment and collection of the deficiency. The Senate amendment also contains a sentence providing that such waiver shall not bar the taxpayer from receiving a refund if the final decision of the Board determines an overpayment of tax. This sentence is omitted from the bill as agreed to in conference as being surplusage.

In view of the foregoing, it is the opinion of this office that both of the questions presented must be answered in the affirmative, and that the claims for refund filed by the M Company, covering interest paid by it for the period from the date of the expiration of 30 days after the filing of the waiver under section 274 to the date the deficiencies in tax were assessed, should be allowed.

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

ARTICLE 1235: Interest on a deficiency. VI-50-3534
T. D. 4104

RECEIVERSHIP—FEDERAL TAXES—DECISION OF COURT.

RECEIVERSHIP—FEDERAL TAXES—INTEREST.

The claim of the United States for taxes against the funds of an insolvent in the hands of a receiver, being entitled to priority over the other claims, carries the right to the interest allowed by statute where any part of a tax is not paid within the time prescribed for its payment.

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 *W. B. Pearsall* v. *Central Oil & Gas Co. of America* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved November 30, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

W. B. Pearsall v. *Central Oil & Gas Co. of America.*

OPINION.

GIBSON, District Judge: Exceptions have been filed to the schedule of the distribution reported by the master on behalf of D. B. Heiner, collector of internal revenue, and by the Franklin Trust Co.

The exception of the collector is based upon the failure of the master to allow, in addition to the claim for taxes, the interest prescribed by statute upon failure to pay such taxes in due time.

Ordinarily, interest is not allowed upon claims against the funds of an insolvent in the hands of a receiver. This rule is applicable when the fund is to be shared by general creditors, or by lienholders of equal rank; but where the claims are not of equal rank, interest is to be allowed to the date of distribution upon those entitled to priority, even though the fund be exhausted by them. In the instant matter it is conceded that the claim of the United States for taxes is entitled to priority over the other claims, and in such case it carries the right to interest. See *American Iron Co.* v. *Seaboard Air Line* (233 U. S., 261); *First National Bank* v. *Ewing* (103 Fed. Rep., 168 (190)).

The exceptions of D. B. Heiner, collector, to the master's report, so far as they relate to the failure of the master to allow interest upon the items of the claim filed, must be sustained. An order will be made by which the amount of $392.25, awarded to the collector by the master, will be increased by the addition of interest upon each of the various items making up the claim. The sum of $28.12, interest at 1 per cent per month on $30.57, income tax for the year ending December 31, 1917, from August 22, 1918, will be added; also $58.86, interest on $108, capital stock tax for the year ending June 30, 1922, from October 15, 1921; also $49.76, interest on $117, capital stock tax for year ending June 30, 1923, from October 4, 1922; also $36.62, interest on $118, capital stock tax for the year ending June 30, 1924, from September 19, 1923. The total amount to be distributed to D. B. Heiner, collector, is $565.61.

The Franklin Trust Co. has excepted to the order of the master whereby he awarded priority in distribution to certain wage claims, and a claim for office rent, as against a judgment in favor of T. B. McFadden, for use of the Franklin Trust Co. The labor claims were for services rendered within six months preceding the receivership, August 10, 1925. The judgment of the exceptant had been entered on November 7, 1922, upon a mechanics lien on July 8, 1922. The master has cited *Allentown National Bank* v. *Helios Dry Color & Chemical Co.* (9 Pa. Super. Ct., 275) in support of his award of priority to the labor claims. That case holds that wages of labor take precedence over mechanics liens and judgments entered subsequently to the performance of the services for which the labor claim was filed. The learned master seems to have failed to observe the difference in the facts of the case cited and those of the instant matter. In the matter under present consideration the mechanics lien claim had been reduced to judgment and stood upon the same plane as any other judgment; and instead of being entered subsequently to the performance of the services upon which the wage claims were based, it had been entered over two years prior to such performance. The Act of April 9, 1872 (P. L. 47), giving priority to wage claims, expressly provides that the preference established by it shall not impair the lien of a mortgage or judgment entered before the service is rendered for which wages are claimed.

The exception of the Franklin Trust Co. to the allowance of priority to the wage claims of R. H. Braham for $45.70, H. D. Boyd for $66.60, Harry A. Stuck for $290, and C. C. Ward for $24 must be sustained, as the exceptant's judgment is plainly entitled to payment in advance of them.

The learned master was also in error in awarding precedence to the rent claim of W. B. Pearsall for $315 over the judgment of T. B. McFadden, for use of the Franklin Trust Co. The rent was for the office of the present insolvent from November, 1924, to August 14, 1925. The lessor had made no levy upon any goods of the Central Oil & Gas Co. of America in the office, and the fund in which he was claiming a preference was from the sale of the company's real estate. Plainly the rent claim was subordinated to the judgment entered two years prior to the inception of the rent claim.

The exception of the Franklin Trust Co. to the report of the master that the claim for rent was entitled to payment in advance of the payment of the judgment of the exceptant must be sustained.

SECTIONS 277 AND 278.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION OF TAX.

ARTICLE 1271: Period of limitation upon assessment of tax. VI–39–3444 G. C. M. 2256

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

More than five years after the filing of delinquent income tax returns for 1916, 1917, and 1918, and the assessment of the taxes and penalties shown thereon, a field investigation disclosed that the returns were also false and fraudulent.

The additional taxes found to be due may be assessed under section 278(a) of the Revenue Act of 1926.

The following facts and question in regard to false and fraudulent income tax returns have been submitted to this office:

A taxpayer filed delinquent income tax returns for the years 1916, 1917, and 1918, upon the basis of which taxes and the ad valorem delinquency penalties, provided in section 3176 of the Revised Statutes, were assessed.

Subsequently, more than five years after the filing of the delinquent returns and the assessment of the taxes and penalties, a field investigation disclosed that the income shown on the delinquent returns was grossly understated. It appears from the evidence presented that such understatements were willful and made for the purpose of evading tax. The following question arises:

Assuming that the returns in question, which were delinquent, were also false and fraudulent, and willfully made with intent to evade tax, may the Bureau, notwithstanding the five-year period provided for the assessment of the taxes, now make assessment of the additional taxes found to be due by virtue of the fact that the returns so filed were false and fraudulent?

Section 277(a) of the Revenue Act of 1926 provides as follows:

SEC. 277. (a) Except as provided in section 278—

(3) The amount of income, excess-profits, and war-profits taxes imposed by the Act entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909, the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October 3, 1913, the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, and by any such Act as amended, shall be assessed within five years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

Section 278 (a) and (e) of the Revenue Act of 1926 provides as follows:

SEC. 278. (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * * * *

(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.

Accordingly, if at the time of the enactment of the 1926 Act the assessment sought herein was barred by the statutory period of limitation properly applicable thereto, no assessment can be made. It, therefore, becomes necessary to examine the Revenue Acts of the respective years involved and subsequent Acts to see if the assessment for the years involved was barred by the statutory period of limitation at the time of the enactment of the Revenue Act of 1926.

That part of section 9(a) of the Revenue Act of 1916 which is applicable hereto for the years 1916 and 1917 provides as follows:

SEC. 9. (a) That all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the 1st day of June of each successive year, and said amounts shall be paid on or before the 15th day of June, except in cases of refusal or neglect to make such return and in cases of erroneous, false, or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, or has been made, make a return upon information obtained as provided for in this title or by existing law, or require the necessary corrections to be made, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such person or persons immediately upon notification of the amount of such assessment; * * *.

The above-quoted section of the Revenue Act of 1916 makes it obligatory upon the Commissioner to discover that the return was erroneous, false, or fraudulent within a period of three years. Obviously, the three-year period had elapsed before the enactment of the Revenue Act of 1926 or before the discovery that the returns were erroneous, false, or fraudulent in the instant case. Therefore, unless some subsequent Act of Congress has nullified this three-year provision for discovery, the assessment of taxes due under the Revenue Act of 1916 will necessarily be barred. Section 250(d) of the Revenue Act of 1921 provides in part as follows:

(d) The amount of income, excess-profits, or war-profits taxes due under any return made under this Act for the taxable year 1921 or succeeding taxable years shall be determined and assessed by the Commissioner within four years after the return was filed, and the amount of any such taxes due under any return made under this Act for prior taxable years or under prior income, excess-profits, or war-profits tax Acts, or under section 38 of the Act entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909, shall be determined and assessed within five years after the return was filed, unless both the Commissioner and the taxpayer consent in writing to a later determination, assessment, and collection of the tax; and no suit or proceeding for the collection of any such taxes due under this Act or under prior income, excess-profits, or war-profits tax Acts, or of any taxes due under section 38 of such Act of August 5, 1909, 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: * * * *Provided further*, That in the case of a false or fraudulent return with intent to evade tax, or of a failure to file a required return, the amount of tax due may be determined, assessed, and collected, and a suit or proceeding for the collection of such amount may be begun, at any time after it becomes due: * * *.

It has been held by the Bureau that, notwithstanding the fact that assessments may have been barred under the provisions of prior statutes at the time of the passage of the Revenue Act in 1921, assessments may be made within the period prescribed by section 250(d) of said Revenue Act. That part of the above-quoted section of the 1921 Act dealing with the false and fraudulent returns was carried forward in section 278(a) of the Revenue Act of 1924, and also in section 278(a) of the Revenue Act of 1926.

In view of the foregoing, it is the opinion of this office that the above-quoted section of the Revenue Act of 1921 does away with the former requirement that the fraud shall have been discovered within three years, and under those circumstances neither assessment nor collection of the tax being barred at the time of the enactment of the Revenue Act of 1926, it is proper for the tax to be assessed for the years 1916 and 1917 at any time after the fraud is discovered. Likewise, it is proper for the tax for 1918 to be assessed at any time after the fraud is discovered, particularly in view of section 250(d) of the Revenue Act of 1918, which reads as follows:

(d) Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. In the case of such false or fraudulent returns, the amount of tax due may be determined at any time after the return is filed, and the tax may be collected at any time after it becomes due.

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

ARTICLE 1272: Period of limitation upon collection of tax. VI-28-3301 G. C. M. 1799

REVENUE ACT OF 1926.

A taxpayer may waive the benefit of any statute of limitations, or other statute of repose which may be enacted for his benefit, where there is no actual or implied statutory inhibition against such a waiver; and such waiver is equally effective whether the act of waiving the statute of limitations occurs before or after the expiration of the period provided by the statute so waived.

An opinion is requested as to the validity of a waiver of the statute of limitations on collection of tax, where such waiver was filed subsequent to the expiration of the period provided in the statute.

It appears that an item of tax for the year 1918 was assessed against the taxpayer on the 1919 list. A waiver of the statute which prescribes the period during which the tax might be collected was executed on October 19, 1925, and by the terms of this waiver the taxpayer consented to the collection of the tax at any time prior to December 31, 1926. A second waiver was executed by the taxpayer on December 8, 1926, which permitted the collection of the tax at any time prior to December 31, 1927.

It is pointed out that the waiver dated October 19, 1925, was filed more than five years after the filing on March —, 1919, of the return of tax for the year 1918, and inquiry is made whether such waiver was inoperative and of no effect by reason of its being filed after the statutory period for the collection of tax had expired, and prior to the enactment of the Revenue Act of 1926.

The statutory period of limitation in effect at the present time, with respect to the collection of the income, war-profits, or excess-profits taxes imposed under the Revenue Act of 1918, is that provided in paragraphs (d) and (e) of section 278 of the Revenue Act of 1926, which read as follows:

(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.

In the instant case it will be noted that the tax was assessed within the statutory period applicable thereto, and that prior to the enactment of the Revenue Act of 1926 the taxpayer and the Commissioner agreed in writing, as evidenced by the waiver dated October 19, 1925, that the tax could be collected after the expiration of the statutory period of limitation applicable at the time of the filing of such waiver, which has been continued in effect by the waiver of December 8, 1926, extending the time in which collection may be made to December 31, 1927.

It is the opinion of this office that a taxpayer may waive the benefit of any statute of limitations, or other statute of repose which may be enacted for his benefit, where there is no actual or implied statutory inhibition against such a waiver; and that such waiver is equally effective whether the act of waiving the statute of limitations occurs before or after the expiration of the period provided by the statute so waived. Therefore, in the instant case, the waiver executed by the taxpayer on October 19, 1925, as extended in its effect by the waiver executed December 8, 1926, is valid for the collection of the tax.

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

ARTICLE 1272: Period of limitation upon collection of tax.

VI–45–3496
G. C. M. 2513

REVENUE ACTS OF 1924 AND 1926.

A deficiency in tax for the year 1918 having been assessed against the taxpayer on March 18, 1925, it was collected by distraint on December 15, 1926. A waiver as to determination, assessment, and collection was filed on January 29, 1924, effective for one year after the statutory period of limitation.

Held, that the 5-year period of limitation began with the filing of the completed return on July 14, 1919, and not on March 14, 1919, the date the tentative return was filed. The assessment was made within the statutory period applicable as extended by waivers, and collection was made within the period of limitation provided in the Revenue Acts of 1924 and 1926.

An opinion is requested as to the legality of an assessment and collection of income and profits taxes for the year 1918 in the case of the M Company under the following statement of facts:

It appears that on March 14, 1919, the taxpayer filed a tentative return (Form 1031–T) of tax for the calendar year 1918, and requested an extension of time within which to file a completed

return, which was subsequently filed on July 14, 1919. On January 29, 1924, a waiver was filed, under the terms of which the taxpayer consented to a determination, assessment, and collection of the amount of tax due on any return made for the year 1918 under the Revenue Act of 1921 or prior Acts. By its terms the waiver was to remain in effect for a period of one year after the expiration of the statutory period of limitation. On March 18, 1925, a deficiency in tax amounting to $64x$ dollars was assessed, which was later reduced to $13x$ dollars. The taxpayer refused to pay this latter amount and it was collected by distraint on December 15, 1926.

The taxpayer has protested against the assessment and collection of the deficiency, and the contention advanced is that the statutory period for the assessment and collection of the tax under section 250(d) of the Revenue Act of 1921 expired five years subsequent to March 14, 1919, the date of the filing of the tentative return, and that the waiver filed on January 29, 1924, only operated to provide a year's extension, which caused the assessment and collection of the tax to be barred after March 14, 1925.

The Bureau has taken the position that the filing of a tentative return does not start the running of the statute of limitations applicable to assessments, and that the 5-year period of limitation upon assessment provided for in section 250(d) of the Revenue Act of 1921 begins with the date of the filing of a completed return. (S. M. 1404, C. B. III–1, 335.) The position of the Bureau in this respect has been upheld by the Board of Tax Appeals in the appeal of Dallas Brass & Copper Co. (3 B. T. A., 856), in which it was held that the so-called tentative return on Form 1031–T was not the return required by section 239 of the Revenue Act of 1918 and that the beginning of the 5-year period of limitation upon assessment was the date of the filing of the completed return.

In the instant case the completed return was filed on July 14, 1919, and by the terms of the waiver which was filed on January 29, 1924, the deficiency in tax could be assessed within six years after July 14, 1919. Under the provisions of section 278(c) of the Revenue Acts of 1924 and 1926, where both the Commissioner and the taxpayer have consented in writing to the assessment of the tax after the expiration of the statutory period during which assessment of such tax is permitted, the tax may be assessed any time prior to the expiration of the period agreed upon.

Section 278(d) of the Revenue Acts of 1924 and 1926 provides that where the assessment of the tax is made within the period prescribed in section 277 or 278 of those Acts, such tax may be collected by distraint or by a proceeding in court begun within six years after the assessment of the tax.

Since the tax in the instant case was assessed within the statutory period applicable thereto, as extended by waivers, and the collection of such tax was made within the period of limitation provided in the Revenue Acts of 1924 and 1926, a refund of the tax based upon the contention that such tax was assessed and collected after the expiration of the statutory periods applicable to the assessment and collection of the tax must be denied.

ARTICLE 1272: Period of limitation upon collection of tax. VI–47–3507 G. C. M. 2581

REVENUE ACTS OF 1921, 1924, AND 1926.

Partial payment of an additional assessment as a result of a warrant of distraint being issued after the running of the statute of limitations as to collection does not constitute a waiver of the statute so that distraint proceedings for the balance of the assessment may be instituted.

In March, 1923, an additional assessment of $6x$ dollars was made against the taxpayer for the year 1917, which, less an overassessment of $2x$ dollars for 1918, resulted in a net additional assessment of $4x$ dollars. The taxpayer's return for 1917 was filed on April —, 1918, so the additional assessment was made within five years from the time the return was filed. A warrant of distraint for the unpaid tax on account of the additional assessment was served on the taxpayer in October, 1926. The taxpayer paid x dollars to the officer who served the distraint warrant, but later refused to pay the balance. It was contended that collection by means of distraint was barred under section 278(e) of the Revenue Acts of 1924 and 1926, citing the decision of the United States Supreme Court in *Bowers* v. *New York & Albany Lighterage Co.* and allied cases (273 U. S., 346; T. D. 4009, C. B. VI–1, 268).

The collector of internal revenue for the —— district of —— requests that the balance of the assessment, amounting to $3x$ dollars, be abated as uncollectible. An opinion is requested as to whether the making of a partial payment by the taxpayer constituted a waiver of the statute of limitations so that distraint proceedings for the balance may now be instituted.

The principle upon which part payment takes a case out of the statute is that the party paying intended by it to acknowledge and admit the greater debt to be due. (*United States* v. *Wilder*, 13 Wall., 254.) But the mere payment of a part of an asserted income tax which has been assessed can not be regarded as an acknowledgment or an admission on the part of the taxpayer that the amount assessed is due, since where an assessment has been made the taxpayer's remedy lies only in his right to sue for its recovery after the tax is paid. (*Graham* v. *DuPont*, 262 U. S., 234.)

The conclusion of this office is that the partial payment made after the period of limitation on collection had expired did not extend the period within which collection might be made as to the balance of the assessed amount.

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

SECTION 280.—CLAIMS AGAINST TRANSFERRED ASSETS.

ARTICLE 1291: Claims in cases of transferred assets. VI–41–3461 G. C. M. 2408

REVENUE ACT OF 1926.

An assessment against a transferee of assets within one year after the expiration of a waiver executed by the transferor extending the period of limitation for assessment against the transferor is valid.

The liability of a corporation for income taxes may be enforced against the transferees to the extent of all assets distributed to the shareholders, or owners of beneficial interests, including the assets representing surplus as well as other property of whatever kind so distributed.

The question has arisen with respect to the liability of the transferees of the M Association as to whether the statute of limitations ran prior to the time assessments on account of such liability were made against them.

It appears that the association, which is taxable as a corporation, has gone out of business and the assets have been distributed to the owners of the beneficial interests or members, but that the association has not been dissolved. The organization filed its income returns for the years 1920 and 1921, indicating that no tax was due, on March 15, 1921, and March 15, 1922, respectively, and the statute of limitations with respect to both years would have run March 15, 1926. The organization, however, under date of September —, 1925, filed a waiver for both years, signed by its president and secretary, extending the period of limitation until December 31, 1926, for the purpose of assessment. There were assessed against the association in 1926 taxes for the years 1920 and 1921 amounting to x dollars, which have not been paid. The association has no assets. Assessments were made against the transferees under date of August —, 1927, in accordance with section 280 of the Revenue Act of 1926, it being necessary to invoke the provision of section 279 pertaining to jeopardy assessments.

The representative for the association contends that the assessments against the transferees were barred on March 15, 1927, and that the waiver filed by the transferor extending the period of limitation to December 31, 1926, was invalid so far as the transferees are concerned.

Section 280 of the Revenue Act of 1926 provides in part as follows:

SEC. 280. (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.

* * * * * * *

(b) 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 * * *.

As stated in section 280(b)1, the period of limitation for assessment of any such liability of a transferee is within one year after the expiration of the period of limitation against the transferor. The period of limitation upon assessment and collection of a deficiency in the case of the association is contained in section 277(a) of the Revenue Act of 1926, which provides that except as provided in section 278 of that Act, the amount of income, excess-profits, or war-

profits taxes imposed by the Revenue Act of 1921 shall be assessed within four years after the return was filed and such taxes due under the Revenue Act of 1918 shall be assessed within five years after the return was filed. One of the exceptions contained in section 278 reads as follows:

SEC. 278. (c) Where both the Commissioner and the taxpayer have consented in writing to the assessment of the tax after the time prescribed in section 277 for its assessment *the tax may be assessed at any time prior to the expiration of the period agreed upon.* [Italics supplied.]

Although the general period of limitation for assessment for the years 1920 and 1921 is five and four years, respectively, after the return is filed, yet in accordance with the exception contained in section 278 the period of limitation is increased by any period of time agreed upon in writing by the Commissioner and the taxpayer. In other words, the period of limitation referred to includes not only the specific number of years provided for by the statute but any additional period of time agreed upon in writing by the Commissioner and the taxpayer. In General Counsel's Memorandum 491 (C. B. V–2, 83) it was concluded that the term "statute of limitations" used in section 277(b), Revenue Act of 1926, refers to the time during which an assessment of tax imposed by the Acts therein referred to may be made, and that manifestly includes the time agreed upon by the Commissioner and the taxpayer pursuant to the provisions of section 250(d), Revenue Act of 1921, and section 278(c), Revenue Acts of 1924 and 1926. In the case of *United States* v. *Kemp* (12 Fed. (2d), 7), it was held that a suit by the United States against the stockholders of a dissolved corporation to recover taxes due from the corporation is not barred by section 250(d) of the Revenue Act of 1921, although begun after five years from the date the return was filed, where an unlimited waiver on behalf of the dissolved corporation was executed by its president and secretary prior to the expiration of the five-year period, and assessment of the tax was made and suit was begun within the period of limitation as extended by the waiver.

In view of the foregoing, it is evident that the period of limitation for assessment against the association transferor was extended to December 31, 1926, and that under section 280(b)1 the period of limitation for assessment against the transferees was extended to December 31, 1927. The jeopardy assessments made August —, 1927, against the transferees were therefore valid.

The question has also been raised as to whether the Bureau could proceed against the transferees on account of the assets representing surplus which were distributed to the owners of the beneficial interests, or whether the liability of the transferees was limited to assets exclusive of those representing surplus.

Section 280 provides that the liability at law or in equity of a transferee of property of a taxpayer shall be assessed, collected, and paid in the same manner and subject to the same limitations as in the case of a deficiency in tax. Stockholders receiving assets of a dissolved solvent corporation which has not paid excess-profits or income taxes due take such assets impressed with a trust, and are liable in suit for such taxes. (*Updike* v. *United States*, 8 Fed. (2d), 913, citing *Wood et al.* v. *Dummer et al.*, 30 Fed. Cas. 435, No. 17,944.)

It is well established that the capital *and other property* of a corporation are deemed to be a trust fund for the payment of the debts of the corporation, so that the creditors have a lien upon or right of priority of payment out of it, in preference to any of the shareholders of the corporation. (10 Cyc., 653, citing numerous decisions.) Although, strictly speaking, taxes are not debts, and in respect to them the Government is not a creditor, taxes being of a higher nature, no reason appears why they are not within the principle that those who gratuitously take *all a debtor's property*, to the extent thereof may be held to respond to its present debts and obligations. (*United States* v. *McHatton*, 266 Fed., 602.)

In the case of *United States* v. *Boss & Peake Automobile Co.* (285 Fed., 410 [T. D. 3442, C. B. II–1, 43], affd. 290 Fed., 167 [T. D. 3525, C. B. II–2, 195]), the owner of one half the stock of a corporation sold his stock to the owner of the other half, who transferred all the assets to a partnership and dissolved the corporation. The district court stated as follows:

> It must be conceded that where, upon dissolution of a corporation, its assets are distributed among the stockholders, the stockholders become liable to the creditors of the corporation, at least to the extent of *the property* received by them. This is referable to the so-called trust doctrine.

Surplus from an accounting viewpoint generally means accumulated earnings and is ordinarily represented by cash or property in which the surplus is invested. Although it may be admitted that bona fide dividends paid by a corporation reasonable in amount and during the regular course of business are not subject to the debts of the corporation and may not be followed by creditors into the hands of the shareholders, yet where a distribution is made of practically the entire assets, including those in which the surplus is invested, there exists no reason to hold that the assets representing surplus are exempt from the unpaid obligations of the transferor.

The fact that the association has not been formally dissolved is not material in enforcing the liability in equity of its transferees. 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. 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. (*United States* v. *Fairall et al.*, 16 Fed. (2d), 328 [T. D. 4008, C. B. VI–1, 267], citing *Bank of Commerce* v. *McArthur*, 256 Fed., 84, and other cases.)

This office is of the opinion, therefore, that the assessments against the transferees of the assets of the association were made within the statutory period of limitation and are valid under section 280 of the Revenue Act of 1926, and that the liability for income taxes may be enforced against the transferees to the extent of all the assets distributed to the shareholders or owners of beneficial interest, including the assets representing surplus as well as other property of whatever kind so distributed.

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

ARTICLE 1291: Claims in cases of transferred assets. VI-47-3508 G. C. M. 2514

REVENUE ACT OF 1926.

Where a stockholder of a corporation organized under the laws of California received no assets from the corporation upon its dissolution, by way of a distribution to stockholders or as liquidating dividends, he is not liable for additional tax assessed against such corporation as transferee, but is liable, under State law, for such part of the tax as the amount of stock owned by him bears to the whole of the subscribed capital stock of the corporation.

An opinion is requested as to whether a stockholder of the M Company, a dissolved California corporation, is liable for unpaid income taxes of the corporation under the following circumstances:

It appears that additional income taxes in the amount of x dollars were assessed against the M Company, a California corporation, which taxes have not been paid. A was a stockholder of the M Company, and owned one-sixth of the corporation's outstanding capital stock during the period under consideration. The corporation subsequently became insolvent and was dissolved.

It is contended by A that no assets were received by him from the corporation, either by way of liquidating dividends or in any other form of distribution, and that the corporation became insolvent and never fully paid its indebtedness to him for personal advances. These contentions are supported by the evidence.

As A did not receive any of the assets or avails of the assets of the corporation by way of a distribution to stockholders or as liquidating dividends, he is not liable under the trust fund doctrine for the payment of any portion of the tax due from the dissolved corporation, for the reason that he was not a transferee of corporate assets.

It should be noted, however, that section 322 of the Civil Code of California (Deering, 1915) provides in part as follows:

Each stockholder of a corporation is individually and personally liable for such proportion of all its debts and liabilities contracted or incurred during the time he was a stockholder as the amount of stock or shares owned by him bears to the whole of the subscribed capital stock or shares of the corporation. * * *

This office is of the opinion, therefore, that under these provisions of the State law A, as an owner of one-sixth of the capital stock of the M Company, is individually liable for one-sixth of its debts and liabilities, which would include a liability for Federal taxes accruing during the time he was a stockholder.

SECTION 284.—CREDITS AND REFUNDS.

ARTICLE 1301: Authority for abatement, credit, and refund of tax. VI-30-3329 G. C. M. 1960

REVENUE ACT OF 1926.

The Commissioner of Internal Revenue is without authority to refund any moneys that the United States has collected as the result of a judgment of a court having jurisdiction of the subject matter, unless the decision of that court is subsequently reversed by a higher court.

An opinion is requested in the case of the M Company.

The case involves an adjustment of two claims for refund of additional taxes assessed against the M Company for the years 1918 and 1919, the amount of which was paid by A and B, the owners of all the stock of the M Company.

The grounds upon which the refund is sought are set forth in the claims in the following language:

> The amount hereby sought to be refunded was paid by the claimants on a deficiency assessment against the M Company, a defunct State bank, all the stock of which had been owned by the claimants. The assessment had been predicated by the Bureau of Internal Revenue upon the assumption that the claimants, upon the dissolution of the bank, had acquired its assets of an aggregate value in excess of its assumed liabilities, and as transferees of net assets therefore were liable for the deficiency in question. The defunct bank was in fact insolvent at the time of its liquidation, and the claimants therefore assumed no net assets wherewith a payment of the assessment against the bank might legally have been collected; and the aforementioned payment, having been illegally collected, should be refunded.

It is stated that no assessment was made against A and B, but that, knowing the taxes in question were legally due from the M Company, and since the company was a family affair, A and B voluntarily made payment of the taxes. It appears, however, from a review of the evidence that the payment of the taxes involved in this case was the result of a suit in equity, brought by the United States in the United States District Court for ——, against A and B who, as former stockholders of the M Company, received the assets of the M Company upon its dissolution. It also appears that after the trial of the case in ——, 1926, judgment was entered in favor of the Government in the total amount of the outstanding tax, together with interest and costs, which amount was paid to the clerk of the court, who in turn remitted to the collector a sum representing the amount of the judgment.

It thus appears that the payment of the taxes involved in the claims for refund was not a voluntary payment by A and B, but was in pursuance of a judgment of the United States district court.

The Commissioner of Internal Revenue is without authority to refund any moneys that the United States has collected as the result of a judgment of a court having jurisdiction of the subject matter, unless the decision of that court is subsequently reversed by a higher court. This proposition is covered at some length in the case of *Seat* v. *United States* (18 Ct. Cl., 458), in which the court stated in part as follows:

> If the views we have expressed be correct—of which we entertain not the least doubt—then the judgment remains just as it was before the order was made, and is to-day just as conclusive of the right of the Government to the money as it was when it was rendered. Its existence is an insuperable barrier to any inquiry by the Commissioner of Internal Revenue, the Secretary of the Treasury, or any other officer of the Government into the legality of the assessment of the taxes for which the judgment was rendered. And when the claimant paid the judgment, he closed and barred the door against all attempts to reclaim through any executive department any part of the money.

It is the opinion of this office that there is no ground upon which the claims for refund which have been filed in this case may be allowed.

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

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid. VI-35-3405 T. D. 4073

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. CREDIT OR REFUND—STOCKHOLDER OF CORPORATION DENIED PERSONAL SERVICE CLASSIFICATION.

Where an individual stockholder paid the normal income tax under the Revenue Act of 1918 upon his distributive share of the income of a corporation, upon the theory that it was a personal service corporation, but subsequently the corporation was denied personal service classification, the stockholder is entitled to a refund under section 1210 of the Revenue Act of 1926 only if the corporation has paid the tax due from it.

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 Washington, Northern Division, in the case of *James A. Haight, jr., Trustee in Bankruptcy*, v. *United States of America*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 22, 1927.

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

UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION.

James A. Haight, jr., Trustee in Bankruptcy, plaintiff, v. *United States of America, defendant.*

[June 8, 1927.]

OPINION.

George B. Hall and Hazel T. Hall, husband and wife, were the sole stockholders in the G. Batcheller Hall Co., a corporation. In 1918 and 1919 the corporation filed income tax returns as a personal service corporation. Hall and his wife filed individual tax returns pursuant to the law and regulations then in force, and included in each of the returns undistributed profits, returnable as income only if the company was, in fact, under the rulings of the Department, a personal service corporation, and other items of income. Hall and his wife paid the income tax upon the personal returns. Thereafter the Commissioner of Internal Revenue held that the G. Batcheller Hall Co. was not a personal service corporation, and in March, 1924, each of the Halls filed amended returns for the years 1918 and 1919, and made claims for refund in harmony with the ruling of the Commissioner of Internal Revenue; and on December 6, 1924, the refunds were granted in favor of George B. Hall ($2,326.14) and Mrs. Hall ($2,374.56), and on the 3d of April, 1925, George B. Hall and the community composed of Hall and his wife were adjudicated bankrupts, and thereafter the plaintiff in this action was elected trustee in bankruptcy. The refunds were property of Hall and of the community composed of Hall and his wife. The tax for the George B. Hall Co. corporation had not been paid.

The trustee in bankruptcy, succeeding to the assets of the bankrupt Hall and the community of Hall and wife, made demand for the refunds allowed and granted, and, on refusal, instituted this action.

The Government contends that the refunds granted for the years involved in the suit are controlled by the personal service corporation element, which is governed by section 1210 of the Revenue Act of 1926, and since the tax due from the corporation has not been paid, the plaintiff may not recover.

NETERER, District Judge: It is axiomatic that the Government may not be sued unless upon the authority of Congress. Immunity from suit is an inherent right of self-protection (*Cary* v. *Curtis*, 44 U. S., 236; *Cheatham* v. *U. S.*, 92 U. S., 85; *R. I. A. & L. R. Co.* v. *U. S.*, 254 U. S., 141) and if the right to sue is withheld by section 1210, or its provisions are applicable, or conditions named are absent, the action must be dismissed.

"SEC. 1210. Any individual who has paid a tax (in accordance with section 218 of the Revenue Act of 1918 or section 218 of the Revenue Act of 1921) as a stockholder of a personal service corporation shall be entitled to a credit or refund, in the manner provided in section 284, if (a) such corporation has been finally determined not to be a personal service corporation, and (b) such corporation has paid the tax imposed by Title II of the Revenue Act of 1918 or Title II of the Revenue Act of 1921, as the case may be, and (c) claim therefor is filed within one year after the enactment of this Act, or before the expiration of the period of limitations upon the filing of such claim, whichever is the later."

This section and sections 218, Act 1918, and 218, Act 1921 (6336⅛ i, C. S.) must be construed together. Section 6336⅛ i, supra, provides in substance that personal service corporations shall not be subject to taxation, but the individual stockholders thereof shall be taxed in the same manner as members of partnerships. A member of a partnership under this section is liable for income tax in his individual capacity; in computing the net income each partner to include his distributive share, whether distributed or not.

Section 218, Act 1918, is repealed by section 1400 of the Act of 1921 (sec. 6371⅛ n, C. S.). The Act, however, remained in force for the assessment and collection of all taxes which have accrued under the Revenue Act of 1918. The provision of this section with relation to personal service corporations, and return and payment by the stockholder, is as section 218, Act 1921 (6336⅛ i, C. S.), supra. It is therefore apparent that the provisions of section 1210, supra, have relation to the right to refund of Hall and wife, if any, pursuant to the return and tax payment. The Halls, as stockholders, made returns in harmony with section 218, Act supra (6336⅛ i, C. S.), and upon the determination of the Commissioner of Internal Revenue that the Hall corporation was not a personal service corporation, and the assessment of additional taxes against the corporation, which had not been paid, the Halls became entitled to refund only *if such corporation had paid the tax*, and, this not having been done, it is obvious that the plaintiff has no claim with relation to the personal service corporation feature. There does appear, however, an overassessment on items other than those arising from the personal service corporation provision. These have not been discussed, but may be determined upon entry of decree.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid. (Also Section 1106, Article 1341.)

VI–39–3449
I. T. 2382

REVENUE ACT OF 1926.

Effect to be given to the decision of the Supreme Court of the United States in the case of *Bowers* v. *New York & Albany Lighterage Co.* (273 U. S., 346, 47 S. Ct., 389; T. D. 4009 [C. B. VI–1, 268]).

Many inquiries are being received both from within and without the Bureau as to the action which the Bureau should take in making refunds as a result of the decision of the Supreme Court in the case of *Bowers* v. *New York & Albany Lighterage Co.*

Great uncertainty exists as to the extent and application of the decision of the Supreme Court. It has been suggested that the New York & Albany Lighterage Co. decision may have no application to cases where bonds were filed or where claims in abatement were filed, and that, in view of section 1106 of the Revenue Act of 1926, the decision should be limited to refunds resulting from court decisions and has no application to refunds by the Commissioner. Furthermore, section 1106 was not raised in the Albany Lighterage Co. case and was not considered in connection with the confession of error made by the Government in the Toxaway Mills case before the Supreme Court (47 S. Ct., 471). The subsequent action of the Court of Claims raises grave doubt as to the application of the Albany Lighterage Co. decision to other cases in view of section 1106.

In view of the great uncertainty as to the whole matter, it is believed that no action toward making refunds should be taken by the Bureau in reliance upon the Albany Lighterage Co. decision unless and until the situation is clarified by further court decisions or by legislative action. The problem is already under consideration by the Joint Committee on Internal Revenue Taxation, and it will be presented to the Congress as soon as it convenes for such action toward a clarification of the situation as it deems proper.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid.

VI–40–3452
G. C. M. 2022A

REVENUE ACT OF 1926.

An instrument purporting to be a waiver filed by the former executors and the sole legatee of an estate after the estate was closed and the executors discharged is not filed by the "taxpayer" as required by section 284(g) of the Revenue Act of 1926, and is, therefore, not valid for the purpose of extending the period for filing claims for refund.

An opinion is requested as to whether a refund of income taxes in the amount of x dollars collected from the estate of A for the calendar year 1920 may be made on the basis of a claim therefor filed June 14, 1926.

The material facts, briefly stated, are as follows:

A died on or about September —, 1919, leaving a will, which was duly admitted to probate in the probate court of —— County, State of R. The will named the M organization as the sole residuary legatee of said estate. The O Company, B, and C were the duly appointed, qualified, and acting executors of said estate, and on behalf thereof paid the sum of x dollars Federal income taxes for the calendar year 1920. The estate was closed and these executors discharged on December —, 1922. Subsequent to such discharge and more than five years after the 1920 tax return was due and more than four years after such tax was paid, the former executors joined with the sole residuary legatee in executing an instrument, intended to be a waiver, which they filed on June 9, 1926. They also executed and filed on June 14, 1926, a claim for refund of the above-mentioned taxes.

It is apparent from an examination of the evidence presented that the purported waiver and claim for refund were filed upon the belief that the decision in *Lederer* v. *Stockton* (260 U. S., 3 [T. D. 3407, C. B. I–2, 156]) is applicable in this case, and that, therefore, the above-mentioned income taxes paid by the estate for 1920 were erroneously collected and paid. It does not appear that any determination has been made as to whether or not such taxes were erroneously collected. However, a refund of such amount may now be made only, if at all, pursuant to the provisions of section 284 of the Revenue Act of 1926, which reads in part as follows:

SEC. 284. (a) Where there has been an overpayment of any income, war-profits, or excess-profits tax imposed by * * * the Revenue Act of 1918, * * * the amount of such overpayment shall, except as provided in subdivision (d), be credited against any income, war-profits, or excess-profits tax or installment thereof then due from the taxpayer, and any balance of such excess shall be refunded immediately to the taxpayer.

* * * * * * *

(g) If the taxpayer has, within five years from the time the return for the taxable year 1917 was due, filed a waiver of his right to have the taxes due for such taxable year determined and assessed within five years after the return was filed, or * * *. *If the taxpayer has, on or before June 15, 1926, filed such a waiver in respect of the taxes due for the taxable year 1920* or 1921, *then such credit or refund relating to the taxes for the taxable year 1920 or* 1921 *shall be allowed or made if claim therefor is filed either on or before April 1, 1927*, or within four years from the time the tax was paid. * * * [Italics supplied.]

The purported waiver was filed before June 15, 1926, and said refund claim was filed before April 1, 1927, in compliance with the above-quoted statutory provision. These instruments, as hereinabove stated, were executed and filed after the estate had been closed and the executors discharged. Each was signed and filed by both the former executors and the sole residuary legatee. The M organization has been advised that said waiver was not properly filed for the reason that neither the former executors nor the sole residuary legatee was the "taxpayer," as required by section 284(g), supra. Such advice is in accord with the opinion expressed in Solicitor's Memorandum 4870 (C. B. V–1, 124), interpreting sections 2(a)9 and 281(e) of the Revenue Act of 1924. A comparison of these sections with the corresponding sections of the Revenue Act of 1926, sections 2(a)9 and 284(g), reveals their material similarity. The construction applied in Solicitor's Memorandum 4870 is applicable to the similar provisions of the Revenue Act of 1926, and it is the opinion of this office that the conclusion therein reached is a sound and correct interpretation of the statutory provisions. It follows, therefore, that neither the former executors nor the sole residuary legatee may, in the instant case, be said to have been the "taxpayer" at the time the instrument purporting to be a waiver was filed. The purported waiver does not comply with section 284(g), supra, and the claim for refund should, therefore, be rejected.

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

TITLE XI.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTION 1102.—RECORDS, STATEMENTS, AND SPECIAL RETURNS.

ARTICLE 1322: Officers authorized to administer oaths. VI–49–3527 G. C. M. 2668

REVENUE ACT OF 1926.

The acknowledgment of the collector on Form 669 (Certificate of discharge of tax lien) should be made before an officer authorized to take acknowledgments by the law of the particular State, Territory, or the District of Columbia within which the certificate is to be filed.

A deputy collector is without authority to take an acknowledgment.

A collector in Pennsylvania asks whether his acknowledgment on Form 669 (Certificate of discharge of tax lien) may be taken before a deputy collector; and, if not, before what officer must he appear to acknowledge the certificate of discharge.

The lien of the United States for internal-revenue taxes is an all-embracing one and affects the entire estate, real and personal, of the delinquent taxpayer. In many States papers affecting property—real property in particular—must be acknowledged before some officer authorized by law to take acknowledgments. It is manifest, therefore, that the acknowledgment on Form 669 should be made before an officer duly authorized by the law of the particular State within which the certificate of discharge is to be filed to act as an acknowledging officer to instruments affecting property or rights to property.

Section 3165, Revised Statutes, as amended by section 1317 of the Revenue Act of 1918, and since reenacted without change in the later Revenue Acts, gives to collectors, or a deputy collector, among others, the authority—

* * * to administer oaths and to take evidence touching any part of the administration of the internal-revenue laws with which he is charged, or where such oaths and evidence are authorized by law or regulations authorized by law to be taken.

Clearly, under this statute a deputy collector is without authority to take an acknowledgment, for an acknowledgment is in no sense an oath but merely a declaration or admission before an authorized court or public officer by a person who has executed an instrument that such instrument is his act and deed. The sufficiency of an acknowledgment is to be determined by the law of the place where the property involved is situated and the instrument is to be recorded as that law stood at the time of taking the acknowledgment. (See *Munday* v. *Wisconsin Trust Co.*, 252 U. S., 499; *Clark* v. *Graham*, 6 Wheat., 577; *U. S.* v. *Crosly*, 7 Cranch, 115; *Fisk* v. *Happing*, 48 N. E., 323; *Griffith* v. *Black*, 10 Ser. & R., 160.)

In the State of Pennsylvania various public officials are authorized to take acknowledgments (see secs. 8704–8731, Pennsylvania Statutes Complete, West Pub. Co.'s edition of 1921), among them being notaries public, recorders of deeds, judges of the courts of common pleas, and others. In this connection attention is called to the fact

that under the terms of Executive order 977, dated November 24, 1908, a notary public who is an officer, clerk, or employee in the executive service of the United States (except postmasters at offices of the fourth class and rural carriers) is prohibited from charging or receiving any compensation whatever for any notarial act performed during the hours of such notary's service to the Government.

While this memorandum is responsive to a request as to the proper practice to be followed by a collector in the State of Pennsylvania, the law, as stated herein, is applicable to all States, Territories, and the District of Columbia, and in each of these several territorial divisions the acknowledgment of the collector should be made before an officer authorized by the statutes of the particular State, Territory, or the District of Columbia to take acknowledgments.

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

SECTION 1106.—FINAL DETERMINATIONS AND ASSESSMENTS.

ARTICLE 1341: Final determination and assessment of tax or penalty.

REVENUE ACT OF 1926.

Effect of the decision of the Supreme Court of the United States in the case of *Bowers* v. *New York & Albany Lighterage Co.* (See I. T. 2382, page 102.)

SECTION 1116.—INTEREST ON REFUNDS AND CREDITS.

ARTICLE 1371: Interest on refunds and credits. VI–36–3410
I. T. 2378

REVENUE ACT OF 1926.

The provisions of section 1116 of the Revenue Act of 1926 do not apply to any allowance made under section 1200 of the Revenue Act of 1924, and interest will not be paid upon such allowances.

Under date of May 17, 1927, the taxpayer acknowledged the receipt of several checks covering the 25 per cent refund of 1923 taxes authorized by section 1200, Title XII, of the Revenue Act of 1924. In reply to his inquiry as to whether interest on the several amounts would be allowed, the collector advised him under date of May 18, 1927, that no interest would be paid, as section 1204, Title XII, of the Revenue Act of 1924, provides as follows:

The interest provided in section 1019 of this Act shall not be allowed in respect of the allowance provided for in this title.

The taxpayer refers to section 1116 of the Revenue Act of 1926, providing for interest on refunds and credits, and calls attention to subdivision (c), which reads as follows:

This section shall be applicable to any refund paid, and to any credit taken, on or after the date of the enactment of this Act, even though such refund or credit was allowed prior to such date.

The taxpayer contends that the provisions of section 1116(c) apply to any and all refunds paid after February 26, 1926, regardless

of the years involved and regardless of the reasons for making the refund.

Section 1019 of the Revenue Act of 1924 and section 1116 of the Revenue Act of 1926 provide for the payment of interest upon "the allowance of a credit or refund of any internal-revenue tax erroneously or illegally assessed or collected, or of any penalty collected without authority, or of any sum which was excessive or in any manner wrongfully collected." The amounts received by the taxpayer were refunded under the provisions of section 1200, Title XII, of the Revenue Act of 1924. Section 1204 provides that the interest allowed under section 1019 shall not be allowed with respect to the amounts refunded under section 1200. It is clear that the amounts refunded under section 1200 were considered as not coming within the class of credits or refunds "of any internal-revenue tax erroneously or illegally assessed or collected, or of any penalty collected without authority, or of any sum which was excessive or in any manner wrongfully collected." Therefore, the provisions of section 1116 of the Revenue Act of 1926 do not apply to any allowance made under section 1200 of the Revenue Act of 1924 and interest will not be paid upon such allowances.

ARTICLE 1371: Interest on refunds and credits. VI-44-3487
G. C. M. 2455

REVENUE ACT OF 1926.

Where there is a deficiency under the Revenue Act of 1918 against which there is credited an overpayment for a subsequent year there is no interest payable by the Government on the overpayment if the overpayment is not greater than the deficiency.

On September 11, 1926, there was assessed against the taxpayer a deficiency of $76x$ dollars, income tax and interest from February 26, 1926, for the taxable year 1918. Under date of September 18, 1926, there was scheduled for refund overpayments for the taxable years 1919 and 1920 of $45x$ dollars and x dollars, respectively, making a total of $46x$ dollars. In order to insure the offset or credit, the additional tax list was noted, as is the practice in such cases, "Collector—Withhold demand for comparison with 1919 overassessment and 1920 overassessment." After the assessment list was received and before notice and demand was sent, the collector, on September 22, 1926, accepted a check for the amount of tax assessed for 1918 before his lists had been posted, although the credit had been allowed prior to that date—namely, September 18, 1926. This resulted in an overpayment of $46x$ dollars, which, for the reasons hereinafter stated, must be treated as an overpayment for 1918. The question involved is whether the taxpayer is entitled to interest on the overpayments for 1919 and 1920 under the circumstances stated.

Section 284(a) of the Revenue Act of 1926 provides in substance that where there has been an overpayment of income tax the amount of overpayment shall be credited against any income tax due from the taxpayer and the balance shall be refunded. In accordance with this section of the law the Bureau applied the overpayments of taxes for 1919 and 1920 against the deficiency in tax for 1918. In due course the taxpayer would have received a formal notice and demand

for the balance, but without waiting for the customary procedure to be carried out he paid on September 22, 1926, the entire amount assessed for 1918, which had previously been satisfied in part by the crediting of the overpayments for 1919 and 1920. To the extent of $46x$ dollars, therefore, he paid an amount which was not due and for which no demand was made, and which must be treated as an overpayment for 1918 made on September 22, 1926.

Section 1116(a) of the Revenue Act of 1926 provides as follows:

> Upon the allowance of a credit or refund of any internal-revenue tax erroneously or illegally assessed or collected, or of any penalty collected without authority, or of any sum which was excessive or in any manner wrongfully collected, interest shall be allowed and paid on the amount of such credit or refund at the rate of 6 per centum per annum from the date such tax, penalty or sum was paid to the date of the allowance of the refund, or in the case of a credit, to the due date of the amount against which the credit is taken, but if the amount against which the credit is taken is an additional assessment made under the Revenue Act of 1921, the Revenue Act of 1924, or this Act, then to the date of the assessment of that amount.

It is noted that under the above-quoted section interest shall be allowed and paid on the amount of a credit or refund at the rate of 6 per centum per annum from the date such tax, penalty, or sum was paid to the date of the allowance of the refund, or in the case of a credit, to the *due date of the amount against which the credit is taken.* However, if the amount against which the credit was taken is an additional assessment made under the Revenue Act of 1921, the Revenue Act of 1924, or the Revenue Act of 1926, then interest shall be allowed on the overpayment to the date of the assessment of the deficiency. That in effect means that where there is a deficiency in tax for 1920 or prior years interest is payable by the Government, in the case of a credit of an overpayment, at the rate of 6 per cent from the date the overpayment was made to the due date of the deficiency against which the credit is taken. This result was evidently intended, for the reason that the Government could not collect interest under the Revenue Act of 1918 except where the tax remained unpaid after the date it was due and for 10 days after notice and demand as provided by section 250(e) of the Revenue Act of 1918. If, however, the deficiency arose under the Revenue Act of 1921 or subsequent Acts, interest is collectible by the Government from the original due date of the tax to the date the deficiency is assessed, or to the thirtieth day after filing a waiver under section 274(d), whichever is earlier, as provided by section 274(j) of the Revenue Act of 1926, and if an overpayment is applied as a credit against such deficiency the overpayment bears interest at the rate of 6 per cent from the date it was made to the date of the assessment of the deficiency as provided by section 1116(a).

It follows, therefore, that the overpayments by the taxpayer for 1919 and 1920, amounting to $46x$ dollars, made in 1920 and 1921, respectively, bear no interest, for the reason that the due date of the deficiency for 1918, amounting to $76x$ dollars, against which such overpayments were applied, was prior to the dates of the overpayments for 1919 and 1920. It may be stated as a general rule that where there is a deficiency under the Revenue Act of 1918 against which there is credited an overpayment for a subsequent year, there is no interest payable by the Government on the overpayment if the overpayment is not greater than the deficiency.

TITLE XII.—GENERAL PROVISIONS.

SECTION 1211.—SALARIES OF STATE AND MUNICIPAL OFFICERS.

REVENUE ACT OF 1926.

Compensation of New Jersey and New York Sandy Hook pilots. (See G. C. M. 1867, page 39.)

REVENUE ACT OF 1926.

Compensation of pilots, Boston Harbor. (See G. C. M. 1832, page 44.)

REVENUE ACT OF 1926.

Compensation of bar pilots, New Orleans. (See G. C. M. 211A, page 49.)

REVENUE ACT OF 1926.

Compensation of pilots licensed under laws of Pennsylvania. (See G. C. M. 1833, page 51.)

REVENUE ACT OF 1926.

Compensation of pilots licensed under laws of Delaware. (See I. T. 2372, page 53.)

REVENUE ACT OF 1926.

Compensation of the river port pilots of New Orleans. (See G. C. M. 2286, page 56.)

REVENUE ACT OF 1926.

Compensation of pilots licensed under laws of Georgia. (See I. T. 2387, page 56.)

INCOME TAX RULINGS.—PART II.

REVENUE ACT OF 1924.

TITLE I.—GENERAL DEFINITIONS.

SECTION 2.—GENERAL DEFINITIONS.

ARTICLE 1504: Association distinguished from trust.

REVENUE ACT OF 1924.

Trust administered by sole trustee. (See G. C. M. 2405, page 10.)

ARTICLE 1504: Association distinguished from trust.

REVENUE ACT OF 1924.

Real estate development project operating under a trust instrument under which the beneficiaries control the trust. (See G. C. M. 1736, page 11.)

TITLE II.—INCOME TAX.

PART I.—GENERAL PROVISIONS.

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

ARTICLE 1561: Determination of the amount of gain or loss. VI–45–3497 I. T. 2386

REVENUE ACT OF 1924.

> The requirement of section 202(b) of the Revenue Act of 1924 and the provision of article 1561, Regulations 65, authorizing an increase of cost or other basis by carrying charges on unproductive property were intended only to relieve a taxpayer who had not previously had the benefit of these deductions. It was not contemplated that the tax liability for years when carrying charges had properly been deducted in determining tax liability should be redetermined in order that the taxpayer might have the benefit of an adjustment for these charges in determining the gain or loss from a sale made under the Revenue Act of 1924.

Advice is requested relative to the income tax liability of the M Company for 1924.

A claim for refund was filed based on the statement that in determining the gain or loss from the sale of certain unproductive property in 1924 there should be added to the cost carrying charges of prior years, such as interest and taxes, which were capitalized on the books of the corporation.

Section 202(b) of the Revenue Act of 1924 provides that in determining the gain or loss from the sale of property proper adjustment shall be made to the cost or other basis of the property for "any expenditure properly chargeable to capital account," and in interpreting this provision article 1561 of Regulations 65 provides that the cost or other basis of the property shall be increased by the cost of capital improvements and betterments made since the basic date and by carrying charges, such as taxes on unproductive property. In Solicitor's Memorandum 5033 (C. B. V–1, 9) the Bureau held that interest and taxes paid with respect to unproductive property may be added to the cost or other basis of property used in determining the amount of gain or loss in 1924, provided they have not been taken as deductions in computing net income or used in determining liability for filing returns of income for prior years.

While the M Company had capitalized these items on its books instead of treating them as deductible in its returns, the benefit of deductions for these charges was nevertheless taken in determining its income tax liability for all of the prior years involved.

No adjustment to the cost or other basis of the property in determining the gain or loss from its sale reported in the 1924 return of the M Company should be made with respect to carrying charges which have been allowed as deductions in determining the company's income tax liability for prior years. The requirement of section 202(b) of the Revenue Act of 1924 that in determining the gain or loss from the sale of property an adjustment shall be made for any expenditure or item of loss properly chargeable to capital account did not appear in prior Revenue Acts, and the provision of article 1561 of Regulations 65 authorizing an increase of the cost or other basis by carrying charges appeared for the first time in those regulations. It was not contemplated either under the law or under the regulations that the Commissioner should be obliged to redetermine the liability of a taxpayer for years when carrying charges had properly been deducted in determining income tax liability in accordance with rulings of the Bureau then in effect in order that a taxpayer might have the benefit of an adjustment for these charges in determining the gain or loss from a sale made under the Revenue Act of 1924. The provisions in question were intended only to relieve a taxpayer who had not previously had the benefit of these deductions.

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

ARTICLE 1574: Exchanges in connection with corporate reorganizations.

REVENUE ACT OF 1924.

New corporation organized to take over the assets and assume the liabilities of the old corporation and the transfer of the interests of the stockholders in the old company effected by an exchange of securities. (See I. T. 2392, page 17.)

ARTICLE 1577: Definitions. VI–46–3501
(Also Section 204, Article 1599.) G. C. M. 2177

REVENUE ACT OF 1924.

The M Company was a holding company owning all the capital stock of the O Company, the P Company, and various other minor companies. Pursuant to a court decree, the stock in the P Company owned by the M Company was transferred by it to a new corporation, the R Company, which issued its entire authorized capital stock to trustees, who held such stock in trust for the benefit of the M Company and its stockholders, specifically the holders of certificates of interest. The M Company issued to its stockholders assignable warrants evidencing their right to subscribe for such certificates of interest at the rate of a certificate of interest in one share of the R Company for each two shares of M Company stock held by them. The M Company became an operating company by agreement of merger with the O Company and the other minor companies.

Held, there was a reorganization and a merger to which the M Company was a party within the provisions of subdivisions (h)1(B) and (h)1(A), respectively, of section 203 of the Revenue Act of 1924. The receipt of the warrants by the stockholders of the M Company was a transaction in which no gain can be recognized. The basis for computing gain or loss from the sale of the warrants should be determined by apportioning the basis of the shares of M Company stock before the distribution of the warrants between the stock and the warrants in proportion to the respective values thereof at the date of the issuance of the warrants.

The M Company was originally incorporated in 1871 under the laws of the State of Y. In 1896 the M Company, through a reorganization, acquired all the capital stock of the O Company, which was an operating company, and all the capital stock of the P Company, which was an operating — company. In 1897 a general mortgage was placed upon the property of the P Company and the property of the M Company (which included all the capital stock of the P Company) as security for bonds issued by the M Company. Subsequently the M Company also acquired all the capital stock of 12 smaller operating companies.

The M Company continued to own the capital stock of the companies mentioned until 1920, when the —— Court ordered a dissolution of the combination between the M and P Companies, and directed the —— Court to cause such disposition by the M Company of the shares of stock held by it as might be necessary to establish the entire independence of each company from the other.

Pursuant to the court order a plan of reorganization was prepared and approved. Under the plan of reorganization, as finally consummated, the following action was taken:

The R Company was organized under the laws of the State of Z on December 19, 1923. Pursuant to an agreement of sale dated December 28, 1923, the M Company transferred all the capital stock of the P Company to the R Company, subject to the lien of the general mortgage covering the stock of the P Company, as modified by agreements executed as part of the general plan of reorganization. The R Company issued to trustees all of its authorized capital stock, consisting of —— shares of no par value, to be held by the trustees in accordance with the terms of a trust agreement dated

December 28, 1923. Under the terms of such agreement and pursuant to the general plan of reorganization, the trustees issued certificates of interest in the stock of the R Company, which certificates of interest were offered by the M Company to its stockholders for subscription by issuing to such stockholders, preferred and common, share and share alike, assignable warrants evidencing their right to subscribe for such certificates of interest at the rate of a certificate of interest in one share of the R Company for each two shares of stock of the M Company held by them. The certificates of interest were delivered by the trustees to the subscribers therefor upon payment of the subscription price within the time prescribed in the offer. The holder of such a certificate of interest was entitled, upon filing an affidavit to the effect, in substance, that he did not own any shares of stock of the M Company, to receive in exchange for the certificate of interest a stock certificate for the number of shares of stock of the R Company as were represented by such certificate of interest. The voting power of all the shares of stock of the R Company held by the trustees was vested in personal trustees appointed by the court, and all dividends paid on such stock were collected and held by the trustees, to be paid over to the person receiving the stock certificate upon the exchange therefor, in the manner described, of the certificate of interest issued by the trustees. To the extent that the stockholders of the M Company did not avail themselves of the right to subscribe to the certificates of interest in the stock of the R Company, such rights were disposed of by the M Company for its own account, and certificates of interest were delivered by the trustees to the persons to whom the rights were transferred. In the event the holders of any of the certificates of interest did not exchange such certificates for stock of the R Company within the time prescribed by the court, the shares of stock represented by the certificates were disposed of and the proceeds distributed to the holders of such certificates.

A settlement of the intercorporate accounts between the M Company, the P Company, and the O Company was consummated. The liability upon the bonds secured by the general mortgage of 1897 covering the property of the M Company and the P Company was adjusted, part of such liability being assumed by the P Company and secured by a new mortgage dated January 2, 1924, and part being assumed by the M Company and secured by a new mortgage dated January 2, 1924.

The M Company surrendered all of its corporate powers other than the powers appropriate to an operating company, and by agreement of merger with the O Company and the 12 other smaller companies, the stock of which was owned by the M Company, became an operating company, letters patent being issued by the State of Y in the name of the M Company.

The first question presented is whether the receipt in 1924 of the subscription warrants by the stockholders of the M Company entitling them to subscribe for certificates of interest in the stock of the R Company constituted the receipt by them of a taxable dividend to the extent that the M Company had on hand earnings or profits accumulated subsequent to February 28, 1913, or whether the dis-

tribution of such warrants was a nontaxable distribution within the provisions of section 203 of the Revenue Act of 1924.

Section 203(c) of the Revenue Act of 1924 provides:

> 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.

Section 203(b)2 of the same Act provides:

> No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

The provisions of section 203(c) quoted apply 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 terms "reorganization" and "a party to a reorganization" are used in section 203. Likewise, the provisions of section 203(b)2 quoted apply only to an exchange of stock or securities in a corporation which is a party to a reorganization pursuant to a plan of reorganization for stock or securities in such corporation or in another corporation which also is a party to the reorganization as the terms "reorganization" and "a party to a reorganization" are used in section 203.

Subdivision (h) of section 203 provides:

> As used in this section and sections 201 and 204—
> (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.

In the instant case the M Company was a holding company owning all the capital stock of the O Company, the P Company, and various other companies. Pursuant to the court order, the stock in the P Company owned by the M Company was transferred by it to a new corporation, the R Company, which issued its entire authorized capital stock to trustees, who held it in trust for the benefit of the M Company and its stockholders, specifically the holders of certificates of interest. While it is true that the voting power of the stock of the R Company was vested in personal trustees appointed by the court until the certificates of interest were exchanged for shares of stock in the R Company, and that no person who was a stockholder in the M Company could exchange a certificate of interest for a share of stock in the R Company until he had first disposed of his stock in the M Company, yet immediately after the transfer by the M Company of the stock of the P Company to the R Company, the M Company, or its stockholders, or both, were the owners of the entire beneficial interest in all the capital stock of the R Company. The fact that at some later date to be determined by the court one of the two holdings was required to be disposed of does not change the fact that

immediately after the transfer the M Company, or its stockholders, or both, were in control of the R Company within the meaning of section 203 (i) of the 1924 Act, which provides:

> As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Under the particular facts presented, therefore, it is the opinion of this office that there was a reorganization of the M Company within the purview of section 203, subdivision (h)1(B), of the Revenue Act of 1924, and that the M Company as well as the R Company was a party to the reorganization. Furthermore, as the M Company was also a party to a merger under the laws of the State of Y, there was a reorganization within section 203, subdivision (h)1(A).

If the view is taken that the M Company continued in existence after the transfer of the stock of the P Company to the R Company, with the various other companies merged into the M Company, the stockholders of the M Company received stock or securities in the R Company pursuant to the plan of reorganization without the surrender of their certificates of stock in the M Company. Since the M Company as well as the R Company was a party to the reorganization, the transaction would come within the scope of section 203 (c) of the Revenue Act of 1924, and, accordingly, no gain to the stockholders by reason of the receipt of the warrants would be recognized.

If the view is taken that as a result of the reorganization of the M Company (the holding company) that company was dissolved and a new M Company (an operating company) and the R Company came into existence, the stockholders of the old M Company in lieu of the shares of stock owned by them in that company received, share for share, stock of the new M Company and also stock or securities in the R Company. Since the old M Company, the new M Company, and the R Company were under such a view all parties to a reorganization, and the exchange was in pursuance of a plan of reorganization, the transaction would fall within the provisions of section 203 (b)2 of the Revenue Act of 1924, and no gain to the stockholders of the M Company by reason of the exchange, of which the receipt of the warrants was an integral part, would be recognized.

The adoption of either view of the case results in the conclusion that the receipt of the warrants by the stockholders of the M Company was a transaction in which no gain can be recognized.

The other question presented relates to the basis of the warrants for the purpose of computing gain or loss resulting from the sale thereof. Such basis should be determined by apportioning the basis of the shares of stock of the M Company before the distribution of the warrants between the stock and the warrants in proportion to the respective values thereof at the date of the issuance of the warrants in accordance with the principles laid down in article 1599 of Regulations 65.

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. VI-37-3421 I. T. 2379

REVENUE ACT OF 1924.

Where a decedent, a resident of the District of Columbia, died in 1914, leaving two wills, which were declared invalid in 1918, and her real estate passed to her heir, the date of acquisition of such property acquired by inheritance is the date of death of the intestate.

An opinion is requested in regard to the income tax liability of A.

The case involves the question as to the basis to be used in determining the gain or loss from the sale in 1924 of certain real property situated in the District of Columbia.

The information furnished discloses that the property was acquired by A by inheritance from his mother, B, a resident of the District of Columbia, who died in 1914. B left two wills, both of which were contested and were declared invalid on the ground of the incompetency of the decedent. The contest against the admission of the wills to probate ended in 1918, and the real estate in question was then taken possession of by A. The property had been in the hands of a collector ad colligendum, who had been appointed by the court at the beginning of the litigation to take possession of the property. A contends that the basis to be used in determining the profit from the sale of the real estate in 1924 is the fair market value of the property in 1918, when the will contest ended, rather than the fair market value at the date of B's death. It is admitted by A that the title to the property passed to him as of March, 1914, but only by what he terms a legal fiction, for the reason that during the litigation the property was in the possession and control of an administrator or collector ad colligendum under letters issued by the court. A points out that in the District of Columbia estates in land are defined to be estates of inheritance, estates for life, estates for years, estates at will, and estates by sufferance, and that estates in lands are classified as being in possession or in occupancy. He also points out that the District of Columbia Code defines an estate in possession as existing when the owner has an immediate right to the possession of the land. It is A's further contention that property is not acquired in the District of Columbia by bequest, devise, or inheritance within the meaning of the code until it has been taken over into the physical possession of the legatee, devisee, or heir; that in the instant case the only classification applicable would be an estate in possession; and that he did not acquire the real estate in question until he had an immediate right to possession, which time is stated to be 1918.

Section 204(a)5 of the Revenue Act of 1924 provides that the basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, by bequest, devise, or inheritance shall be the fair market value of such property at the time of such acquisition. The question in the present case, therefore, is as to the date of acquisition. Consideration has been given to the arguments of A in support of the position that the date of acquisi-

tion was the date of the last judgment, holding that B was mentally incapacitated at the time of executing the second will offered for probate, but it is not considered that this position is sustained either under principles of general law or under the Revenue Act.

The effect of the judgment referred to was that B died intestate and her real estate descended in fee simple to her only child, A. Under the common law title to real estate descends to the heirs upon the death of the intestate. Section 940 of the code of the District of Columbia provides that on the death intestate of any person seized of an estate in fee simple, the estate "shall descend in fee simple to such person's kindred" in a designated order, beginning with the child or children and their descendants, if any, equally. The vesting of a fee simple title under section 940 is not a "legal fiction," but a legal fact, and the time of the vesting of such title is upon the death of the intestate. Real property is "acquired" within the meaning of section 204(a)5 of the Revenue Act of 1924 when a fee simple title vests.

In interpreting section 204(a)5, article 1594 of Regulations 65 provides that in the case of such property so acquired its value as appraised for the purpose of the Federal estate tax, or in the case of estates not subject to that tax, its value as appraised for the purpose of State inheritance taxes, shall be deemed to be its fair market value when acquired. This provision does not state that property is acquired on the date of the death of the decedent or at any other particular time, but indicates that irrespective of the date when the property comes into the physical possession of the legatee, devisee, or heir, the basis when acquired shall be deemed to be the value as appraised for the purposes indicated. The Commissioner has not acquiesced in the decision of the United States Board of Tax Appeals in the case of F. W. Matthiessen, jr. (2 B. T. A., 921), which is relied upon by A. It may be pointed out, however, that that decision has reference to personal property acquired by inheritance and not to real estate so acquired. The decision rendered by the Court of Claims April 4, 1927, in the case of Matilda R. Dodge et al., administrators of the estate of John F. Dodge, deceased, is not in point.

It is accordingly held that the date of acquisition of the property by A was the date of death of B in June, 1914.

ARTICLE 1599: Dividend stock.

REVENUE ACT OF 1924.

Warrants evidencing rights to subscribe for certificates of interest in the stock of another corporation. (See G. C. M. 2177, page 112.)

ARTICLE 1601: Stock or securities acquired in "wash sales."

REVENUE ACT OF 1924.

Interpretation of "wash sales" provisions. (See G. C. M. 1210, page 60.)

ARTICLE 1602: Basis for allowance of depletion and depreciation.

REVENUE ACT OF 1924.

Development expenditures in computation of net income from a discovery property. (See G. C. M. 2315, page 21.)

PART II.—INDIVIDUALS.

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

ARTICLE 31: What included in gross income.

REVENUE ACT OF 1924.

Opinion of Attorney General (T. D. 3754, C. B. IV-2, 37) and decision in appeal of Leah Brunt, administratrix (5 B. T. A., 134), distinguished. (See G. C. M. 2056, page 65.)

ARTICLE 31: What included in gross income. VI-39-3445
I. T. 2381

REVENUE ACT OF 1924.

Under the law of the State of Missouri the proceeds and profits of an estate by the entirety are divisible between the title holders in equal proportions, available to each of them individually, if with the assent and concurrence of the other. Income tax returns showing an equal division of income arising from stock held by A and B, husband and wife, as tenants by the entirety should be accepted by the Bureau.

An opinion is requested relative to the income tax liability of A and his wife, B.

It appears that A and B are domiciled in the State of Missouri, that A is president of the M Company, and that on June —, 1924, he owned 19*y* shares of the stock of this company and his wife owned 15*y* shares. A stock dividend of 20 per cent was declared as of that date. As a result of the payment of this dividend and upon the turning in by both A and B of certificates representing 15*y* shares of stock, new certificates for 36*y* shares of stock were issued in the name of "A and B as tenant in the entirety and the survivor of them." The shares so issued consisted of B's original 15*y* shares, 15*y* shares of A's holdings, and the 20 per cent stock dividend with respect to such shares. Dividends received subsequently have been deposited in the joint bank account of A and B. They filed separate income tax returns for the years 1923, 1924, and 1925, and in reporting dividends from stock held as tenants by the entirety one-half of such dividends was included in the husband's return and one-half in the wife's return. The revenue agent inquires whether this division of income is permissible.

It is evident that the words used in connection with the issuance of the stock to A and B indicate an intent to create a tenancy by the entirety. The Missouri courts have recognized estates by the entirety

in personal property, and as to such property the common law relating to estates has not been changed other than by the married woman's act, which has taken away the husband's common law right to the wife's personal property. (*Johnston* v. *Johnston*, Sup. Ct. Mo. (1903), 173 Mo., 91, 73 S. W., 202; *Lomax* v. *Cramer et al.*, K. C. Ct. of Appeals, 202 Mo. App., 365, 216 S. W., 575; *Ryan* v. *Ford*, Sup. Ct. (1910), 151 Mo. App., 689, 132 S. W., 610.) The incidents of an estate by the entirety are peculiar to that estate. The interest of the grantees is neither joint nor in common and the parties do not hold moieties but take as one person, each being seized of the whole and owning the whole. The estate does not descend upon the death of either, but the survivor being already seized of the entire estate is the owner of it. (*Corinth* v. *Emery*, 63 Vt., 505, 30 L. R. A., 306; *Lomax* v. *Cramer et al.* (supra).

At common law the fruits and profits of property held as tenants by the entirety belonged to the husband exclusively. This was in accord with the jus mariti, which conferred on the husband dominion over all of the wife's property, including rents and profits. (*Cole Mfg. Co.* v. *Collier et ux*, 95 Tenn., 115, 30 L. R. A., 315; *Bertles* v. *Nunan*, 92 N. Y., 152, 44 Amer. Rep., 361.) The general trend of judicial opinion in the United States is to the effect that the husband's right at common law to the fruits and profits of a tenancy by the entirety was not an incident of that kind of tenancy but grew out of the wife's disabilities at common law and does not exist where such disabilities have been removed by statute. In the case of *Hiles* v. *Fisher* (144 N. Y., 306), the court held that the parties become tenants in common or joint tenants of the use of an estate by the entirety, each being entitled to one-half of the rents and profits during their joint lives, with power to each to dispose of or to change his or her moiety. This view has been followed in other jurisdictions (*Branch* v. *Polk*, 61 Ark., 388, 33 S. W., 424; *Kip* v. *Kip*, 33 N. J. Equity, 213; *Goodrich* v. *Otega*, 110 N. E., 162). In the case of *Goldberg Plumbing & Supply Co.* v. *Taylor et ux.* (St. Louis Court of Appeals (1922), 209 Mo. App., 98, 237 S. W., 900), the court held that the married woman's act (secs. 7323–7328, Revised Statutes of Missouri (1919)) deprived the husband of his right to the use and possession of his wife's real estate, so that the jus mariti in an estate by the entirety no longer exists. The court further held that the married woman's act did not affect the title in such estate but left it as it was at common law, and that neither party could sever the union of interest without the concurrence of the other. The Supreme Court of Missouri, in the case of *Hall* v. *Stephens* (65 Mo., 670), adopted the rule in the case of *Hiles* v. *Fisher* relative to the profits from an estate by the entirety, and subsequent Missouri cases follow that rule until the decision in the case of *Stifel's Union Brewing Co.* v. *Saxy et al.* (273 Mo., 159, 201 S. W., 67.) In that case the supreme court, in the light of the married woman's act (secs. 8295–8310, Revised Statutes Missouri (1909)) criticized the decision in the case of *Hall* v. *Stephens* and declared that as to third parties neither title holder in an estate by the entirety had any separate, alienable interest. This is the Missouri rule now recognized. (*Kingman* v. *Banks*, St. Louis Court of Appeals (1923), 251 S. W., 449.)

The Missouri courts, however, have been consistent in holding that in case of a divorce, where the proceedings are "inter sese," the estate loses its character and is treated as one held in common. (*Russell* v. *Russell*, 122 Mo., 235, 26 S. W., 677; *Joerger* v. *Joerger*, Sup. Ct. (1906), 91 S. W., 918; *Aeby* v. *Aeby*, Sup. Ct. (1916), 192 S. W., 97; *Elliott* v. *Roll et al.*, K. C. Ct. of Appeals (1920), 226 S. W., 590.) In other proceedings "inter sese," the Missouri courts have authorized and ordered an accounting of one-half of the proceeds and profits of an estate by the entirety where one of the parties has received and retained more than his proportionate share. (*Rezabek* v. *Rezabek*, St. Louis Court of Appeals (1917), 196 Mo. App., 673, 192 S. W., 107.) In the case of Stifel's Union Brewing Co. (supra), the Supreme Court also held that neither the husband nor the wife could dispose of any part of the estate by the entirety without the assent of the other. These decisions clearly indicate that the Missouri courts consider the proceeds and profits of an estate by the entirety to be divisible between the title holders in equal proportions, available to each of them individually, if with the assent and concurrence of the other. The fact that in the instant case the parties placed such proceeds in a joint bank account and each consistently reported one-half of such proceeds for income tax purposes, shows the intent of the title holders to concur in an equal division.

Accordingly, income tax returns showing an equal division of the income arising from the shares of stock held by A and B as tenants by the entirety should be accepted by the Bureau.

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

ARTICLE 72: Proceeds of insurance—Compensation—Pensions.

REVENUE ACT OF 1924.

Taxable gain to insured from receipt of proceeds of endowment insurance policy, issued prior to March 1, 1913, upon maturity thereof in 1924. (See I. T. 2380, page 32.)

ARTICLE 88: Compensation of State officers and employees. VI–32–3354 I. T. 2371

REVENUE ACTS OF 1921 AND 1924.

I. T. 2256 (C. B. V–1, 34), exempting from income tax the compensation received for services rendered as Texas branch pilots, is reversed, in view of General Counsel's Memorandum 1867, published on page 39.

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1924.

Compensation received by the New Jersey and New York Sandy Hook pilots not exempt from tax. (See G. C. M. 1867, page 39.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1924.

Compensation of pilots, Boston Harbor. (See G. C. M. 1832, page 44.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1924.

Compensation of bar pilots, New Orleans. (See G. C. M. 211A, page 49.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1924.

Compensation of pilots licensed under laws of Pennsylvania. (See G. C. M. 1833, page 51.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1924.

Compensation of pilots licensed under laws of Delaware. (See I. T. 2372, page 53.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1924.

Compensation of pilots licensed under the laws of Georgia is not exempt from income tax. (See I. T. 2387, page 56.)

ARTICLE 89: Additional exclusions from gross income.

REVENUE ACT OF 1924.

Amendment of article 89, Regulations 65, to include France 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. 4098, page 58.)

SECTION 214(a)4, 5, 6.—DEDUCTIONS ALLOWED INDIVIDUALS: LOSSES.

ARTICLE 146: Losses from the sale and repurchase of securities.

REVENUE ACT OF 1924.

Interpretation of "wash sales" provisions. (See G. C. M. 1210, page 60.)

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

ARTICLE 155: Reserve for bad debts.

REVENUE ACT OF 1924.

Addition to a reserve for bad debts in the case of debts represented by bonds. (See G. C. M. 1887, page 61.)

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

ARTICLE 163: Depreciation of intangible property.

REVENUE ACT OF 1924.

Amendment. (See T. D. 4055, page 63.)

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

ARTICLE 201: Depletion of mines, oil and gas wells; depreciation of improvements.

REVENUE ACT OF 1924.

Basis for depletion deductions in case of allottees of Quapaw Indian lands. (See G. C. M. 2056, page 65.)

SECTION 219.—ESTATES AND TRUSTS.

ARTICLE 345: Credits to trust or beneficiary.

REVENUE ACT OF 1924.

Instructions relative to distributing dividends reported on return of fiduciary where amount received exceeds net income. (See Mim. 3584, page 72.)

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

ARTICLE 361: Withholding tax at source. VI–51–3541
G. C. M. 2745

REVENUE ACT OF 1924.

Under the provisions of section 221 (b) and (c) of the Revenue Act of 1924, the obligor is the person charged with withholding and payment of the tax and making the returns. The appointment of a trustee to make the returns, who is under no duty to pay the tax, imposes a burden upon the trustee with respect only to the making of returns. If the trustee never received funds from the obligor with which to pay the tax, he can not be held liable under section 1017 of the Revenue Act of 1924. A distribution of the proceeds of the sale of the obligor's assets

to secured creditors, whose liens were prior to that of the Government, creates no liability on the part of the trustee for unpaid taxes under the provisions of section 3467, Revised Statutes.

An opinion is requested as to whether the O Company, trustee for the M Company, is liable for taxes withheld at the source in accordance with the provisions of section 221(b) of the Revenue Act of 1924.

It appears that in 1923 the M Company issued bonds, secured by a trust indenture of closed first mortgage on its real property, under which indenture the O Company was made trustee. Each of the bonds contained a tax-free covenant providing that the principal and interest should be paid—

* * * without deduction for any tax or taxes or governmental charges which may be imposed thereon by any present or future law of the United States of America * * * and which the company or trustee may be required or permitted to pay or to deduct or to retain therefrom, except estate or inheritance taxes and income taxes on the interest of this bond, in excess of a rate of two (2) per cent per annum, and the company will pay the Federal income tax upon said interest not exceeding a rate of two (2) per cent per annum, which may become payable to the United States by any holder hereof under any existing or future Act of Congress.

"The company" referred to in the bond, and throughout the trust deed, is the obligor on the bonds, not the trustee.

In article —, section —, of the trust deed the company covenants with the trustee that the company assumes the payment of taxes to the extent and with the exceptions expressed in said bonds.

In article —, section —, it is provided that the trustee shall be under no duty to pay any taxes imposed upon the property or to see that they are paid.

On October —, 1923, the company appointed the trustee its withholding agent under the bond issue. The appointment reads as follows:

OCTOBER —, 1923.

O COMPANY.

GENTLEMEN: This is to advise you that we hereby appoint you withholding agent under our bond issue which is secured by the mortgage dated April —, 1923, from ourselves to you as trustee and which mortgage was recorded on June —, 1923, in book —, trust deeds, at page —, and we authorize you to file with the Secretary of the Treasury at Washington, D. C., or with his duly authorized agents as required by law, monthly and annual information returns of normal income tax to be paid at the source and such other returns as he may require of withholding agents.

Very truly yours,

[SEAL.] M COMPANY.

Under the provisions of section 221 (b) and (c) of the Revenue Act of 1924, the *obligor* is the person charged with withholding the tax at the source, the payment thereof to the proper Federal official, and the making of the returns. The trust deed in the instant case makes no attempt to impose all of these duties upon the trustee. On the contrary, it expressly provides that the obligor shall pay the taxes, and that the trustee is under no duty to pay or see to their payment. The appointment of the trustee as withholding agent imposed a burden upon the trustee with respect only to the making of returns, not with respect to payment of the tax.

During 1924 the trustee, as withholding agent, filed monthly returns on Form 1012 and an annual return on Form 1013, disclosing a tax of $5y$ dollars, which has never been paid. The trustee has filed

an affidavit stating that it never received funds from the obligor with which to pay the tax, and that the tax of y dollars for the year 1923 was paid by the obligor company after the Government's notice and demand for tax had been received by the trustee and forwarded to the company. Since the trustee denies ever having received funds to pay the tax for 1924, and since there is no evidence to the contrary, there is no basis for holding the trustee liable under section 1017 of the Revenue Act of 1924.

The only other basis of a possible liability on the part of the trustee is found in section 3467 of the Revised Statutes (U. S. Comp. Stat., sec. 6373), providing that—

> Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debt due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

It appears that on April —, 1925, the M Company defaulted in paying interest on the bonds, and that on September —, 1925, the trustee, pursuant to the power of sale in the trust deed, sold the property covered by the deed for the benefit of the bondholders. According to the trustee's affidavit, however, the amount received from the sale was x dollars, and, as the bond issue was $2\frac{1}{2}x$ dollars, there was no surplus. Since the lien of the trust deed was prior to any lien acquired by the United States for the taxes of 1924, the trustee was not authorized, under section 3467, Revised Statutes, supra, to pay those taxes before paying the bondholders. (*Brent* v. *Bank of Washington*, 10 Pet., 596, 611; *U. S.* v. *Delaware Ins. Co.*, Fed. Cas. No. 14942; *U. S.* v. *Duncan*, Fed. Cas. No. 15003.) The lien of the trust deed also covered the costs of sale, the compensation of the trustee, etc., so that it does not appear likely that any money was paid out by the trustee to other persons which it was not authorized to pay before paying the United States. The affidavit of the trustee states that at no time did it take possession of the properties, or operate the business of the obligor, or act as trustee in liquidation. Apparently, therefore, it never became a trustee for, or had dealings with, unsecured creditors of the obligor, or with secured creditors whose liens were subsequent to the lien of the United States. In the absence of any evidence of such dealings there is no ground for assuming that the trustee is liable for the tax under Revised Statutes, 3467, supra.

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

PART III.—CORPORATIONS.

SECTION 231.—CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

ARTICLE 518: Business leagues.

REVENUE ACT OF 1924.

Amendment. (See T. D. 4089, page 74.)

SECTION 233.—GROSS INCOME OF CORPORATIONS DEFINED.

ARTICLE 541: Gross income.

REVENUE ACT OF 1924.

Income of trust formed for use of stockholders of corporation. (See G. C. M. 2185, page 75.)

SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 632: Consolidated returns. VI–29–3311
G. C. M. 1808

REVENUE ACT OF 1924.

The election to file returns under section 240(a) in cases where the stock of two or more corporations is owned by the same interests is to be made by the affiliated group as a whole and not by a so-called principal corporation.

An opinion of this office is requested in connection with the question hereafter set out.

The M Company, the O Company, and the P Company were affiliated for the years 1919 to 1924, inclusive, by reason of the fact that all the stock of the three corporations was owned by the same interests. For the years 1919 to 1924, inclusive, consolidated returns were filed in the name of the M Company, the O Company being designated as the subsidiary company. The P Company, however, filed separate returns for the whole period.

The three corporations have been ruled affiliated for the years 1919 to 1923, inclusive, and have acquiesced in the determination of tax liability on a consolidated basis for those years. For the year 1924 the corporations contend that no election has been exercised under section 240(a) of the Revenue Act of 1924 and that the tax liability for that year should be determined on the basis of separate returns.

The following questions have arisen:

1. What company or companies in a class "B" affiliation may make an election under the provisions of section 240(a) of the Revenue Act of 1924 which will be binding on all other companies affiliated therewith?

2. If an election is made by the principal company, *who* shall determine which is the principal company and *how* shall the principal company be determined?

3. In the instant case, which company is the principal company, if the principal company makes the election?

4. If the principal company does not make the election, has an election been made in the instant case?

Section 240(a) of the Revenue Act of 1924 provides, in substance, that corporations which are affiliated within the meaning of that section may make separate returns or make a consolidated return.

Article 632 of Regulations 65 provides in part as follows:

Affiliated corporations as defined in section 240(c) and article 633, irrespective of the basis upon which returns were filed prior to 1924 under section

240(a) of the Revenue Act of 1921, may elect to make separate returns or file a consolidated return in which will be reported the consolidated net income of the affiliated group. [Italics supplied.]

In Solicitor's Memorandum 2683 (C. B. IV–1, 238) this office expressed the opinion that when corporations were affiliated they must either elect to file one consolidated return for the entire group or file individual returns for each corporation.

From a reading of section 240(a), supra, and article 632, supra, it is apparent that the election to file returns upon one basis or the other is made by the "affiliated corporations." This is especially true in the case of a class "B" affiliation. Hence the election in such cases is made by the affiliated group as a whole, and not by any one corporation as the principal company. Each corporation in the affiliated group should have a voice in the selection of the basis upon which the return or returns for the affiliated group should be made, and in order that the selection made will constitute an election as required by the statute and regulations, supra, there must be a substantial unanimity on the part of the affiliated corporations. In other words, if the affiliated group is to be treated as a single enterprise, the number of constituent corporations that agree upon the basis of making the return must be such that their action is substantially the action of the affiliated group.

Thus, in the instant case, where the stock of the three corporations forming the affiliated group was owned by the same interests throughout the years in question, the action of two of the corporations in selecting a different basis for filing returns than was selected by the third corporation can not be treated as equivalent to the action of the affiliated group as a whole, and it follows that no election has been made by the affiliated corporations under section 240(a), supra, for the year 1924.

Consequently, it is the opinion of this office that the election to file returns under section 240(a) of the Revenue Act of 1924, in cases where the stock of two or more corporations is owned by the same interests, is made by the affiliated group as a whole and not by a so-called principal corporation. It is the further opinion of this office that the affiliated corporations in the instant case did not elect to file a consolidated return for the year 1924.

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

ARTICLE 632: Consolidated returns. VI–32–3355
G. C. M. 2123

REVENUE ACT OF 1924.

An election by the M Company and the O Company, which were affiliated under section 240 of the Revenue Acts of 1921 and 1924, to file a consolidated return for the two companies for the fiscal year ended July 31, 1924, applies to the whole of the fiscal year and not simply to the part thereof falling within the calendar year 1924.

The case of the M Company and the O Company is before this office for consideration in connection with the question whether their election to file a consolidated return under the Revenue Act of 1924

applies to the entire fiscal year ending July 31, 1924, or only to that portion of the fiscal year falling within the calendar year 1924.

The M Company was affiliated with the O Company under section 240 of the Revenue Acts of 1921 and 1924. Separate returns were filed by the two companies for the fiscal year ending July 31, 1923. Although permission was not obtained from the Commissioner to change the method of filing returns, a consolidated return was filed for the two companies for the fiscal year ending July 31, 1924.

In Solicitor's Memorandum 2683 (C. B. IV–1, 238) this office expressed the opinion that an election to file returns on one basis under section 240 of the Revenue Act of 1921 was binding under that Act for subsequent years unless permission was secured from the Commissioner to change the basis. Article 632 of Regulations 65 provides in part that affiliated corporations, as defined in section 240(c) of the Revenue Act of 1924, irrespective of the basis upon which returns were filed prior to (the taxable year) 1924 under section 240(a) of the Revenue Act of 1921, may elect to make separate returns or file a consolidated return.

Section 200 of the Revenue Act of 1924 defines a taxable year as follows:

> The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or 232. The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December. The term "taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made. The first taxable year, to be called the taxable year 1924, shall be the calendar year 1924 or any fiscal year ending during the calendar year 1924.

Although by the terms of section 283 of the Revenue Act of 1924, Title II of that Act is made effective as of January 1, 1924, nevertheless any return for a fiscal year ending in 1924 filed under the provisions of the 1924 Act is by reason of the provisions contained in section 200 a return for the whole of the fiscal year and not simply for a part thereof. This conclusion is emphasized by the position taken by the court in *Kentucky Jockey Club* v. *Lucas* (14 Fed. (2d), 539, published as T. D. 3915, C. B. V–2, 191), the court using the following language:

> A more fundamental weakness in this contention of counsel for plaintiff is the assumption that plaintiff's taxes for the period in question accrued under the Revenue Act of 1918. Apparently counsel have fallen into the error of failing to distinguish between the *accrual of plaintiff's income upon which the taxes in question were figured* and *the accrual of the tax itself.* It is agreed that practically all the *income* for the taxable year accrued to plaintiff in the calendar year 1920, but it does not follow from that fact that its taxes accrued in that calendar year, nor that the assessment and collection thereof are controlled by the Revenue Act of 1918. On the contrary, under the express provisions of the Revenue Act of 1921, these taxes accrued under that Act. That law by its express terms makes its income tax and war-profits and excess-profits tax provisions retroactive to January 1, 1921, as to those taxpayers whose returns are based on the calendar year, and when sections 263 and 338 are read in connection with sections 200 and 300 of the Act, it is manifest that the income tax, war-profits and excess-profits tax provisions are retroactive to the beginning of the fiscal year of taxpayers whose fiscal year ended in the calendar year 1921.

It is, therefore, the opinion of this office that the election of the companies to file a consolidated return for the fiscal year 1924 was

proper, and that the return filed on that basis correctly covered the entire fiscal year ending July 31, 1924.

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

ARTICLE 633: When corporations are affiliated. VI–29–3312
G. C. M. 2019

REVENUE ACT OF 1924.

In March, 1924, the O Company was organized and incorporated by the M Company as a sales department of the M Company and from that date disposed of a product manufactured by the M Company, turning over to that company amounts collected as a result of sales made. On October 31, 1924, the O Company took over the entire assets and assumed the liabilities of the M Company, issuing shares of its own stock in payment therefor.

An election to file a consolidated return having been made, the incidents of such a return must take effect from the date of incorporation of the O Company, when the affiliation occurred, notwithstanding the failure formally to issue any certificates of stock until October 31, 1924.

The case of the M Company has been referred to this office for consideration of certain questions relative to the affiliation status of the M Company and the O Company during the year 1924.

In an explanation of the answers to question 7(b) of the 1924 return the following appears in a statement attached to the return:

At the beginning of 1924 the M Company, the parent company, was not affiliated with any other organization.

In March, 1924, the O Company was organized and incorporated by the M Company as a sales department of the M Company, and at the same time the latter company commenced manufacturing on its own account, disposing of its entire output to the O Company. The O Company disposed of the product and collected amounts owing from customers as a result of sales made, turning the proceeds over to the M Company in payment of the merchandise which it, the O Company, acquired for sale from the M Company.

On October 31, 1924, the O Company took over the entire assets and assumed the liabilities of the M Company, issuing in payment *y* shares of the O Company stock.

Before further steps in the reorganization of these two companies could be effected, the M Company became defendant in a lawsuit, and as a result a petition was filed for the appointment of a receiver for both the M Company and the O Company, which petition was granted by the court on November —, 1924.

From that date until the present the companies have been operated by the receiver.

In effect the two corporations are one organization and have been throughout.

A consolidated return was filed by the M Company for the year 1924 which included the O Company as a subsidiary. The two companies were ruled affiliated from March —, 1924, the date of incorporation of the O Company. The taxpayer now contends that there was no affiliation prior to October 31, 1924; that until that date the M Company was the operating company and the O Company was wholly inactive; and that the income for 1924 should be allocated five-sixths against the M Company and one-sixth against the affiliated companies. The question is of importance because of a net loss of the M Company in a prior year which would be more nearly absorbed in 1924 were the allocation contended for by the taxpayer conceded.

The term "stock" as used in the consolidated returns provisions has not been restricted to cases where formal certificates have been issued, but has been considered as having the meaning of "shares of stock," i. e., the rights which the owner or owners have in the management, profits, and ultimate assets of a corporation. (Bouv. Law Dict., Tit. Stock.) Otherwise, of course, the affiliation of associations and of business trusts where no stock is issued could not be upheld. (See, for instance, Appeal of Jordan Marsh Co. et al., 3 B. T. A., 553, where a business trust and a corporation were held to be affiliated.)

The O Company existed as a corporation before stock was issued (sec. 3476, Gen. Laws R. I., 1923), and the failure to issue stock would not affect its corporate status. (I. T. 1680, C. B. II–1, 163.) Therefore, a return was required on its behalf unless excused for reasons not appearing here. (Art. 621, Regulations 65.) All of the rights attributable to stock ownership in it appear to have been vested in the M Company from the date of its incorporation. Indeed, if the statement attached to the return is accepted, these rights actually were exercised in the management and operation of the O Company, and in any event the right to exercise them was at all times in the M Company. Consequently, under the provisions of section 240 of the Revenue Act of 1924, the two corporations must be treated as affiliated, and there could have been filed either separate returns or a consolidated return notwithstanding the failure formally to issue the certificates of stock until October 31, 1924.

An election to file a consolidated return having been made, the incidents of such a return must take effect from the date affiliation occurred, which in this case was the date of incorporation of the O Company.

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

Article 633: When corporations are affiliated. VI–47–3513
T. D. 4100

INCOME TAX.

Consolidated returns of corporations.—Article 633 of * * * Regulations 65, * * * amended.

Treasury Department,
Office of Commissioner of Internal Revenue,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Article 633 of * * * Regulations 65 is hereby amended by omitting from * * * said article the last sentence thereof, having to do with the definition of the words "the same interests."

D. H. Blair,
Commissioner of Internal Revenue.

Approved November 12, 1927.

A. W. Mellon,
Secretary of the Treasury.

SECTIONS 246 AND 247.—TAXES ON INSURANCE COMPANIES.

ARTICLE 693: Deductions allowed insurance companies.

REVENUE ACT OF 1924.

"Losses incurred but not reported" and "resisted losses." (See G. C. M. 2318, page 80.)

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

SECTIONS 277 AND 278—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION OF TAX.

ARTICLE 1271: Period of limitation upon assessments of tax.

REVENUE ACT OF 1924.

Assessment of tax within statutory period as extended by waivers in a case where a tentative return was filed for 1919 and a completed return was subsequently filed. (See G. C. M. 2513, page 93.)

ARTICLE 1272: Period of limitation upon collection of tax. VI-43-3480 T. D. 4097

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

COLLECTION—SUIT—LIMITATION.

The amount of income tax imposed by the Revenue Act of 1918 assessed before the enactment of the Revenue Act of 1924 and within five years after the return was filed, the collection of which was not barred at the time of the enactment of the latter Act, may be collected by a proceeding in court begun within six years after the assessment as provided by section 278(d) of the Revenue Act of 1924.

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 Georgia, Atlanta Division, in the case of *McClure Co., Bankrupt*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved October 13, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF GEORGIA, ATLANTA DIVISION.

In re McClure Co., Bankrupt.

[August 31, 1927.]

SIBLEY, Judge: A proof of claim against the bankrupt for income taxes for the year 1919 was filed by the collector of internal revenue and disallowed by the referee because barred by the limitation fixed by the tax Acts. The pertinent facts are these: The tax return was made June 14, 1920, and amended November 25, 1920. The tax was assessed January 21, 1922. The proof of claim was filed with the referee April 12, 1927.

The filing of the proof in the bankruptcy court is the equivalent of a suit, and is a proceeding in court for the collection of the tax within the meaning of the tax statutes. By the provisions of section 250(d) of the Revenue Act of 1921, of force when the tax was assessed, the proof of claim would be barred because not made within five years from the filing of the tax return. But the Revenue Acts of 1924 and 1926 introduce a longer limitation, to wit, six years from the making of a timely assessment, which the collector contends saves this claim. These provisions for limitation, though enacted subsequent to the accrual of the tax claim, did not create any new liability or change the old one, but affected only the time within which a remedy must be sought. It is elementary that such limitations of time may be freely made and altered, provided that one having a right is not substantially deprived of all remedy. No man has a vested right not to pay a tax or other obligation which he really owes. So that an extension of the time within which the obligation may be enforced or the entire abolition of the limitation is within rightful legislative power.

Nor is there great force in the argument that retrospective operation ought not to be given these statutes. Where general words are used in limiting described causes of action, it is not usual to confine the limitation to causes arising after the statute takes effect. (*Sohn* v. *Waterson*, 17 Wal., 596.) In the statutes cited special words are used expressly designating the taxes accrued under former laws, including the Revenue Act of 1918; so there is no possible doubt that this legislation was intended to be retroactive. Indeed, it must be conceded that this tax demand would be governed by these later statutes if only it had not been liquidated by an assessment prior to June 2, 1924, the date of enactment of the Revenue Act of 1924. (*United States* v. *Crook*, Ct. of App., Fifth Circuit, April 16, 1927.)

Nor is this a case for applying the principle that in construing tax statutes doubt is to be resolved in favor of the taxpayer. That principle may be invoked in determining whether or not the tax has been imposed. When applied it operates to relieve equally all persons sought to be taxed. Here it is not contended that the tax claim is not due, but only that this taxpayer is relieved by the delay of the taxing officers. To solve doubt in favor of this taxpayer is but to shift his just burden to other taxpayers. It would deprive the Government of a right, which it undoubtedly had, by a construction of an act of grace, its own voluntary statute of limitations. The rule is rather to be applied that a grant by the public is to be strictly construed in favor of the public, and that the Government ought not to be excluded from its rightful powers except on clear legislative words.

The present contention specifically stated is that this tax claim arising under the Revenue Act of 1918 is controlled by the limitations of the Act of 1921, and is barred of enforcement because the assessment was made before June 2, 1924, whereas, if the assessment had been delayed until June 3, 1924, the Act of 1924 would have governed and it would not be barred. With no logical or constitutional necessity compelling such a conclusion, it must rest solely on the words of the statutes. The Act of February 26, 1926, was of force when the proceeding in court, the filing of the proof of claim, was instituted. Its provisions are first to be noted. (*Patterson* v. *Gaines*, 6 How., 550.) Its language is free from all doubt. Section 278(d) authorizes a proceeding in court within six years after a timely assessment "whether made *before* or *after* the enactment of this Act," and would sustain the filing of this proof on April 14, 1927. But 278(e) declares that the section shall not authorize collection by distraint or a proceeding in court of a claim already barred by previous statutes at the time of its enactment. We are, therefore, required to ascertain whether the Act of

June 2, 1924, saved this claim from becoming barred by the Act of 1921, five years after the return was filed, to wit, on June 14, 1925. The Act of 1924, section 277(a)2, which deals with tax claims arising prior to 1921, requires that they "except as provided in section 278 * * * shall be assessed within five years after the return was filed, and no proceeding in court for the collection of such taxes shall be begun after the expiration of such period." Section 278(d) provides that "where the *assessment* of the tax is made within the period prescribed in section 277, or in this section, such tax may be *collected* by distraint or by a proceeding in court, begun within six years after the assessment of the tax." The combined effect of the two sections is to require an assessment to be made, or a suit without an assessment to be filed, within five years from the making of the return; but if an assessment is made within that time, a distraint or a suit to enforce it may be had within six years after the assessment. Thus, for the first time, in the Act of 1924, the assessment is made a point from which the limitation on proceedings to enforce collection is to run. The reason for the innovation is thus stated in the Gregg report on the Mellon bill, as quoted by Holmes Federal Taxes (6th ed., p. 1347), note 85:

"If the taxpayer has had notice of an assessment within the statutory period therefor, little hardship to him results from authorizing proceedings thereafter for the collection of the tax. The purpose of the limitation upon assessments is to assure the taxpayer that, after the period has run, and no assessment has been made, no taxes may be collected from him. If, however, the assessment is made within the prescribed period, the assessment is comparable to a judgment at law and should remain alive until the tax is paid."

This reason applies with equal force to every assessment, whether made before or after June 2, 1924. Section 278(d) does not speak of assessments *hereafter* made, but of assessments generally. In reenacting this provision in section 278(d) of the Act of 1926, in order to set at rest any doubt about the intent of the words, Congress inserted a parenthesis: "(whether before or after the enactment of this Act)." The assessment in this case, made within five years after the filing of the return and within six years before the filing of the proof of claim, saves this tax from the bar.

But section 278(e) is said to compel the opposite conclusion. It declares:

"This section shall not (1) authorize the assessment of a tax or the collection thereof by distraint or by a proceeding in court if at the time of the enactment of this Act such assessment, distraint, or proceeding was barred by the period of limitation then in existence, or (2) affect any assessment made, or distraint or proceeding in court begun, before the enactment of this Act."

The plain meaning of the first clause is that if on June 2, 1924, it was, under the provisions of previous statutes, too late to assess a tax, the new statute should not authorize the assessment, and if too late under previous statutes to distrain or sue, no distraint or suit should be had under the new statute. The present assessment was not made under the new statute, and it was not, on June 2, 1924, too late to sue under previous statutes, so this clause has no present application. The second clause seems equally plain and means that if an assessment had been made prior to June 2, 1924, it shall not be affected by the new statute, that is to say, it shall be no better and no worse as an assessment; and if a distress or suit had been begun before that date, it also shall be unaffected by the limitations of the new statute. It is not enacted that the provisions of the new statute *shall not apply* to a tax where a valid assessment was made before June 2, 1924. No reason can be thought of for imputing any such intent to Congress. While a shorter period of limitations was fixed for more recent taxes, it was known that behind 1921 was a great mass of unassessed and uncollected taxes. The period of five years was retained in which an assessment or a suit without assessment must be had on them. But where, within that time, the taxpayer had solemn notice of assessment of the claim, and thereby it was liquidated with prima facie correctness, more time was desired to be given for adjustment and payment before enforcement was to be compelled. An assessment on June 1, 1924, differed in nothing from one on June 3, whether from the standpoint of the taxpayer or the Government. Section 278(e) was not intended to make a distinction where there was no difference. It did not exclude from the new scheme of limitations tax claims that had been assessed prior to June 2, 1924, but only declared that such assessment stood unaffected as assessments. Such an assessment, if timely and valid when

made, remained a good assessment and as capable of being a starting point for the new limitation as one made after June 2. The *proceeding in court* here dealt with was begun long after June 2, 1924, and the second clause of 278(e) does not apply to it at all. It rests upon an *assessment* to which that clause does apply, but only to declare it unaffected, as good an assessment as it ever was, and such an assessment as 278(d) makes the basis for the new six-year limitation; 277(a)3 and 278(d) of the Act of 1926 are but a clarifying reenactment of 277(a)2 and 278(d) of the Act of 1924, and should set at rest any doubt as to the original congressional intent.

I think the proof of claim is not barred and ought to be allowed if otherwise correct.

ARTICLE 1272: Period of limitation upon collection of tax.

REVENUE ACT OF 1924.

Partial payment of additional assessment, made as a result of warrant of distraint issued after running of statute as to collection, acting as collection waiver as to unpaid balance. (See G. C. M. 2581, page 95.)

ARTICLE 1272: Period of limitation upon collection of tax. VI-51-3546
T. D. 4107

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. COLLECTION—SUIT—LIMITATION.

The amount of income tax imposed by the Revenue Act of 1918 assessed before the enactment of the Revenue Act of 1924 and within five years after the return was filed, the collection of which was not barred at the time of the enactment of the latter Act, may be collected by a proceeding in court begun within six years after the assessment, as provided by section 278(d) of the Revenue Act of 1924.

2. ASSESSMENT—VALIDITY—DISSOLVED CORPORATION.

An assessment against a corporation is valid though made after its dissolution, the distribution of its assets, and the discharge of the trustees in liquidation.

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, Fifth Circuit, in the case of *The United States of America, appellant*, v. *Benjamin Russell, J. M. Steverson, T. C. Russell, and Hugh Steverson, appellees*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 13, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT.

The United States of America, appellant, v. *Benjamin Russell, J. M. Steverson, T. C. Russell, and Hugh Steverson, appellees.*

[November 4, 1927.]

OPINION.

FOSTER, Circuit Judge: In this case the material facts, which are undisputed, are these: On June 12, 1919, the Pine Lumber Co., an Alabama corporation, filed a return of its corporate income and profit taxes for the year 1918. The return was audited, a deficiency was determined, and an assessment of additional taxes was made by the Commissioner in March, 1924. The corporation had ceased doing business in March, 1920, was dissolved on April 1, 1923, and its remaining assets were distributed to appellees, who were the sole stockholders. On January 23, 1925, the United States filed her bill against appellees to impress the assets received by them with a trust and to recover the amount of taxes assessed against the corporation, $4,681. A motion to dismiss the bill was filed, on the ground that the action was barred by limitation. This motion was sustained and to reverse that judgment this appeal is prosecuted.

Under the provisions of the Revenue Act of 1921, section 250(d), no suit to collect taxes assessed under that or prior Acts could be commenced after five years from the date the return was filed. Therefore, if this suit is to be controlled solely by the Act of 1921, the action is barred.

The Government relies upon the provisions of the Revenue Act of 1924, which, so far as are material to this case, are as follows:

"SEC. 277. (a) Except as provided in section 278 * * *

"(2) The amount of income, excess profits and war-profits taxes imposed by * * * the Revenue Act of 1918, and by any such Act as amended, shall be assessed within five years after the return was filed, and no proceeding in court for the collection of such taxes shall be begun after the expiration of such period.

"SEC. 278. (d) Where the assessment of the tax is made within the period prescribed in section 277 or in this section, such tax may be collected by distraint or by a proceeding in court, begun within six years after the assessment of the tax. Nothing in this Act shall be construed as preventing the beginning, without assessment, of a proceeding in court for the collection of the tax at any time before the expiration of the period within which an assessment may be made.

"SEC. 278. (e) This section shall not (1) authorize the assessment of a tax or the collection thereof by distraint or by a proceeding in court if at the time of the enactment of this Act such assessment, distraint, or proceeding was barred by the period of limitation then in existence, or (2) affect any assessment made, or distraint or proceeding in court begun, before the enactment of this Act.

"SEC. 1100. (a) The following parts of the Revenue Act of 1921 are repealed * * * Title II (called 'Income Tax') as of January 1, 1924."

It is argued on behalf of appellees that the Act of 1924 should not be given a retroactive effect.

Of course, if there were no express statute, there would be no limitation as to the period within which the United States could assess and sue to collect taxes. When such a statute is enacted it is within the authority of Congress to impose conditions on the taxpayer, provide for the tolling of the statute by executive action, and make it retroactive.

It is well settled that a statute should not be given retroactive effect unless such construction is required by explicit language or by necessary implication. There is an apparent conflict between sections 277(a) and 278(d) of the Act of 1924. Section 277(a) provides that the assessment must be made, and a proceeding in court for the collection of the taxes must be begun, within five years after the return is filed, while section 278(d) gives an additional period of six years for the beginning of suit after the assessment of the tax. It is conceded that suit may be filed for the collection of a tax without first making an assessment and this is recognized by section 278(d). If the provision of section 277 is limited to those cases in which no assessment has first been made the apparent ambiguity disappears.

In providing that the period of limitation of section 250(d) of the Act of 1921 should apply to that and all prior Acts, Congress expressly adopted the policy of making such statutes of limitation retroactive. Section 277(a)2 is clearly retroactive, as it applies to the assessment and collection of taxes under prior Acts. Considering the provisions of 278(e), that the said section shall not authorize the assessment of a tax, or its collection by distraint, or by a proceeding in court, if such assessment, distraint, or proceeding was barred by the period of limitation then in existence, in connection with the expressed repeal of section 250(d) of the Act of 1921, which is included in Title II of that Act, the conclusion is easily reached that the limitations of sections 277(a) and 278(d) of the Act of 1924 were intended to apply to all other cases and the necessary implication is that the Act is retroactive.

It is apparent that this case does not come within the exceptions of section 278(e). The Revenue Act of 1924 was adopted June 2 of that year, at which time the assessment of the tax here in suit had been timely made and there were still 10 days in which to file suit to collect, so that neither was barred under the provisions of the Act of 1921. It follows that as the assessment was made within five years after the return, the Government had six years thereafter within which to bring suit, which it did within one year. The action was not barred by limitation.

Appellees further contend that in this case there was in fact no assessment, as it was made against the corporation after it had been dissolved and its assets distributed.

Under the law of Alabama, section 3516 of the code of 1907, in effect when the corporation was dissolved, a corporation continues to exist for five years after dissolution for the purpose of prosecuting or defending suits, settling its business, and disposing of its property, and the directors are made trustees with full power to settle its affairs. It is argued, however, that in this case the business had been entirely settled, the assets had been distributed, and the trustees were discharged, so that neither the corporation nor the trustees under the law had legal existence at the time the assessment was made. We do not agree with this contention. It can not be said that its business was settled when there was still a possibility of an additional assessment of taxes against the corporation by the United States, notwithstanding all of its assets had been distributed to the stockholders and there was no other business to be transacted. Furthermore, the assessment of taxes under the revenue laws of the United States is a step in the administration of the law and a determination by the Commissioner that the person filing a return actually owed the tax at the time the return was filed. It would be unreasonable to require the Commissioner to inquire in each case whether the taxpayer was still in existence, be he an individual or a corporation, and an assessment in the name of the taxpayer making the return is sufficient, regardless of who may ultimately be held liable for the payment of taxes.

The judgment appealed from is reversed and the case remanded for further proceedings not inconsistent with this opinion.

TITLE X.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTIONS 1014 AND 1015.—LIMITATIONS UPON SUITS AND PROCEEDINGS BY THE TAXPAYER.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. VI–29–3313 T. D. 4033

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. COURTS—JURISDICTION—APPEALS—BOARD OF TAX APPEALS.

A court is without jurisdiction to determine whether a taxpayer has made an overpayment of tax in respect of a taxable year in respect of which the Commissioner has determined a deficiency where the taxpayer's appeal from the Commissioner's determina-

tion is pending before the United States Board of Tax Appeals. In such a case jurisdiction is not acquired by reason of the fact that a part of the tax already paid, less than the deficiency, resulted from the inclusion in income of an amount that was not taxable.

2. DECISION AFFIRMED.

The decision of the district court in the case of *Suhr* v. *United States* affirmed. (14 Fed. (2nd), 227 (T. D. 3894 [C. B. V-2, 124]).)

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 *Suhr* v. *United States*, is published for the information of internal revenue officers and others concerned.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

Approved July 6, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS, THIRD CIRCUIT.

Suhr v. *United States.*

In error to the District Court of the United States for the Western District of Pennsylvania.

[March, 1927.]

Before BUFFINGTON, WOOLLEY, and DAVIS, Circuit Judges.

DAVIS, Circuit Judge: This case was brought here on writ of error of plaintiff to review an action at law for the recovery of income tax paid to the United States for the calendar year 1917. In his return for that year, the plaintiff included his stock dividends. When the Supreme Court decided that they were not taxable, he filed a claim for refund of $3,500. Thereupon the Commissioner of Internal Revenue ordered an examination of the plaintiff's books and accounts. This was made and the field agent's report was reaudited by the Commissioner of Internal Revenue in Washington and as a result an additional tax of $11,290.89 was "proposed," but after some negotiations the Commissioner determined that after giving plaintiff credit for the stock dividends in question he was indebted to the United States on his tax for that year in the sum of $9,987.68. This the plaintiff refused to pay and appealed to the United States Board of Tax Appeals at Washington, averring that "no part of the alleged additional tax was due, but that he had in fact already overpaid his tax for the said year of 1917 to the extent of $986.22." This issue is now pending before that Board.

Three weeks after the appeal was taken the plaintiff filed a complaint in the district court on the same issue and again alleged that "he had already overpaid his tax for the said year of 1917 in the amount of $986.22, and asked that that amount be awarded to him in a judgment." The defendant filed an affidavit of defense raising questions of law to the effect that the court was without jurisdiction until after the determination of the appeal to the Board of Tax Appeals. The court held that if the Board of Tax Appeals finds against the plaintiff, he may "bring suit for the recovery of such part as he may then allege to have been erroneously or illegally assessed or collected. * * * Until that time arrives, this court is without jurisdiction to pass on the question of plaintiff's tax liability in the premises. The plaintiff can not separate one item from his tax return for which he is admittedly entitled to credit and

use that as a basis of conferring jurisdiction on this court to determine the total tax liability for the year."

Defendant contends that the suit in the district court is an effort to have that court determine plaintiff's 1917 tax liability in advance of the determination by the administrative body created by law for that purpose. This is denied by the plaintiff. He says that he did not ask the court to determine his liability to pay the alleged additional tax of $9,987.68, but "what we did ask and what we now ask is that the court shall determine whether or not we have now already been required to pay $986.22 alleged tax more and over and above plaintiff's true and correct liability." Whether or not plaintiff owes, or has overpaid, the Government on his tax liability for that year can not be determined without considering the whole question—the entire tax liability, the amount paid and the stock dividends. This the Commissioner says he did, and found that $9,987.69 is still due the Government. These contentions between the parties constitute the issue which is now being determined by the Board of Tax Appeals. If the district court settles the controversy, it must do exactly what that Board has undertaken and is now doing.

In his petition, plaintiff says that the Commissioner's computation is erroneous in six particulars. That may or may not be true, but whatever the fact is, it will be determined by the Board, to which plaintiff appealed.

Any taxpayer may appeal to the Board of Tax Appeals, but he must do so before his tax is assessed or collected. (Section 274(a), Revenue Act of 1926, 44 Stat., 9, 55.) If appeal has thus been made to the Board, the tax not having been paid, the appellant may not also proceed in the courts until the Board has determined the question of deficiency. If that question is decided against him, he may then pay the deficiency and sue in the district court to recover, or he may appeal to the circuit court of appeals. (Section 1001(a), Revenue Act of 1926, 44 Stat., 9, 109; *Cheatham* v. *United States*, 92 U. S., 85, 88; Revenue Act of 1926, section 284(c), 44 Stat., 9, 66.) The fact that plaintiff was entitled to a refund of the stock dividends did not give him authority to resort to the courts if he owed the Government any taxes for that year. He was simply entitled to have the overpayment credited against his other tax liability. (Section 252, Revenue Act of 1921, 42 Stat., 227; *Blair* v. *U. S. ex rel Birkenstock*, 271 U. S., 348.) None of the various tax Acts provide for recourse to the courts by a taxpayer until he has failed to get relief from the proper administrative body or has paid all the taxes assessed against him. The payment of a part does not confer jurisdiction upon the courts. (*Blair* v. *U. S. ex rel Birkenstock*, supra.) The fact that the plaintiff had paid what he thought was all his taxes before the questions of stock dividends and deficiency arose does not confer upon him the right, after they had arisen and appeal had been taken to the Board, to ignore the appeal and proceed to recover in the district court just as though he had paid the full amount demanded and there was no question about a deficiency still due from him. There is no provision for refund to the taxpayer of any excess payment of any installment or part of his tax if the whole tax for the year has not been paid.

The institution of this suit was premature. It may be that there will be nothing for plaintiff to litigate when the Board of Tax Appeals decides the controversy. At least, the district court at this time is without jurisdiction, and the decree is affirmed.

SECTION 1019.—INTEREST ON REFUNDS AND CREDITS.

ARTICLE 1371: Interest on refunds and credits. VI-29-3314
G. C. M. 2020

REVENUE ACTS OF 1921 AND 1924.

An item appearing on a final refund schedule, signed by the Commissioner on June 2, 1924, prior to 4.01 p. m. of that date, is subject to the interest provisions of the Revenue Act of 1921.

Reference is made to the protest filed on behalf of the M Company, in which exception is taken to an adjustment of interest made in connection with refunds of income taxes for the fiscal years ended September 30, 1917, 1918, 1919, and 1920.

It appears that certain claims for refund filed by the M Company (the taxpayer) were allowed and listed upon a final schedule which was signed by the Commissioner some time during the day of June 2, 1924. Since the Revenue Act of 1924 was signed by the President at 4.01 p. m., June 2, 1924, it becomes necessary to determine whether the interest provisions of section 1324(a) of the Revenue Act of 1921 are applicable, or whether the particular refund claim contained in the schedule dated June 2, 1924, should receive the benefit of the interest provided under section 1019 of the Revenue Act of 1924.

It will be noted that section 1104 of the Revenue Act of 1924 provides that "except as otherwise provided, this Act shall take effect upon its enactment." The Income Tax Unit has reached the conclusion that, taking into consideration the established procedure of the Bureau in force on June 2, 1924, all schedules of allowed refund claims which were handled in the usual course of business on that day must have been signed before 3 p. m.; that any schedules signed by the Commissioner on that date were signed prior to the enactment of the Revenue Act of 1924; and that the Revenue Act of 1921 was still in effect when the particular schedule under consideration was signed by the Commissioner.

The attorneys for the taxpayer rely particularly upon the contention that, regardless of the hour of the day on which the final schedule was signed, the Revenue Act of 1924 was in effect from the beginning of the day of June 2, 1924, and that any schedule signed at any time during that day is subject to the interest provisions contained in the Revenue Act of 1924.

The real issue involved, i. e., whether section 1019 of the Revenue Act of 1924 was in effect all of June 2, 1924, or merely after 4.01 p. m. of that day, should be considered in the light of the decisions of the courts with respect to other cases in which a similar issue was involved.

There are some decisions which have applied a general principle that the courts will not take notice of fractions of days, and that legislation effective upon its enactment will be deemed to be in effect from the beginning of the day on which the legislation was passed. (*United States* v. *Norton*, 97 U. S., 164, *Lapeyre* v. *United States*, 17 Wall., 191.) However, Mr. Justice Harlan, in *Louisville Tp.* v. *Savings Bank* (104 U. S., 469, 475), after referring to these cases and the case of *Arnold* v. *United States* (9 Cranch, 104), involving a similar situation, stated:

* * * it can not be doubted that the court may, when substantial justice requires it, ascertain the precise hour when the statute took effect by approval of the Executive.

In referring to the case of *Louisville Tp.* v. *Savings Bank*, supra, the Circuit Court of Appeals for the Second Circuit held in the case of *Iselin* v. *United States* (87 Fed., 194) that:

* * * The clearly announced doctrine of the case of *Louisville Tp.* v. *Savings Bank* (104 U. S., 469), which is the latest deliverance of the Supreme Court on this particular subject, may be stated to be that when it is necessary to determine conflicting rights, courts of justice will take cognizance of fractions of a day. This case repudiates the ancient doctrine that the law would in no case recognize fractions of a day, and that all statutes are to be construed to take effect from the first moment of the day of their approval by the Executive.

In the case of *Louisville Tp.* v. *Savings Bank*, supra, the court approved the rule declared in *Grosvenor* v. *Magill* (37 Ill., 339) as being consistent with sound reason and public policy, and as being in line with the settled course of decisions in other courts. This language is quoted from the Illinois decision:

* * * It is true that for many purposes the law knows no divisions of a day, but whenever it becomes important to the ends of justice, or in order to decide upon conflicting interests, the law will look into fractions of a day as readily as into the fractions of any other unit of time. (2 Bl. Comm., 140, notes.) The rule is purely one of convenience, which must give way whenever the rights of the parties require it.

In the case of *Bank* v. *Burkhardt* (100 U. S., 686, 689) it was stated:

* * * For most purposes, the law regards the entire day as an indivisible unit. But when the priority of one legal right over another, depending on the order of events occurring on the same day, is involved, this rule is necessarily departed from.

The same principle is stated in 23 American and English Encyclopedia of Law, at page 215, citing many authorities, as follows:

* * * The view which seems to be supported by the weight of authority is that a bill becomes operative only from the time of its approval; that the doctrine that there is no fraction of a day is a legal fiction, which may be overthrown by the fact, when necessary, in order to accomplish substantial justice.

In the case of In re Richardson (2 Story, 571) the court stated:

* * * It is the act of approval which makes it a law, and until that act is done it is not a law. The approval can not look backward, and by relation make that a law at any antecedent period of the same day which was not so before approval, for the general rule is, "Lex prospicit, non respicit."

In this case Judge Story observed that the oft-repeated doctrine that in law there is no fraction of a day is true only in a limited sense, when it will promote the right and justice of the case.

In Sutherland on Statutory Construction (vol. 1, p. 320) it is stated:

* * * The weight of American authority is that a statute which is to go into effect immediately is operative from the instant of its passage. [Citing a long line of decisions.] The law takes notice of fractions of a day when necessary. The general principle declared by Lord Mansfield is believed to be sound and established by the weight of authority, that where it is necessary to justice and it can be done, the law takes notice of the parts of a day; then the precise time when an act is done may be shown. This necessity exists when an act is done on the same day that a legislative act is passed, if that statute being passed afterwards should not affect such act, or, being passed before, should do so.

In *Burgess* v. *Salmon* (97 U. S., 381) it was held that the time of approval of a Revenue Act by the President points out the earliest possible moment at which it could become law. According to that decision, when acts are done in the forenoon, but the statute is not approved by the President until afternoon of the same day, such acts must be governed by the preexisting law. It was therefore held that an Act increasing the tax on tobacco does not apply to tobacco which is stamped, sold, and removed on the very day the Act went into effect but before it had been approved by the President.

The attorneys for the taxpayer in the instant case, in making a reference to a letter from the Bureau dated March 10, 1927, in which certain cases are cited holding to the effect that the courts will con-

sider fractions of a day whenever it is necessary to promote the purpose of substantial justice, contend that such cases apply only in the determination of conflicting priorities of private rights and that the rule has no application to a public statute. In the case of *United States* v. *Iselin* (87 Fed., 194, 198) this contention was disposed of by the statement that the case of *Burgess* v. *Salmon* is an authority clearly to the contrary, that case involving a contention between a citizen and the Government.

It is a well-established rule of statutory construction that the construction given to a statute by those charged with the duty of executing it will be given great weight by the courts if the true construction be doubtful. (*United States* v. *Hill*, 120 U. S., 169, and cases cited at page 182.) The Bureau has taken the position that with respect to the imposition of an internal revenue tax the actual time of the approval of the legislation may be considered. In article 7, Regulations 48, relating to the excise tax on works of art and jewelry imposed under sections 602 and 604 of the Revenue Act of 1924, it is provided that "The tax applies to all sales made on or after June 2, 1924, at 4.01 p. m., Washington time." In Regulations 70, relating to the estate tax under the Revenue Act of 1926, it is provided that the exact moment of the death of a decedent shall be determinative as to the provisions of the Revenue Act which shall govern with respect to the estate tax. Other regulations with respect to taxes imposed under prior Revenue Acts have likewise taken into consideration the exact moment of the enactment of a taxing statute.

Conceding that section 1019 of the Revenue Act of 1924 was designed to be remedial, it is at once obvious that such section can not be held to be retroactive in the sense of permitting the payment of interest on claims allowed before the effective date of that Revenue Act, and that the effect of the Act is not narrowed by the application of such construction.

Nothing in this opinion is to be considered in conflict with I. T. 2059 (C. B. III–2, 307) or I. T. 1603 (C. B. II–1, 228), in which the expressions "on and after June 2, 1924," or "on and after November 23, 1921," occur, but the use of such dates should be deemed to be governed by the actual time on June 2, 1924, or November 23, 1921, at which the Revenue Acts of 1924 and 1921 were approved.

The conclusion has therefore been reached that an item appearing on a final refund schedule, signed by the Commissioner on June 2, 1924, prior to 4.01 p. m. of that date is subject to the interest provisions of the Revenue Act of 1921.

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

INCOME TAX RULINGS.—PART III.

REVENUE ACT OF 1921 OR PRIOR REVENUE ACTS.

TITLE I.—GENERAL DEFINITIONS.

SECTION 2.—GENERAL DEFINITIONS.

ARTICLE 1502: Association.

REVENUE ACTS OF 1917 AND 1918.

Persons acting through an attorney in fact to provide among themselves insurance or indemnity to each other through the medium of reciprocal or interinsurance contracts. (See T. D. 4096, page 314.)

ARTICLE 1504: Association distinguished from trust.

REVENUE ACTS OF 1918 AND 1921.

Trust administered by sole trustee. (See G. C. M. 2405, page 10.)

ARTICLE 1504: Association distinguished from trust.

REVENUE ACT OF 1921.

Real estate development project operating under a trust instrument under which the beneficiaries control the trust. (See G. C. M. 1736, page 11.)

TITLE II.—INCOME TAX.

PART I.—GENERAL PROVISIONS.

SECTION 200.—DEFINITIONS.

ARTICLE 1523: Personal service corporation. VI–41–3462
T. D. 4092

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

CORPORATIONS—PERSONAL SERVICE CLASSIFICATION—CAPITAL.

Where a corporation conducting an advertising agency derives considerable income from using its funds to pay bills of publishers for the advertisements of its customers as they become due, thereby securing a substantial discount for prompt payment, and derives one-fourth of its income in profits from drawings and electrotypes made at its own expense, capital is a material income-producing factor, and, therefore, it is not entitled to personal service classification under section 200 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 District Court for the Western District of Kentucky, at Louisville, in the case of *Thomas E. Basham Co.* v. *Lucas, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 30, 1927.

A. W. MELLON,
Secretary of the Treasury.

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DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF KENTUCKY, AT LOUISVILLE.

Thomas E. Basham Co., plaintiff, v. *Robert H. Lucas, Collector of Internal Revenue for the District of Kentucky, defendant.*

[July 25, 1927.]

OPINION.

The sole question involved in this case is whether the plaintiff was entitled to be classified as a personal service corporation under the provisions of section 200 of the Revenue Act of 1918. The applicable part of that section reads 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."

In determining whether or not the plaintiff is entitled to classification under this section, a well-settled rule of statutory construction must be kept in mind, and that is, that where the enacting clause of a law is general in its language and objects (as is the Revenue Act of 1918), and a proviso or exception is introduced into the Act, that proviso or exception must be strictly construed, and will not be permitted to take any case out of the enacting clause which does not clearly fall within its terms. Anyone claiming the benefit of such proviso or exemption must clearly and unmistakably establish his rights to its benefits. The rule is well expressed in the case of *United States* v. *Dickson* (15 Pet., 141, 40 U. S., 141) in the following language:

"We are led to the general rule of law, which has always prevailed, and become consecrated almost as a maxim in the interpretation of statutes, that where the enacting clause is general in its language and objects, and a proviso is afterwards introduced, that proviso is construed strictly and takes no case out of the enacting clause which does not fall fairly within its terms. In short, a proviso carves special exceptions only out of the enacting clause; and those who set up any such exception must establish it as being within the words as well as within the reasons thereof."

Again, in the case of *Ryan* v. *Carter* (93 U. S., 78), the rule was announced by the Supreme Court in this language:

"The general rule of law is that a proviso carves special exceptions only out of the body of the act; and those who set up any such special exception must establish it as being within the words as well as the reason thereof."

This principle is universal in its application. It is true that the Supreme Court has repeatedly held that taxing statutes, whether general or special, in case of ambiguity or doubt, are construed strictly in favor of the citizen, but the cases which have laid down that rule were dealing with the question of whether or not the citizen was embraced within the enacting clause and general objects of the law, and not with the question of whether or not a citizen who would otherwise come within the language of the enacting clause was excepted therefrom by reason of a proviso or an exemption introduced into the act. On the contrary, the Supreme Court has repeatedly held that a taxpayer embraced within the general language of the enacting clause, and within the general objects of a taxing statute, can not escape taxation by claiming the benefits of a proviso or an exemption contained in the statute, unless he plainly and unmistakably establishes his right thereto. (See *Tucker* v. *Ferguson*, 22 Wall., 527; *New Orleans City & Lake Ry. Co.* v. *New Orleans*, 143 U. S., 192; *Bank of Commerce* v. *Tennessee*, 161 U. S., 134; *Chicago Theological Seminary* v. *Illinois*, 188 U. S., 662. See also *Commercial Health & Accident Co.* v. *Pickering*, 281 Fed., 539; *Hubbard-Ragsdale Co.* v. *Dean*, 15 Fed. (2d ser.), 410.)

Now, in this case we have presented a corporation fairly embraced within the enacting clause of the Act. It seeks to be excepted therefrom and to be treated as belonging to a special class by virtue of the provisions of section 200. As I conceive the law to be, before it can be classified as a personal service corporation under that section, and thereby secure preferential treatment as against other corporations, it must clearly and unmistakably establish its right to such classification. Any substantial doubt as to its right to such classification is fatal to its claim.

It is apparent that a question of fact is presented in each case in which a corporation seeks to claim the benefits of section 200, and each case must be determined by its own particular facts. Before a corporation is entitled to the benefits of that section, it must establish beyond substantial doubt: (1) That its income is primarily due to and the result of the activities of its principal owners or stockholders; (2) that the principal owners or stockholders are themselves regularly engaged in the active conduct of the affairs of the corporation; (3) that capital, whether invested or borrowed, is not a material income-producing factor. Failure to clearly and satisfactorily establish any one of these three requisites is fatal to the claim of the corporation.

In this case it has been established, clearly and satisfactorily, that the plaintiff's principal owners and stockholders are themselves regularly engaged in the active conduct of the affairs of the corporation, but I am unable to say that it has been clearly and satisfactorily established that the income of the corporation can be ascribed primarily to their activities, nor has it been clearly and satisfactorily established that capital has not played a material part in producing the corporate income. These two propositions are closely related, because if capital is a material income-producing factor, it necessarily follows that the income of the corporation can not be ascribed primarily to the activities of its stockholders.

I am bound to say that the testimony in this case leaves me in grave doubt and my mind in confusion as to the amount of capital used in the business. The plaintiff's witnesses contend that the actual cash paid in for capital stock was approximately $2,000. The authorized capital stock of the corporation was $25,000. In 1912, at the time of incorporation, $10,000 of this stock was issued, $8,000 representing good will of the business previously operated by Thomas E. Basham as an individual, and $2,000 representing cash and physical assets turned over to the corporation by Mr. Basham. At the beginning of the taxing year 1919 the outstanding capital stock was $14,100. I can not see how any additional stock could have been issued for good will, and from the entire record I think it is reasonably clear that the additional $4,100 worth of stock represented cash paid in by the other stockholders, or notes executed by them for stock.

During 1919 the plaintiff borrowed at five different times from $2,500 to $3,000, or an aggregate of between $12,500 and $15,000. Just what part this borrowed money and the paid in capital stock played in the production of income for that year, I am left to guess. Furthermore, it is very apparent from this record as a whole that considerable revenue was derived by the taxpayer from using its funds to pay the bills of the publishers as they became due, thereby securing a substantial discount for prompt payment. It is true the taxpayer contends that it was under no legal obligation to pay the pub-

lisher for the advertising placed with such publisher through the agency of the plaintiff, in default of payment on the part of the advertiser, but it admits that it was its uniform practice to pay such bills in event of default on the part of the advertiser, in order that it might maintain its standing and the good will of the advertising medium. If a material part of its income was derived from this practice, it seems to me that it would be of no importance whether the plaintiff was under any legal obligation to pay these bills or not. It would be income derived from the use of capital nevertheless.

There is nothing in this record, however, justifying the contention of the plaintiff that it was not directly liable to the publisher. On the contrary, I think the record conclusively shows that the plaintiff was directly liable to the advertising medium for all advertising inserted therein through the agency of the plaintiff. There is filed with the deposition of Mr. Basham a copy of the form of order used by the plaintiff in placing advertising for its customers with different advertising mediums. I am thoroughly satisfied that such an order as the one filed made the plaintiff directly liable to the advertising medium with which the order was placed, unless it is shown that there was a settled custom and practice in the trade that exempted an advertising agency such as the plaintiff from personal liability, on orders such as the one filed as an exhibit herein, and that the plaintiff and the different advertising mediums with which it placed advertising orders contracted with this custom in mind. The record does not satisfactorily show any such custom. The manner in which the company kept its books would indicate that the company recognized its direct liability for advertising placed with different publishing concerns, because it carried on its books as a liability, under the head of "Accounts payable," the amount which it was to remit to the advertising mediums and as an asset, under the head of "Accounts receivable," the amount which it expected to collect from the advertisers.

It is true the plaintiff undertakes to explain this method of bookkeeping as being merely a matter of convenience, but this explanation is not convincing, coming as it does long after the entries had been made, and when considered in connection with plaintiff's admission that it always paid the publisher, even though the advertiser defaulted. Moreover, Mr. Basham in his testimony practically admitted that the publisher looked to the plaintiff for the payment of these accounts. If I am correct in my conclusion that the plaintiff was primarily liable for the payment of the advertising placed by it for its customers, then capital was a material factor in the production of that portion of the income of the plaintiff represented by the difference between what it had to pay the publishers and what it collected from the advertisers, and the fact that plaintiff in most instances collected from the advertiser before it was required to remit to the publisher does not, in my view, change the situation.

There is another item of income attributable to the use of capital disclosed by the record, viz, the profit derived by the plaintiff on drawings, electrotypes, etc. According to the record, and particularly the testimony of Mr. Basham, this work was done either in plaintiff's office or by some art organization with which the plaintiff had a separate, independent contract. The plaintiff was liable for this work, and payments were made directly to the art organization in the same way as any other account is ordinarily paid, and the plaintiff in turn charged the advertiser a profit on what it had cost to have this work done. This difference, in 1919, amounted to a profit of $3,496.15. There can be no escape from the conclusion that this profit was derived from the use of capital. The total net income for 1919 was $14,019.01. Therefore, the profit derived from the use of capital, in connection with cuts and drawings, was nearly 25 per cent of the total net profit for that taxable year.

In view of this fact, and in view of the failure of the plaintiff to show how much profit was derived from taking the benefit of cash discounts when it paid out of its own resources bills which the advertisers failed to promptly pay, and in view of my conclusion that the plaintiff was primarily and directly liable for all the advertising placed by it under orders such as that filed as an exhibit in this case, I can not say that it has been made to clearly and satisfactorily appear that capital was not a material factor in producing the income for the year 1919.

It follows, therefore, that plaintiff must be denied the relief prayed for, and a judgment conforming to the views herein announced may be prepared and presented for entry.

ARTICLE 1523: Personal service corporation. VI–41–3465
(Also Sections 1318, 1319, and 1320, Article 1050.) T. D. 4093

INCOME AND EXCESS PROFITS TAX—REVENUE ACTS OF 1917 AND 1921—DECISION OF COURT.

1. INVESTED CAPITAL—NOMINAL CAPITAL.

A corporation which made substantial profits from the purchase and sale of merchandise on its own account and which had unsold merchandise on hand at the beginning of the year inventoried at $18,000, had more than a nominal capital and is not entitled to assessment under section 209 of the Revenue Act of 1917, notwithstanding the principal business was that of selling merchandise belonging to others on a commission basis.

2. COLLECTION—STATUTE OF LIMITATIONS—PAYMENT AFTER STATUTORY PERIOD.

A tax paid after the statute of limitations as to collection has expired can not be recovered by suit where prior to the expiration of such period of limitations the taxpayer deposited bonds as security for the payment of the tax upon demand.

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 *George A. Mendes & Co.* v. *Frank K. Bowers, Individually and as Collector of Internal Revenue*, is published for the information of internal revenue officers and others concerned.

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

Approved October 5, 1927.

A. W. MELLON,
Secretary of the Treasury.

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UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

George A. Mendes & Co., plaintiff. v. *Frank K. Bowers, Individually and as Collector of Internal Revenue, defendant.*

[July 28, 1927.]

OPINION.

BONDY, D. J.: Though the business of buying and selling merchandise was only an incident of plaintiff's business of selling on commission goods belonging to others, the evidence discloses that on January 1, 1917, the plaintiff had unsold merchandise on hand inventoried at $17,943.78, and also that it made substantial profits in its business of buying and selling merchandise.

Under such circumstances, I believe that this is not the case of a trade or business having not more than a nominal capital; and that therefore it does not fall within section 209 of the Revenue Act of 1917.

It has been stipulated that on May 17, 1922 (that is, within five years of the filing of plaintiff's income tax return and while payment of an additional tax assessed for the year 1917 could be enforced), the defendant deposited with a bank Liberty bonds of the par value of $20,000 to protect the liability of the collector to the Government and to be turned over to the defendant in the event that the plaintiff fails or refuses to pay the tax when demanded; that on March 24, 1923 (within five years of the filing of the return), the collector of internal revenue demanded payment of $7,373.04, the balance of the tax remaining due after crediting a conceded overassessment; and that on April 2, 1923 (more than five years after the return was filed), the plaintiff paid $7,373.04; that at the

same time the Liberty bonds of the par value of $20,000 were returned to the plaintiff.

The facts stipulated make inapplicable the cases relied on by the plaintiff.

The collector withheld the collection of the tax when the bonds were deposited on the understanding that they were to be returned to the plaintiff only after the tax was paid. The plaintiff never demanded back the bonds on the ground that the payment of the tax was not enforceable, because more than five years had passed since the return was filed. On the contrary, it paid the tax knowing that the bonds would not be returned voluntarily unless the tax was paid. The return of the bonds constituted consideration for the payment; and the payment was voluntarily made in accordance with plaintiff's agreement, notwithstanding that the check was marked "Paid under protest."

The plaintiff after its default in the payment of the tax on demand could not insist on the return of the bonds, especially without making good its default and paying the tax. As stated, the payment was voluntarily made to induce and in consideration of the return of the bonds, notwithstanding the plaintiff's default. There, therefore, should be judgment for the defendant.

SECTION 201.—DIVIDENDS.

ARTICLE 1542: Source of distribution. VI–36–3411
T. D. 4077

INCOME TAX—REVENUE ACTS OF 1916, 1917, AND 1918—DECISION OF COURT.

DIVIDENDS—WHEN TAXABLE—DISTRIBUTION BY ORDER OF COURT.

Where a corporation had a cash surplus at the close of its fiscal year 1916, which was in part distributed by a dividend declared and paid in 1919 pursuant to a court decree entered in 1919 affirming a lower court decree entered in 1917, the dividend was income to the recipient in 1919 and taxable as such.

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 *Matilda R. Dodge and Howard B. Bloomer, as Administrators with the Will Annexed of the Estate of John F. Dodge, deceased*, v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 26, 1927.

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

COURT OF CLAIMS OF THE UNITED STATES.

Matilda R. Dodge and Howard B. Bloomer, as Administrators with the Will Annexed of the Estate of John F. Dodge, deceased, v. *The United States.*

[April 4, 1927.]

OPINION.

GRAHAM, Judge, delivered the opinion of the court.

The Ford Motor Co., a Michigan corporation, had in its treasury at the close of the fiscal year ended July 31, 1916, a large cash surplus. Plaintiffs'

testator, a stockholder, demanded that a portion of this surplus be distributed as dividends in addition to the regular dividend. The directors refused the demand, and the plaintiffs brought equitable action to compel the distribution. The Circuit and Supreme Courts of Michigan decided that the action of the directors in refusing to make the distribution was arbitrary and exceeded their discretion, and ordered them to make distribution of 50 per cent of said surplus, with interest from December 5, 1917, the date of the decree of the lower court. The directors, on July 10, 1919, made the distribution as ordered, and a dividend was paid to and received by the plaintiffs' testator on the same day.

The plaintiffs contend that while the dividend was actually received in cash on the date mentioned, their testator had a right, because of the decision of the court, to receive it in 1916 or 1917; that constructively he received it in 1916, and that therefore it should be accounted for as income for that year and not 1919. The Commissioner of Internal Revenue held that it was received in and should be accounted for as income for 1919.

First let us consider whether the dividend received by plaintiffs' testator could have been treated as income received in 1916 or 1917. It was not "gains or profits" actually received during those years, and therefore was not income for those years. Nor did the plaintiffs' testator then claim that it was or return it as part of his gross income for either of those years. He could not at that time under the revenue statute applicable to 1916 and 1917 have been legally assessed for it as income received during either of those years.

Section 1211 of the Revenue Act of 1917 (40 Stat., 300, 338) is as follows:

"SEC. 31. (b) Any distribution made to the shareholders or members of a corporation * * * shall constitute a part of the annual income of the distributee for the year in which received."

It will be seen from the authorities hereafter cited that the word "received" as used in this Act means actually received during the taxable year, and it must have been preceded by a distribution, i. e., action by the directors effecting a distribution.

During the years 1916 and 1917 there had been no distribution; on the contrary, a suit was pending to compel it, and no dividend had then been actually or even constructively received. The whole matter was in the doubtful field of litigation. Not until the final decree of the Supreme Court of Michigan and the action of the directors in July, 1919, making the distribution of the dividend to the plaintiffs' testator, could the latter have been legally assessed therefor. It was not known until the decision of the supreme court whether there would be a distribution. The court might have decided adversely to plaintiff's petition to compel distribution. As the statute for the years mentioned applied only to cases where there had been an actual distribution and a receipt thereof during those years, no "gains or profits" which had been distributed and received during subsequent years could be legally assessed as income for 1916 or 1917. This claim in 1916 and 1917, and until July, 1919, was a mere claim of a right to distribution. It would thus appear that the dividend was not income within the meaning of the applicable statute for the years 1916 and 1917, and was not "gains or profits" actually received during those years which could be assessed as part of the testator's gross income. Was it then income assessable under the statute of 1919?

The interest which the plaintiffs' testator had in 1916 as far as the undistributed surplus was concerned was the same as that of any other stockholder. Nothing had been set aside for him personally, and the stockholders, and no one of them in 1916 or 1917, had either a claim to any particular sum of money or a right to any particular portion of the assets until the directors concluded that a fund should be set aside for the purpose of paying the dividends. When paid in money or some other divisible property, and then only, does the stockholder realize "gains or profits" which become his own property. (*Eisner* v. *Macomber*, 252 U. S., 189, 209 [T. D. 3010, C. B. 3, 25].) In *Maryland Casualty Co.* v. *United States* (251 U. S., 342, 52 C. Cls., 201) both courts held that "income" used in revenue legislation has a well-settled legal meaning, and that the courts have uniformly construed it to include only what is "received."

What is taxed is the income "received." The courts have always endeavored to place a construction on the statutes which is in accord with the intent to reach the actual and not the potential income. The net income, which is the

measure of taxation, means what has actually been received, not that which though due has not been received and its payment for some reason deferred. (*Mutual Benefit Life Insurance Co.* v. *Herold*, 198 Fed., 199.)

The plaintiffs ask the court to indulge in a fiction that their testator realized or received "gains or profits" in 1916 or 1917 when in fact he received same in 1919.

As to the testator's interest in this fund before distribution, it should be borne in mind that the corporation must be regarded as a substantial entity separate from the stockholders, not only because such is a practical fact but because it is only by recognizing such separateness that a dividend, even when paid in money, may be regarded as the income of the stockholder. (*Eisner* v. *Macomber*, supra, 214.) Even Congress can not tax without apportionment a stockholder's interest in accumulated earnings prior to declaration of dividend. *Eisner* v. *Macomber*, supra (p. 218), and authorities cited.

We are of opinion that the dividend involved, being actually received in the year 1919, was properly assessable as part of testator's gross income for that year.

Section 213(a) of the Revenue Act of 1918 (40 Stat., 1057, 1065), being in force in 1919, is as follows:

"The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period;"

This Act is unambiguous. It makes receipts a part of the gross income "for the taxable year in which received by the taxpayer."

Plaintiffs can not claim that the dividend received in 1919 accrued in 1916 if testator kept his books not upon an accrued but a cash basis, as he did.

Congress was dealing with actualities, with income. It was not intended that the taxpayer should charge himself, as part of his gross income, with sums claimed but not received, and should only be allowed to deduct such sums as he had actually expended and not those for which there were claims against him. Undivided corporate profits are not income of the stockholder. It is of the essence of income that it should be realized. Potentiality is not enough. Income necessarily implies separation and realization. There is no income from an investment until there has been a separate realized gain. The profits of a corporation are its property, they belong to it. When a corporation distributes these profits in dividends, then, and not till then, does the stockholder realize a gain, and this gain is income. Until there is a distribution there can be no income. It is only income when it comes in, when it is received as a gain by the stockholder by reason of a distribution as dividends. The corporation would of course pay its income from its profits, but there is no income to the stockholder until he receives it. Until then it is not "gains or profits" for which he must account under the statute as a part of his gross income.

There has been some contention that the fund in this case was impounded by the preliminary restraining order of the lower court of Michigan. That order did not set aside any fund for dividends but simply restrained the directors from proceeding with a plan to use the surplus or a part of it in building smelting works and other additions. The supreme court reversed the decree of the lower court, particularly as to the restraint put upon the directors by this order, and directed that only a portion of the fund be distributed, allowing the directors to use their discretion as to the balance.

Some stress has been laid upon the fact that the Supreme Court of Michigan in ordering a distribution fixed the same as of the 7th of December, 1917, with interest from that date, being the date of the final decree of the lower court. In the view we take of this case, the fixing of the distribution date as December 7, 1917, is not important. The "gains or profits" were actually received in 1919, and no action of the Supreme Court of Michigan could change what we conclude to be the plain meaning of the Revenue Act of 1919.

The petition should be dismissed and it is so ordered.

ARTICLE 1542: Source of distribution. VI-37-3422
T. D. 4080

INCOME TAX—REVENUE ACTS OF 1917 AND 1918—DECISION OF COURT.

1. DIVIDENDS—WHEN TAXABLE—DISTRIBUTION BY ORDER OF COURT.

Where a corporation had a cash surplus at the close of its fiscal year 1916 which was in part distributed by a dividend declared and paid in 1919 pursuant to a court decree entered in 1919 affirming a lower court decree entered in 1917, the dividend was income to the recipient in 1919 and taxable as such.

2. DIVIDENDS—PROFITS—RATES.

Where profits were made by a corporation in 1917 sufficient to pay a dividend paid in January of that year, such dividend is income of the distributee for the taxable year in which it was received and therefore taxable at the rates prescribed for the year 1917.

3. DECISIONS FOLLOWED.

Dodge et al. v. *U. S.*, decided April 4, 1927, by the Court of Claims [T. D. 4077, page 146], and *Routzahn* v. *Mason* (13 Fed. (2d), 702 (T. D. 3902 [C. B. V-2, 137])) 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 District Court, Eastern District of Michigan, Southern Division, in the case of *Alice G. Kales* v. *Woodworth, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 30, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

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UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF MICHIGAN, SOUTHERN DIVISION—NO. 7031, JUNE 18, 1927.

Alice G. Kales v. *Woodworth, Collector.*

[June 20, 1927.]

OPINION.

SIMONS, District Judge: This is a suit brought to recover income taxes paid under protest. Special findings of fact have been made upon request of counsel, and it is sufficient for the purpose of this opinion to briefly summarize them.

The plaintiff was from 1916 to 1919 a stockholder in the Ford Motor Co., a Michigan corporation. The taxes assessed against her by the Government, paid under protest, and now sought to be recovered, arise out of two cash dividends paid to the plaintiff by the company. The first dividend was the plaintiff's distributive share of the so-called "Dodge" dividend, paid to her July 10, 1919, and the second dividend, one paid to the plaintiff in January, 1917. With respect to the Dodge dividend, its history may be briefly stated as follows:

The Ford Motor Co. had in its treasury at the close of the fiscal year ending July 31, 1916, a large cash surplus. John and Horace Dodge, stockholders of

the company, demanded that a portion of this surplus be distributed as dividends, in addition to the regular dividend. The directors refused the demand, and the Dodges brought suit in equity to compel distribution. The circuit court for the county of Wayne and the Supreme Court of Michigan, upon review of the circuit judge's decree, held that the action of the directors in refusing to make the distribution was arbitrary and exceeded their discretion, and ordered them to make distribution of 50 per cent of the said cash surplus, with interest from December 5, 1917, the date of the circuit court's decree. The directors on July 10, 1919, made the distribution as ordered, and dividend was paid to and received by the plaintiff on that day. Plaintiff thereupon filed an amended 1917 return, including her portion of the Dodge dividend, and paid an additional tax thereon at 1916 rates. The reassessment made by the Commissioner of Internal Revenue was upon the theory that the Dodge dividend was 1919 income, taxable at 1919 rates. The second item of dividend involved in this controversy was paid to the plaintiff on January 19, 1917. It was included by the plaintiff in her report filed in June, 1918, and the tax paid thereon computed at 1916 rates. The Government assessed an additional tax upon this dividend, upon the theory that 68 per cent of it was payable out of undivided profits or surplus accumulated during the first 18 days of the year 1917, and should be taxed at the 1917 instead of the 1916 rate. This added tax was also paid by the plaintiff under protest, and the plaintiff having exhausted all her proper remedies in proceedings before the Department for refund in respect to the added taxes upon both dividends, now sues to recover them. It is conceded that all proper steps were taken preliminary to the filing of this suit, as are required by law, that the suit is properly brought, and that the court has jurisdiction. Disputed issues both of fact and law were submitted to the court without a jury, and the court is asked to make findings of fact and to apply its conclusions of law.

The first and more important aspect of the controversy relates to the Dodge dividend. It was declared on July 10, 1919, and paid to and received by the plaintiff on or about the same day. The statute in force upon the date of the declaration, payment, and receipt of the Dodge dividend was the 1918 Act, effective January 1, 1918. Section 213 of the Act provided that all gains, profits, and income derived from dividends shall be included in the gross income for the taxable year in which received by the taxpayer. The statute in this respect is clear and unambiguous, and the Dodge dividend must be considered as part of the plaintiff's 1919 income, unless, as claimed by the plaintiff, that dividend had acquired a different status by reason of the holdings of the Circuit and Supreme Courts of Michigan in the Dodge litigation, and the consequent necessity of applying to those dividends the statute applicable at the time the dividend was ordered paid, or should have been paid.

It is contended, first, upon behalf of the plaintiff that the Dodge dividend should have been taxed as 1916 income, at 1916 rates. It is difficult to see how such contention can be given serious consideration. There was no receipt by the plaintiff of dividend in 1916, there was no declaration of dividend by the corporation, and there was no order entered by any court directing that such dividend be declared. Reliance is placed upon the fact that a temporary injunction issued out of the circuit court for the county of Wayne, which it is claimed impounded the surplus then in possession of the Ford Motor Co. for the purpose of paying a dividend in the event that such dividend should thereafter be ordered by the court to be paid by the company. Even were it to be considered that the impounding of a sum out of which dividends were later declared and paid would in some way make of such dividends income of the taxpayer as between the taxpayer and the Government, reference to the terms of the temporary injunction issued by the circuit court makes it clear that there was no such impounding of any surplus in the hands of the Ford Motor Co. as is claimed by the plaintiff. The extent to which the temporary injunction of the circuit court went was the restraining during the pendency of the suit, and until the further order of the court, the use or appropriation of the accumulated cash profits on hand for the establishment of a smelting plant by the Ford Motor Co., an enterprise which was claimed by the plaintiffs in that suit to be ultra vires. No limitation on the right of the Ford Motor Co. to use its cash surplus in the regular course of business was imposed by the court. It is conceivable that had the period following 1916 been a disastrous one in the automobile business, that the Ford Motor Co. might have used its available cash to pay losses, or availed itself of such surplus for working capital. Certainly nothing in the court's injunction forbade such use of cash surplus.

It is next urged that the Dodge dividend, if not taxed as 1916 income, must be treated as 1917 income, and taxed at 1916 rates. In the Dodge suit against the Ford Motor Co. the Wayne County circuit judge entered a decree December 5, 1917. By the terms of the decree the directors of the Ford Motor Co. were ordered to declare a dividend in an amount equal to one-half of and payable out of the accumulated cash surplus of the company on hand at the close of the fiscal year ending July 31, 1916. Upon appeal from the decree of the circuit court, the Supreme Court of the State of Michigan, *Dodge* v. *Ford Motor Co.* (204 Mich., 459), affirmed so much of the decree of the lower court as directed the distribution of dividends, and ordered the payment of interest upon such dividends at the legal rate from the date of the decree of the lower court. Upon the date of the decree of the Wayne County Circuit Court on December 5, 1917, the income tax law in force was the Act of 1917. This statute, like its predecessor, the Act of 1916, provided for the taxation of dividends. It defined (section 31 (a)) dividends as any distribution made or *ordered to be made by a corporation.* It is now contended that the mandate of the decree was such an ordering of distribution of dividends to be made by the Ford Motor Co. as to bring such ordered distribution within the definition of dividends both in the 1916 and 1917 statutes; that the Dodge dividend having been ordered declared by competent authority in 1917, out of the 1916 surplus, that the dividend thereby became the income of the taxpayer if not in 1916 at least in 1917. It is urged that the ordering of the dividend by a court to be made by a corporation is tantamount to the declaration of the dividend by the corporation, and that the order of the court is a higher and more potent order than a declaration by the corporation itself when the court assumes to supersede the directors of the corporation; that the language of the statute is not limited in its express terms to the declaration of a dividend by the board of directors, but is broad enough and was undoubtedly intended to cover any distribution of profits which a corporation might be lawfully ordered to make.

The argument is plausible and ingenious. It is not convincing. Clearly the Congress must have had in mind, by the language "distribution made or ordered to be made," the usual and ordinary method of distribution which follows the declaration of a dividend by a corporation, which is at once distributed by the officers of the corporation, or which ordered by resolution of directors to be distributed by such officers is to be distributed at some future time. In the ordinary course of events the actual payment of dividends follows immediately or within a reasonable time the order of the corporation that they be distributed. It is more logical to assume that Congress intended to reach the distribution actually made or ordered to be made in the usual way, and not the unusual and extraordinary situation that results from a dividend ordered by a court to be made by a corporation after a period of more or less extended litigation.

I am not able to see the force in this connection of the plaintiff's argument that if there is any ambiguity in the language of the statute in relation to dividends ordered to be made by a corporation, that resort must be had to the rule that the statute will be construed in favor of the taxpayer and most strongly against the Government. We are dealing now with the 1917 statute. There is no ambiguity in the 1918 law, under which the tax was assessed and paid. The status of the Dodge dividend as 1917 income is asserted on authority of the 1917 statute. In other words, if the dividend is not 1918 income, it must be income that was taxable, and could have been taxed by the Government under the 1917 statute. If there is ambiguity in the 1917 statute, and it is claimed there is, and if the rule contended for is applied, it is applied to the 1917 statute and not to the 1918 Act. So applied, the dividend could not have been taxed as 1917 income under the Act in force at the date of the decree, and if not taxable under the 1917 statute, the result is inevitable, that it must be taxable under the 1918 statute, as of the date when it was received by the taxpayer.

Other considerations, however, are applicable to this situation. Section 31(b) of the Act of 1917 provides that any distribution made to the shareholders or members of a corporation in 1917 or subsequent tax year shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received. The 1918 law contains a similar provision, section 201(e) (F par. 3102), amended in such respects as are not here material. The language of the 1917 Act received careful consideration

and was given clear interpretation by the Supreme Court in the case of *Edwards* v. *Douglas* (269 U. S., 204 (5 Am. Fed. Tax Rep., 5666) [T. D. 3797, C. B. V–1, 158]). It will be observed that this case construed a statute which defined dividends as distributions made or ordered to be made by a corporation. The court, discussing the history of the statute and the purpose of the Congress with respect to the presumption incorporated in section 31(b), considered that it was essential that every declaration of the corporation should be disregarded and that the dividends should not be deemed to have been paid from the profits of the earliest year, of which there remained accumulated profits available for distribution, but that the dividends shall be deemed to have been paid out of the available profits or earnings of the most recent year or years, and the court held that its intention so to provide was adequately expressed by the use of the phrase "most recently accumulated" in connection with the words "undivided profits or surplus."

Following the decision of the Supreme Court in *Edwards* v. *Douglas*, supra, came the reversal by the Circuit Court of Appeals of the Sixth Circuit of the decision of the Northern District Court of Ohio, in *Mason* v. *Routzahn, Collector* (8 Fed. (2d), 56 (5 Am. Fed. Tax Rep., 5592), a decision greatly relied upon by the plaintiff, the opinion of the circuit court of appeals being found under the title *Routzahn* v. *Mason* in 13 Fed. (2d), 702 (5 Am. Fed. Tax Rep., 6107). There the court of appeals, in discussing dividends as income, declared:

"That, as between the stockholder and the corporation and from many points of view, such a declaration is a distribution of profits, is indisputable; but this is a taxing statute, the dominant thought of which is that the citizen should suffer an annual burden upon his annual current income. 'Distribution' must mean a disposition which at that moment results in income, because to ascertain taxable income is the purpose and subject matter of the Act, and a dividend declared this year, payable in the next or some more distant year, is not within the normal conception of income for this year. Though the legal duty to pay is fixed by such a declaration, it is commonly recognized that actual and prompt payment is contingent upon the continuance of expected conditions."

It will again be observed that in the Mason case, as well as in *Douglas* v. *Edwards*, supra, the statute construed was the 1917 statute, which defined dividends as any distribution made or ordered to be made by a corporation, and it will also be observed that in both cases dividends had actually been declared by the corporation in 1916, but were not paid until 1917. In view of the reversal of the district court in the Mason case, the decision in *Phillips* v. *United States*, decided by the District Court of the Western District of Pennsylvania in January, 1926, in which the district judge relied upon the opinion of the lower court in the Mason case, loses its force as authority for the proposition that dividends become income when declared and not when distributed.

The fundamental error in the plaintiff's position seems to me to be based upon a confusion of definitions as between dividends and income. Certainly as between the stockholders of the Ford Motor Co. and the corporation, the rights of the stockholders were settled by the final decree of the circuit court of the county of Wayne in so far as it was affirmed by the Supreme Court of the State of Michigan. This court has no power to review the findings of the State court in that respect, and does not do so. The obligation of the Ford Motor Co. to its stockholders was fixed as of a certain date. The Dodge dividend, however, did not become the income of the stockholder until the decree of the State court became effective, and it is immaterial whether we say the decree became effective when they were entered or whether we say they became effective when the Ford Motor Co. directors, observing the mandates of the decree, made the distribution of dividends, for until the Dodge dividend was distributed it was not income, the stockholders exercised no control or dominion over it, no part of it could have been used for the payment of taxes or for any other purpose, nor could it have been assessed and taxed prior to the effective date of the decree. Stress is laid upon the fact that the court in the Dodge case allowed interest from the date of the decree in the lower court, and also upon the fact that the Internal Revenue Department, upon request of the Ford Motor Co., construed this interest to be an expense of the company rather than a distribution of dividends. The adding of the interest to that portion of the Dodge dividend ordered by the court to be paid pro rata to the stockholders but emphasizes the fact that the distribution was not made

until the decree became effective. If the Ford directors, under the doctrine of constructive receipt, had become trustees for the plaintiff, it would be expected that they would be made chargeable with the interest rather than having interest made a charge upon the very surplus out of which the dividend itself was paid. To assert that the Government fixed the status of the Dodge dividend as income as of December 5, 1917, by a ruling that such interest was an expense of the Ford Motor Co. is to assert against the Government acting in its sovereign capacity the doctrine of equitable estoppel. That this doctrine is not applicable appears to be well settled.

Still another consideration may be helpful in understanding whether the Dodge dividend became income when distributed or whether it became income as of some prior date when, as the plaintiff claims, it ought to have been distributed. Could the Government have taxed the Dodge dividend at any time prior to 1919? That any effort the Government might have made to assess such dividends either in 1916 or 1917 could have been successfully resisted seems to me to be clear. In *Eisner* v. *Macomber* (252 U. S., 189 (3 Am. Fed. Tax Rep., 3029) [T. D. 3010, C. B. 3, 25]), the Supreme Court discussed very fully and comprehensively the nature of income, and especially the nature of income that is permitted to be taxed without pro rata distribution under the authority of the sixteenth amendment.

"Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The Government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. '*Derived from capital*'—'the gain derived from *capital*,' etc. Here we have the essential matter; *not* a gain *accruing* to capital, not a *growth* or increment of value *in* the investment, but a gain, a profit, something of exchangeable value *proceeding from* the *property, severed from* the capital however invested or employed, and *coming in*, being '*derived*,' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit, and disposal; *that* is income derived from property. Nothing else answers the description."

It may be suggested, though it is not necessary as a basis for decision, that under the reasoning of the case of *Eisner* v. *Macomber*, that the definition of income in the 1916 and 1917 laws, as including dividends paid or *ordered to be paid*, might have been successfully attacked on constitutional grounds had the Government in a proper case attempted to tax dividends declared in one year and ordered to be paid in some other year as of the date of declaration. It is not without importance to note that during the many years that income tax legislation, and especially proportional income tax legislation, was under consideration, it was urged by economists and taxation experts too numerous to quote that a proportional income tax more adequately than did any other tax measured the ability of the taxpayer to pay. Some such thought was undoubtedly in the mind of Mr. Justice Pitney in writing the opinion in the Eisner case, when on page 213 of the opinion he said:

"Yet without selling, the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the dividend stock. Nothing could more clearly show that to tax a stock dividend is to tax a capital increase and not income than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax."

Is this reasoning not just as applicable to dividends which were not distributed, though perhaps they ought to have been distributed, as it is to stock dividends? Such undistributed dividends are of no avail to the taxpayer, either for the purpose of paying the tax or for any other purpose, and so do not constitute income.

Nor is the plaintiff aided in her position by the asserted doctrine of constructive receipt of income. There was in the instant case no such constructive receipt of the Dodge dividend until the date of the supreme court's decree; no control at any time could have been exercised by the plaintiff over her distributive share of the corporation's surplus and undivided profits. Nor is there merit in the contention that the Government may not tax the Dodge dividend as income of 1919 for the reason that by doing so the Government would be in a position of profiting by the fraud of the directors of the Ford Motor Co. The Government was no party to such fraud, nor can the doctrine of equitable estoppel be invoked against it acting in its sovereign capacity. Finally, the

status of the Dodge dividend was since the trial and argument of the instant case submitted to the Court of Claims upon substantially the same state of facts, and based largely upon the same line of reasoning. In the case of *Matilda R. Dodge et al.* v. *United States*, decided April 4, 1927 (par. 1791), it was there held that the gains or profits from the Dodge dividend were actually received in 1919, and were taxable in that year. While the discussion here has taken a somewhat different course from that in the above case, the conclusion reached is the same.

There remains now only to be considered the assessment made upon the special dividend paid to the plaintiff in January, 1927. Eighteen days of the current calendar year had elapsed when this dividend was paid. There had been no ascertainment of surplus or undivided profits of the corporation for that period.

The Government allocated 68 per cent of this dividend to the current profits for 1917, and taxed that portion of the dividend at 1917 rates, the balance being taxed at 1916 rates. It is now claimed by the plaintiff that all of the dividend should have been taxed at 1916 rates. It is the plaintiff's contention that no profits having been ascertained at the time the dividend was paid, no part of the dividend should be allocated to the profits or surplus made during 1917. The record discloses that profits were made in 1917 sufficient to pay the aliquot part of the 1917 special dividend. In view of this state of facts, I am foreclosed by controlling authority from arriving at any other conclusion with respect to the January, 1917, dividend than that it was properly assessed. The Circuit Court of Appeals for the Sixth Circuit, in *Routzahn* v. *Mason*, supra, in interpreting *Douglas* v. *Edwards*, supra, considered that it is not unreasonable to suppose that the most recently accumulated profits are to be judged from the end of the fiscal year during which the income was received, and that no other construction will furnish a common yardstick by which the tax can be measured in all cases. Guided by this authority, as I must be, I am constrained to hold that the tax upon the special dividend of January, 1917, was also properly assessed.

In view of the foregoing, it follows that judgment must be entered in favor of the defendant and as against the plaintiff of no cause of action, with costs to be taxed against the plaintiff.

SECTION 202.—BASIS FOR DETERMINING GAIN OR LOSS.

ARTICLE 1561: Basis for determining gain or loss from sale. VI-29-3315 G. C. M. 1345A
(Also Section 214(a)10, Article 220.)

REVENUE ACT OF 1921.

A transfer of assets between affiliated corporations effected during years for which consolidated income tax returns were required is productive of neither taxable gain nor deductible loss in computing the consolidated net income of the affiliated group. In subsequent transactions the basis upon which possible gain or allowable deductions shall be computed is the same in the hands of the transferee as it was in the hands of the transferor.

To the extent that the intercompany transferor of a natural resource deposit would have been entitled to depletion on the basis of discoveries previously made discovery depletion should be allowed to the intercompany transferee.

An opinion is requested as to the basis for depletion and gain or loss on subsequent disposition of certain assets acquired by the M Company (the taxpayer) in ——, 1920, from the N Company. Both companies were subsidiaries of the O Company and the three corporations were affiliated at the time of the transaction.

In 1920 the O Company owned 100 per cent of the capital stock of the N Company, and the latter owned certain oil properties. The O

Company devised a plan for separating the oil properties of the N Company from its other assets. As described in the minutes of the meeting of the executive committee held ——, 1920, the plan involved the following features: (1) To organize a corporation with a capital stock of —— shares of no par value to be purchased by the O Company at x dollars per share; (2) to transfer to the N Company the stock of the R Company held by the O Company, consisting of —— shares; (3) to have the N Company convey all of its oil-bearing lands in the State of S, consisting of about —— acres, and the R Company stock to the newly organized corporation for the following: (*a*) —— dollars in cash; (*b*) a fuel oil supply contract between the new corporation and the O Company; and (*c*) an agreement on the part of the new company to purchase the O Company's holdings of R Company bonds at par and interest, at the rate of —— dollars face value each year; (4) to offer at x dollars per share to the holders of the O Company stock of record on ——, 1921, one share of the new company's stock for each share of the O Company's stock owned by such stockholders, the offer to be accepted and payment made on or before ——, 1921.

On the recommendation of the executive committee the plan was adopted by the board of directors of the O Company.

On ——, 1920, the M Company was organized with a capital stock of —— shares of no par value. The O Company paid to the M Company the sum of —— dollars for all its capital stock. On ——, 1920, the N Company transferred its oil-bearing lands in the State of S and stock in the R Company to the M Company for the sum of —— dollars, the M Company retaining —— dollars as working capital. The transfer of the oil lands was subject to a number of exceptions and reservations for existing and future rights of way for railroads, pipe lines, and other installations, together with necessary land for the operating facilities of the grantor.

Under date of ——, 1920, the M Company entered into a fuel oil contract, reciting that it was entered into by the M Company as part consideration for the conveyance to it by the N Company of —— shares of stock in the R Company and of its oil-bearing lands in the State of S. By this agreement the O Company assured itself of a supply of fuel oil for itself and its subsidiaries for a period of —— years. The bond purchase agreement, dated ——, 1920, likewise recited that it was entered into as part consideration for the conveyance to the oil company of the properties of the N Company. This contract did not obligate the O Company to sell the bonds, and thus constituted essentially a guarantee against loss occasioned by a possible decline in value of the bonds held by the O Company.

The transfer of the property from the N Company to the M Company apparently took place on ——, 1920, but was subject to the provision that all earnings of the land were to be retained and all expenses of operation were to be borne by the N Company up to midnight of December 31, 1920.

The M Company continued to operate as a 100 per cent owned subsidiary of the O Company during January and February of 1921. The M Company's stock was distributed by the O Company to its stockholders on ——, 1921. The affiliation then ceased and thereafter the M Company operated as an independent corporation.

The taxpayer contends that the basis for depletion should be the value of the assets as of ——, 1920, the date of acquisition by the M Company, irrespective of the basis for depletion allowed to the N Company, and irrespective of the amount which the M Company paid for the property. It is stated that the assets were transferred to the M Company for a sum far below their real value and that the difference between the actual value of the property at the time of transfer and the amount paid for it constituted a gift from the N Company to the M Company. The taxpayer urges the pertinency of section 202(a)2 of the Revenue Act of 1921 and section 204(a)4 of the Revenue Acts of 1924 and 1926, which provide that in the case of property acquired by gift on or before December 31, 1920, the basis for ascertaining gain or loss from a sale or other disposition thereof shall be the fair market price or value of such property at the time of such acquisition. Section 204(c) of the 1924 and 1926 Acts confirms, the taxpayer states, the rulings of the Bureau under the 1921 Act that the basis for depletion was the same as that for the computation of gain or loss.

The taxpayer's contention for a new basis according to the fair market value of the assets as of the date of acquisition by the M Company rests on the assumption that the difference between the value of the assets transferred and the sum of —— dollars constituted a gift. In stressing the difference in value between the property transferred and the —— dollars, the taxpayer omits consideration of the reservations contained in the deed, the fuel-oil contract, and the bond-purchase contract.

In determining the nature of the transaction it is unnecessary, however, to distinguish between its probable character as a gift or as a sale. The transaction constituted but a rearrangement of assets within a single affiliated group. The transfer of the assets from the N Company to the M Company was an intercompany transaction and the amount, if any, of consideration passing between the two subsidiaries can have no effect on the basis of the assets in the hands of the transferee for the purpose of depletion.

A transfer of assets between members of an affiliated group effected during years for which consolidated income tax returns were required, an intercompany transaction, is productive of neither taxable gain nor deductible loss in computing the net income of the affiliated group. Nothing has come into or gone out from the group whose income is to be computed as a unit. Neither taxable gain nor deductible loss is imputed to the parties to the transfer nor to the group. Any gain to be realized and taxed to the group with respect to the property involved must arise in connection with a subsequent transfer from the group. Any deductible loss to be recognized and allowed for the benefit of the group with respect to that property must be sustained as an incident to subsequent dealings in the property which do not constitute intercompany transactions. Since the gain, if any, ultimately to be realized and taxed to the group, as well as any deductions allowable to the group, arises only in connection with subsequent transactions, it must follow that the basis upon which such possible gain or allowable deductions shall be computed is the same in the hands of the tranferee member as it was in the hands of the transferor member of the group. An intercompany

transaction, productive neither of taxable gain nor deductible loss, is not productive of a new or independent basis for the computation of gain or loss on subsequent sale or other disposition.

An intercompany transfer of a natural resource deposit, a transaction productive of neither gain nor loss to the group nor of a new basis for computing gain or loss, does not operate to destroy the discovery value basis for depletion available to the transferor member for the benefit of the group. Depletion allowance to the group in connection with property held by the transferee should be computed upon that basis which would have been conceded to and recognized in the transferor had the intercompany transaction never been consummated. To the extent that the intercompany transferor would have been entitled to depletion on the basis of discoveries previously made, discovery depletion should be allowed to the intercompany transferee.

The M Company stock was distributed on ——, 1921, among the stockholders of the O Company. Of whatever characteristics that transaction may partake, it had no effect upon the assets of the M Company nor upon their basis previously established. A subsequent breaking up of affiliation can not alter consequences fixed as a result of a transfer of assets consummated while the affiliation existed. That the affiliation lasted but two months after the transfer was so consummated can not affect its substantial nature as an intercompany transaction.

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

ARTICLE 1561: Basis for determining gain or loss from sale. VI-30-3335 T. D. 4046

INCOME TAX—REVENUE ACT OF 1917—DECISION OF SUPREME COURT.

1. OIL OR MINING PROPERTIES—GAIN OR LOSS BASIS—DEPLETION—DEPRECIATION.

In determining the gain or loss from the sale of oil or mining properties, the basis is required to be diminished by the aggregate depreciation or depletion to which the taxpayer was entitled since the date of acquisition of the property or March 1, 1913, as the case may be.

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 *United States, petitioner*, v. *Charles A. Ludey* is published for the information of internal revenue officers and others concerned.

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

Approved July 18, 1927.

Carl T. Schuneman,
Acting Secretary of the Treasury.

SUPREME COURT OF THE UNITED STATES.

United States, petitioner, v. *Charles A. Ludey.*

[May 16, 1927.]

Mr. Justice BRANDEIS delivered the opinion of the court.

Ludey brought this suit in the Court of Claims to recover an amount exacted as additional taxes for 1917, under the income and excess profits provisions of the Revenue Act of 1916, September 8, 1916 (ch. 463, Title I, 39 Stat., 756, 757–759), as amended by the Revenue Act of 1917, October 3, 1917 (ch. 63, 40 Stat., 300, 329). The tax was assessed on the alleged gain from a sale in 1917 of oil mining properties which had been owned and operated by him for several years. The Commissioner of Internal Revenue determined that there was a gain on the sale of $26,904.15. Ludey insists that there was a loss of $14,777.33. The amount sued for is the tax assessed on the difference. Whether there was the gain or the loss depends primarily upon whether deductions for depletion and depreciation are to be made from the original cost in determining gain or loss on sale of oil mining properties. The question is one of statutory construction or application. The Court of Claims entered judgment for the plaintiff. (61 Ct. Cls., 126.) This court granted a writ of certiorari. (271 U. S., 651.)

The properties consisted, besides mining equipment, in part of oil land held in fee, in part of oil mining leases. The aggregate original cost of the properties was $95,977.33. Of this amount, $30,977.33 was the cost of the equipment used in the business; $65,000 the cost of the oil reserves. The 1917 sale price was $81,200. For the purpose of determining the cost of the properties sold in 1917 the Commissioner deducted from the original cost $10,465.16 on account of depreciation of the equipment through wear and tear and $32,258.81 on account of depletion of the reserves through the taking out of oil by the plaintiff after March 1, 1913. There was no dispute of fact concerning the correctness of the estimates upon which these deductions were made. The finding of the depletion was in accordance with the method of computation employed by the Bureau of Internal Revenue; and there was no objection specifically to the method of computation. But Ludey insisted that the amount of depletion, if any, could not be found or stated as a fact, since, in the nature of the case, it was impossible to determine how much oil was recoverable either when he acquired the properties or when he disposed of them. The finding of the depreciation was, likewise, in accordance with the method of computation employed by the Bureau; and there was no objection to the method of computation. But Ludey insisted also in respect to depreciation that the property was, as a matter of law, unchanged in character and quantity throughout the period of operation.

Until 1924, none of the Revenue Acts provided in terms that, in computing the gain from a sale of any property, a deduction shall be made from the original cost on account of depreciation and depletion during the period of operation. But ever since March 1, 1913, the Revenue Acts have required that gains from sales made within the tax year shall be included in the taxable income of the year, and that losses on sales may be deducted from gross income. And each of the Acts has provided that, in computing the taxable income derived from operating a mine, there may be made a deduction from the gross income for the depreciation and that some deduction may be made for depletion. The applicable provisions of section 5(a) of the Revenue Act of 1916 concerning deductions to be allowed in computing net income are these:

"Fourth. Losses actually sustained during the year, incurred in his business or trade * * * *Provided*, That * * * the * * * value of * * * property (acquired before March 1, 1913) as of March 1, 1913, shall be the basis for determining the amount of such loss * * *.

"Seventh. A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade * * *.

"Eighth. (a) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production * * * (b) in the case of mines a reasonable allowance for depletion thereof * * *: *Provided*, That when the allowances * * * shall equal the capital originally invested * * * no further allowance shall be made."

Ludey does not deny that Congress has power to require that deductions for depreciation and depletion shall be made from the original cost when determin-

ing the cost of oil properties sold. His contention is that, at the time of the sale in question, Congress had not in terms required the deductions in the case of any property and that special reasons exist why the acts should be construed as not requiring the deductions in the case of oil wells. He urges that a corporation organized for the purpose of utilizing a wasting property, like an iron mine, is not deemed to have divided a part of its capital merely because it has distributed the net proceeds of its mining operations; that this is true even where the necessary result of the operation is a reduction of the mineral reserve; that, *a fortiori*, the proceeds of oil mining are to be deemed income, not a partial return of capital, since there is no ownership in oil until it is actually reduced to possession; that a purchase of an oil reserve can not be likened to the purchase of a certain number of barrels of oil; that an oil reserve is not a reservoir; that Congress allowed the deduction from gross income for depreciation and depletion probably as a reward in an extrahazardous enterprise in order to encourage new producing properties; and that to allow the deductions would result, in the event of a sale of the property, in taking back the rewards so offered.

The Government contends that in operating the properties Ludey disposed, in the form of oil, of part of his capital assets; that in the extraction of the oil he consumed so much of the equipment as was represented by the depreciation and disposed of so much of the oil reserves as was represented by the depletion; that the sale of the properties made by him in 1917 was not a sale of all of the property represented by the original cost of $95,977.33, since physical equipment to the amount of the depreciation and oil reserves to the amount of the depletion had been taken from it during the preceding years; and that, for this reason, the cost to plaintiff of the net property sold in 1917 was not $95,977.33, but $53,258.36.

The Court of Claims did not consider whether ordinarily deductions for depreciation and for depletion from the original cost would be proper in determining whether there had been a profit on a sale of property. It held that no deduction from original cost should be made here because of the nature of oil mining properties. The deduction for depletion was, in its opinion, wrong, because oil properties are in essence merely the right to extract from controlled land such oil as the owner of the right can find and reduce to possession; because the existence of oil in any parcel of land is dependent upon the movement which the oil makes from time to time under the surface; and because whether there is oil in place which can be reduced to possession, and if so, how much, can not be definitely determined. It held that, in the case at bar, the right to explore for and take out oil may actually have been more valuable at the time of the sale than at the time of the purchase; and that, for this reason, the removal of the oil by plaintiff during the years of operation can not be said to have depleted the capital. It held that the depreciation was not deductible, because wear and tear of equipment was an expense or incident of the business.

We are of opinion that the Revenue Acts should be construed as requiring deductions for both depreciation and depletion when determining the original cost of oil properties sold. Congress, in providing that the basis for determining gain or loss should be the cost or the 1913 value, was not attempting to provide an exclusive formula for the computation. The depreciation charge permitted as a deduction from the gross income in determining the taxable income of a business for any year represents the reduction, during the year, of the capital assets through wear and tear of the plant used. The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sum set aside will (with the salvage value) suffice to provide an amount equal to the original cost. The theory underlying this allowance for depreciation is that by using up the plant a gradual sale is made of it. The depreciation charged is the measure of the cost of the part which has been sold. When the plant is disposed of after years of use, the thing then sold is not the whole thing originally acquired. The amount of the depreciation must be deducted from the original cost of the whole in order to determine the cost of that disposed of in the final sale of properties. Any other construction would permit a double deduction for the loss of the same capital assets.

Such being the rule applicable to manufacturing and mercantile businesses, no good reason appears why the business of mining should be treated differently. The reasons urged for refusing to apply the rule specifically to oil

mining properties seem to us unsound. If the equipment had been used by its owner on the oil properties owned by another, it would hardly be contended that the depreciation through wear and tear resulting from its use should be ignored in determining, on a sale of the equipment, whether its owner had made a gain or a loss. The fact that the equipment sold is owned by the person who owned the mining rights, like the fact that it is used in one class of mining rather than in another, may have an important bearing both upon the price realized on the sale and upon the rate of depreciation which should be allowed; but these facts can not affect the question whether the part which has been theretofore consumed by use shall be ignored in determining whether a sale of what remains has resulted in a loss or a gain.

The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed. The fact that the reserve is hidden from sight presents difficulties in making an estimate of the amount of the deposits. The actual quantity can rarely be measured. It must be approximated. And because the quantity originally in the reserve is not actually known the percentage of the whole withdrawn in any year, and hence the appropriate depletion charge, is necessarily a rough estimate. But Congress concluded, in the light of experience, that it was better to act upon a rough estimate than to ignore the fact of depletion.

The corporation tax law of 1909 had failed to provide for any deduction on account of the depletion of mineral reserves. (*Stratton's Independence* v. *Howbert*, 231 U. S., 399; *von Baumbach* v. *Sargent Land Co.*, 242 U. S., 503; *United States* v. *Biwabik Mining Co.*, 247 U. S., 116; *Goldfield Consolidated Mines Co.* v. *Scott*, 247 U. S., 126.) The resulting hardship to operators of mines induced Congress to make provision in the revenue law of 1913 and all later Acts for some deduction on account of depletion in determining the amount of the taxable income from mines. It is not lightly to be assumed that Congress intended the fact to be ignored in determining whether there was a loss or a gain on a sale of the mining properties. The proviso limiting the amount of the deduction for depletion to the amount of the capital invested shows that the deduction is to be regarded as a return of capital, not as a special bonus for enterprise and willingness to assume risks. It is argued that, because oil is a fugacious mineral, it can not be known that the reserve has been diminished by the operation of wells. Perhaps some land may be discovered which, like the Widow's cruse, will afford an inexhaustible supply of oil. But the common experience of man has been that oil wells, and the territory in which they are sunk, become exhausted in time. Congress in providing for the deduction for depletion of oil wells acted on that experience. Compare *Lynch* v. *Alworth-Stephens Co.* (267 U. S., 364). In essence, the deduction for depletion does not differ from the deduction for depreciation.

The Court of Claims erred in holding that no deduction should be made from the original cost on account of depreciation and depletion; but it does not follow that the amount deducted by the Commissioner was the correct one. The aggregate for depreciation and depletion claimed by Ludey in the income tax returns for the years 1913, 1914, 1915, and 1916, and allowed, was only $5,156. He insists that more can not be deducted from the original cost in making the return for 1917. The contention is unsound. The amount of the gain on the sale is not dependent on the amount claimed in earlier years. If in any year he has failed to claim, or has been denied, the amount to which he was entitled, rectification of the error must be sought through a review of the action of the Bureau for that year. He can not choose the year in which he will take a reduction. On the other hand, we can not accept the Government's contention that the full amount of depreciation and depletion sustained, whether allowable by law as a deduction from gross income in past years or not, must be deducted from cost in ascertaining gain or loss. Congress doubtless intended that the deduction to be made from the original cost should be the aggregate amount which the taxpayer was entitled to deduct in the several years.

The findings do not enable us to determine what that aggregate is. The sale included several properties purchased at different times. The deduction allow-

able in the several years for each of the properties is not found. Under the Act of 1913 the full amount of the depletion was not necessarily deductible. In order that the amount of the gain in 1917 may be determined in the light of such facts, the case is remanded for further proceedings in accordance with this opinion.

ARTICLE 1561: Basis for determining gain or loss from sale. VI-37-3423 T. D. 4087

INCOME TAX—REVENUE ACTS OF 1918 AND 1921—DECISION OF COURT.

1. GAIN OR LOSS—DEPRECIATION.

In the determination of the amount of gain or loss from the sale of buildings the cost or other basis must be decreased on account of depreciation.

2. DEDUCTIONS—PREMIUMS ON LIFE INSURANCE POLICY.

Deductions in respect of premiums paid on a policy of insurance covering the life of a taxpayer whose estate is the beneficiary are inhibited by section 215(d) of the Revenue Act of 1918 and section 215(a)4 of the Revenue Act of 1921, notwithstanding such policy may have been assigned to a bank as security for a business loan.

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 *Rieck* v. *Heiner, Collector*, is published for the information of internal revenue officers and others concerned.

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

Approved August 31, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

UNITED STATES DISTRICT COURT, WESTERN DISTRICT OF PENNSYLVANIA.—LAW No. 3555.

Rieck v. *Heiner, Collector.*

[April 20, 1927.]

OPINION.

SCHOONMAKER, Judge: This is an action at law to recover additional income taxes for the years 1920 and 1921 assessed against the plaintiff by the Commissioner of Internal Revenue and paid by the plaintiff under protest. These taxes grew out of additional assessments made by the Commissioner owing to his recomputation of plaintiff's returned profit on the sales of certain real estate and the disallowance of life insurance premiums paid by plaintiff and claimed by him as allowable deductions from his taxable income. A jury trial was waived and a stipulation of certain agreed facts was filed.

In addition to the facts agreed upon, the plaintiff sought to show by the testimony of certain witnesses that there was no basis in fact for the depreciation deducted by the Commissioner from the cost or fair value of the real estate on March 1, 1913, involved, because there had been no depreciation in the buildings upon the real estate. The proof failed in this particular, and we find that the buildings upon this real estate were subject to depreciation according to the ordinary rule adopted by the Commissioner under the regulations,

i. e., 2 per cent per annum from the cost or fair value thereof on March 1, 1913. We therefore find the facts of this case to be as shown in the stipulation of agreed facts. Briefly stated, these are: The plaintiff sold certain real estate in the years 1920 and 1921, and in his income tax returns for those years accounted for the profit or loss on those transactions by deducting from the cost price or fair value thereof on March 1, 1913, a certain depreciation from the value of the building (which was much less than the depreciation figured according to the 2 per cent per annum rule used under the regulations), and then taking the difference between that result and the sale price as the profit or loss on the real estate sold. The Commissioner deducted from the cost or fair value on March 1, 1913, of this real estate depreciation figured at the rate of 2 per centum per annum, and then took the difference between that result and the sale price, thereby increasing the taxable income of the plaintiff for the two years in question as follows: For the year 1920 by $940; for the year 1921 by $2,282.50.

In the year 1920 the plaintiff deducted from his taxable income $8,278.40 paid by him as an insurance premium on a certain policy of insurance in the Mutual Life Insurance Co. issued August 20, 1920, upon the life of the plaintiff under the ordinary life plan and payable to his estate, which policy was on December 3, 1920, assigned by the plaintiff to the Diamond National Bank of Pittsburgh as collateral security for the plaintiff's loan at this bank. This policy was taken out and assigned to the bank at its request and was released and reassigned by the bank to the plaintiff on December 24, 1924. In the year 1921 the plaintiff likewise deducted from his taxable income the premiums paid on this policy in the sum of $6,914.70. Both of these deductions were disallowed by the Commissioner and the taxable income of the plaintiff for these years was increased accordingly. The increased tax thus assessed against the plaintiff by the Commissioner was paid, with accrued interest, by the plaintiff under protest on July 27, 1926, as follows: For the year 1920, $4,889.44; and for the year 1921, $6,429.17.

On this state of facts we must find that the plaintiff can not recover and that judgment must be entered for the defendant.

As to the depreciation item, the plaintiff contends that it is not a proper element to be taken into consideration in the computation of profit or loss on the sale of real estate under the terms of the revenue statutes (Act of 1918, sec. 202(a), 202(a) 1, 2, 40 Stat. L., 1057, ch. 18, and Act of 1921, sec. 202(a), 202(b), 202(b)1, 202(b)2, 202(b)3, 42 Stat. L., 227, ch. 136). However, it will be noted that both of these statutes merely fix the cost or fair value on March 1, 1913, as the basis of the computation for ascertaining the gain or the loss. There is no provision that the gain or the loss shall be the difference between the cost or fair value on March 1, 1913, and the sale price. There is nothing in the section referred to which prevents the taking into consideration of all proper elements for the purpose of ascertaining the cost. Surely every proper factor that would go to make up the profit or the loss should be taken into account. The plaintiff himself in his sworn tax return recognized depreciation as a proper element to be considered in the computation of the gain or the loss. He thus admits the principle that depreciation is a proper factor to be considered, for he used it as one of the elements in computing his income tax liability for the years in question.

It is really not the fact of depreciation but the amount thereof that is involved in this suit, for the plaintiff is not seeking to recover the tax paid by him on his own computation as erroneously made. The testimony offered by the plaintiff on the subject of depreciation is clearly insufficient to take the buildings on the real estate involved out of the class of buildings subject to depreciation charges under the regulations. That buildings do decay and depreciate is a matter of common knowledge. The burden of proving it would be upon him who asserts that no decay or depreciation has taken place. However, the plaintiff finds no fault with the rule adopted by the Commissioner for figuring the amount of depreciation, if the buildings are subject to depreciation charges at all, but contents himself in asserting that no depreciation can be charged under the statute, and that, even if it could be legally charged, no depreciation accrued at all on the plaintiff's buildings because they were kept in a perfect state of repair. His construction of the statute is wrong. His testimony fails to show that the buildings were not subject to ordinary decay and depreciation.

The plaintiff cites case of *Ward* v. *Hopkins* (U. S. Dist. Court, Northern District of Texas, unreported); *Ludey* v. *U. S.* (U. S. Court of Claims, No. 360,

decided November 9, 1925) as supporting his construction of the statute. We must disagree with the reasoning of these cases. We hold that had Congress intended that the gain or loss was to be determined merely by taking the difference between the cost, or fair value on March 1, 1913, and the sale price, it would have so provided by proper words, and surely would not in that case have referred to the cost or fair value on March 1, 1913, as the basis of the computation, which can only mean that such cost or fair value is the primary figure in the computation of gain or loss. All proper elements that enter into the determination of the gain or loss must be considered. As an illustration, if after purchase on or after March 1, 1913, additions or improvements were made to buildings upon real estate, the cost of such addition or improvements is a proper factor to be considered. To interpret the statute as plaintiff requests us would deny to the taxpayer that very proper element in the computation of gain or loss.

The depreciation of buildings is a proper subject of annual deduction from the taxable income of taxpayers. To permit a taxpayer to take an annual deduction for depreciation to buildings and then not take into consideration that depreciation in the computation of gain or loss on sale of the property would be to give the taxpayer credit twice for that depreciation. The statute should not be construed to give the result unless its plain language demands such a construction. There are no words in the statute which require such a forced construction.

We coincide exactly with the views expressed by the United States Board of Tax Appeals in appeal of Even Realty Co. (vol. 1, U. S. Tax Rep. Appeals, p. 355). In that case the taxpayer took no account of depreciation to buildings on its real estate during its ownership and the Board held that in ascertaining loss or gain on the sale of this real estate due allowance must be made for exhaustion, wear and tear, and obsolescence of the building thereon during the period of ownership, whether or not deductions have been taken therefor in prior tax returns. In this case Commissioner Ivins, in discussing the statute, said:

"There is no ground for believing that Congress, in using the word 'basis' intended it to carry any other than its commonly accepted meaning. The New American Encyclopedic Dictionary defines 'basis' as follows:

"'A. Ordinary language:

"'I. Lit. of things which are or are assumed to be material: That on which anything rests or is supposed to rest; the lowest part of anything, as the foundation of a building, etc.

"'II. Of things immaterial: The fundamental principle, groundwork, or support of anything.'

"Webster's New International Dictionary says:

"'Basis: 1. The foundation of anything; that on which a thing rests; the base. * * * 4. The principal component part of a thing. 5. The groundwork; the first or fundamental principle; that which supports or sustains.'

"We have no hesitation in holding that Congress in using the word 'basis' meant nothing but 'starting point' or 'primary figure' in the computation of gain or loss, and had no intention of restricting that computation to a simple subtraction of the basis from the selling price or vice versa. It expected the computation to include all adjustments necessary to a logical ascertainment of gain or loss. The only reason for using the word at all was to take care of the different situations arising when the property disposed of had been acquired (a) before and (b) on or after March 1, 1913. It fixed the starting point or primary figure of computation in the respective cases, but did not attempt to define every step of the computation under varying circumstances. In some cases, as when a taxpayer buys a security for one price and sells it for another, a simple subtraction is all that is necessary to determine his gain or loss. But, in other cases, either the basis or the sale price must be adjusted before making the subtraction in order to have the difference truly represent the gain or loss."

As to the life insurance premiums, the plaintiff claims that they are properly deductible business expenses because the policy was assigned to a bank as collateral security for business loans, and that these premiums are not within the inhibitions either of the Revenue Act of 1918 or 1921.

Section 215(d) of the Act of 1918 and section 215(a)4 of the Act of 1921 contain the same restrictions, i. e.:

"That in computing net income, no deduction shall in any case be allowed in respect of—* * *

"(d) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy."

In the first place, life insurance premiums paid upon policies issued upon the life of a taxpayer are not, under the statute, proper items of business expense allowable as deductions from taxable income, even though the policy be made payable to the estate of the taxpayer. Such payments are rather in the nature of a speculative investment for the benefit of the taxpayer's estate, and are no more a business expense than would be a life investment in bonds which might later be assigned as collateral security for the taxpayer's debts. The fact that the policy is assigned to a bank as collateral security for the repayment of loans would not change the premiums paid to a business expense, nor change it back to an investment when the loan was paid off.

In addition, we are of the opinion that the premiums paid upon this policy upon plaintiff's life come within the inhibitions of the statute. The policy covers the life of a person financially interested in the plaintiff's business, i. e., the plaintiff himself. The plaintiff is directly or indirectly a beneficiary under the policy. It is payable to his estate. If he dies while the policy is up as collateral for debt, the insurance will go to the bank, thereby reducing the debt to the amount of the insurance and indirectly benefiting the taxpayer's estate. If the loan be repaid and the collateral be released, then the insurance would be directly paid to the taxpayer's estate and thereby become a direct benefit.

We, therefore, conclude on the whole case that the additional taxes assessed against the plaintiff were legally and properly assessed against him and may not be recovered back.

Let judgment be entered in favor of the defendant and against the plaintiff, with costs.

ARTICLE 1562: Sale of property acquired by gift after December 31, 1920. VI-34-3384 T. D. 4063

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

INCOME—GAIN—BASIS—GIFT AFTER DECEMBER 31, 1920—CONSTITUTIONALITY.

The provision of section 202(a)2 of the Revenue Act of 1921 that the basis for ascertaining the gain derived from a sale of property acquired by gift after December 31, 1920, shall be the same as that which it would have in the hands of the donor is not in violation of the Constitution.

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 cases of *Frank K. Bowers, Collector*, v. *Elizabeth C. Taft and Gilbert C. Greenway, jr.*, is published for the information of internal revenue officers and others concerned.

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

Approved August 12, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Frank K. Bowers, Collector of Internal Revenue for the Second District of the State of New York, plaintiff in error (defendant below), v. Elizabeth C. Taft, defendant in error (plaintiff below).

Frank K. Bowers, Collector of Internal Revenue for the Second District of the State of New York, plaintiff in error (defendant below), v. Gilbert C. Greenway, jr., defendant in error (plaintiff below).

Before MANTON, L. HAND, and SWAN, Circuit Judges.

Writ of error to the District Court for the Southern District of New York. Actions by Elizabeth C. Taft and Gilbert C. Greenway, jr., against Frank Bowers, collector of internal revenue, defendant, to recover for income taxes paid under protest. Judgments for plaintiffs; defendant appeals. Reversed.

MANTON, Circuit Judge: These cases were argued together and will be considered in one opinion. The defendant in error, Miss Taft, received a gift from her father of 150 shares of the common stock of the Nash Motors Co.; 100 shares in December, 1921, and 50 shares in March, 1922. They were transferred on the books of the corporation in her name on December 26, 1922, when she became the record owner thereof. They were obtained by her father as a bonus in connection with the purchase of preferred stock of the Nash Motors Co. In February, 1923, the Nash Motors Co. declared a stock dividend of 4 shares of common and 3 shares of preferred on each share of common stock to the stockholders of record on December 26, 1922. As a result, she became the owner of 750 shares of common and 450 shares of preferred stock. After the receipt of this stock in 1923, she sold 200 shares of common and 130 shares of preferred stock for $34,345.30. The market value of her 150 shares of common at the time she received the gift from her father was $42,350. The stock which she sold in 1923 brought $11,708 more than it was worth when she received it. In making her income tax return and paying the same for 1923, she included the entire gain of the sale of the stock sold by her as income for that year. This was required by section 202(a) of the Revenue Act of 1921. She paid a tax upon the basis of the original return and thereafter protested against the tax upon the full amount of the proceeds, arguing that she should have been required to account, as income, for the difference between the value of the stock when she acquired it and the price at which she had sold it, to wit, $11,708.80.

In Mr. Greenway's case, the action is to recover a tax paid under protest as income tax for the year 1922, payment being made in 1923. The stock sold by this defendant in error was also a gift made by his brother to him. The stock was likewise sold at a profit.

The statute involved, section 202(a)2 of the Revenue Act of 1921, provides:

"(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

"(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."

A profit resulting from the conversion of capital assets is income within the sixteenth amendment of the Constitution. (*Merchants' Loan & Trust Co. v. Smietanka*, 255 U. S., 509, T. D. 3173 [C. B. 4, 34]; *Eldorado Coal & Mining Co. v. Mayer*, 255 U. S., 522, T. D. 3175 [C. B. 4, 38]; *Walsh v. Brewster*, 255 U. S., 536, T. D. 3176 [C. B. 4, 41].) Income from gifts is treated in the same manner as income from other sources, and income has been defined as gain derived from capital and labor or from both combined provided it be understood to include profit or gain through a sale or conversion of capital assets. (*Eisner v. Macomber*, 252 U. S., 189, T. D. 3010 [C. B. 3, 25].) The statute here attacked

recognized this definition of income and measures the profit or loss upon the sale or conversion of the gift as a difference between the price which the donor paid for it and the price which the donee obtained. The value of the property at the time the donor transferred it to the donee is ignored and Congress, in effect, charged the gift with the tax which the donor would have paid had he received the market value for it at the time of the gift.

The arguments of the defendants in error are that a gift is in the nature of capital assets and that no tax is imposed upon the gift as such. The arguments further are that by taxing as income the difference between the cost to the donor and the price realized by the donee, the tax is being imposed upon the corpus of the gifts themselves and that section 213(b) of the statute forbids this. But the question is whether the method adopted by Congress for measuring income is, in the case of the donee, a reasonable one in the aid of the purposes of Federal income taxation. Section 213(b) does not define what is income from a gift. The defendants in error accede to the position that what each received when they sold the property, if it shows an increase, is a profit, but in measuring it, the price at the date each received the gift must be assumed to be its worth to them. But Congress has measured otherwise and it says, in protecting the Government against loss of revenue, it is proper that where the donee pays nothing, it accepts as a measure of gain or loss the cost to the donor without reference to its actual value when received by the donee.

The obvious purpose of section 202(a)2 was to prevent the loss of income represented within the profit to the donor during the period he held the property before he made his gift. Congress has determined that this same increment shall be recognized as income, even though a gift intervenes. The transfer by gift is but a change of ownership in the specific property. In doing this, Congress imposes no tax upon an unrealized gain. The value of the property is ignored or not taken into account until the property is finally disposed of in such a way that it could be determined that the owner made either a gain or a loss and, until there is a sale, there is no necessity for measuring income, nor is there an opportunity to do so. This avoids tax evasion or tax avoidance. This statute puts the donee, who pays nothing for the property, and who, therefore, loses nothing on any theory of economic principle, in the position the donor would have been, in so far as taxation is concerned.

Nor does this method of taxation suggest that the statute is unconstitutional as in violation of the fifth amendment. While the power to tax is not absolute, a tax should be shown to be arbitrary and capricious before it is condemned. The power of Congress to tax as permitted under the sixteenth amendment must be recognized as well as protection under the fifth amendment. The method of the statute which regards the corpus of the gift, irrespective of its value, as a thing which is transferred is essential to the entire taxing scheme. The method results in no greater tax than that which would have been imposed upon the donor and the donee if each had been asked to pay a proportion of the tax based upon the amount of the increment when in the hands of each. Only the income from the gift is affected by the statute. It is not the donee's income from other sources. The statute is prospective in operation and relates to gifts made after a certain date. A donee must, therefore, be charged with the knowledge that under the law, the gift may be worth less to him because of the necessity of sharing part of the profits with the Government—that part which had accumulated up to the time he had received the gift. The argument against the constitutionality of the section loses sight of the fact that the statute is directed toward a means for collecting the revenue which is made available under the income tax statute. (*Knowlton* v. *Moore*, 178 U. S., 41; *N. Y. Trust Co.* v. *Eisner*, 256 U. S., 345.)

The statute may, indeed, be said to be an execution of the main design of the Income Tax Act. That it is proper to ignore the value of property at the time of the gift is illustrated by the excess-profits tax. A tax upon a donor for making a gift is not in violation of the Constitution. (*Anderson* v. *McNeir*, 16 F. (2d), 970, T. D. 3993 [C. B. VI–1, 310].)

The Supreme Court said in *La Belle Iron Works* v. *United States* (256 U. S., 377, T. D. 3181 [C. B. 4, 373]):

"Nor can we regard the Act—in basing 'invested capital' upon actual costs to the exclusion of higher estimated values—as productive of arbitrary discriminations raising a doubt about its constitutionality under the due process clause of the fifth amendment. The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the States under the equal protection clause,

much less of Congress under the more general requirement of due process of law in taxation. Of course it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion within the bounds of geographical uniformity. Courts have no authority to pass upon the propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation."

So here Congress, in effect, has said that notwithstanding the value of the property, from an economic standpoint for the purpose of this taxation, that value is ignored and only the value when the property was acquired by the donor is considered. This is deemed necessary to the enforcement of this aspect of the income tax law where a gift is made and where a profit or loss is afterwards realized and it becomes necessary to make proper measurement thereof. Although popularly the gift has a fixed value at the date of transfer, there is no constitutional objection, for income tax purposes, in rejecting or in ignoring that fact and holding that the rights transferred by the gift which include the increment while in the hands of the donor, are subject to the tax. No one would have doubted the power of Congress to impose a tax upon the donor at the time of the gift and the tax could have been measured by the difference between the price he paid for it and its value when he transferred it. Nor could it be criticized if the donee was left to pay the balance of the tax based upon the diffcrence between the value on the date of acquisition and the value on the date of sale. The statute does no more than tax the donee for a gift when he sells it and measures that income for income tax purposes as based upon the difference between the cost when acquired by the donor and the price realized by the donee. It is not capricious to put property acquired by gift in a special class and to tax it differently from property acquired by purchase. (*Bowman* v. *Cont. Oil Co.*, 256 U. S., 642; *Brushaber* v. *Union Pac. R. R. Co.*, 240 U. S., 1; *Thomas* v. *U. S.*, 192 U. S., 363, T. D. 3170 [C. B. 4, 25].) It is sufficient for the main purposes of the sixteenth amendment, and the income tax enactments pursuant thereto, if the method of taxation is consistent with the entire scheme of taxation and the tax imposed by that method may not be considered direct.

We think that Congress in levying the tax here was well within its constitutional power in creating a classification which was reasonable and neither the tax nor the method of enforcing it was arbitrary or capricious. (*Barclay & Co.* v. *Edwards*, 267 U. S., 442, T. D. 3691 [C. B. IV–1, 207].)

The judgments below are reversed with costs.

L. HAND, Circuit Judge (concurring): In each of these cases the amount of the tax does not exceed the increase in value of the gift while in the donee's hands. Strictly speaking, the question does not therefore arise whether Congress may, as a tax on income, seize any part of the increase in value of the gift before the donee accepted it. I am not entirely sure that a tax, if limited to the increase in the donee's hands, might not be calculated upon the difference between what the donor paid and the donee got. At the argument, I was disposed to think that these cases might be decided on some such reasoning, but it is pretty clear that that would make a new statute. Congress did not mean so to limit the tax. In the first place, the results would be so capricious that the validity of the law might be doubtful, and in the second, such revenue would be lost which was certainly intended to be reached. We may hardly so far strain the law to save it. So I think that this Act must be good in whole or not at all.

No increase in value not realized in cash can be taxed as income under the sixteenth amendment; that was very deliberately decided in *Eisner* v. *Macomber* (252 U. S., 189), supra. If so, it is impossible to tax the increase in the donor's hands at all; it is not income, though at any time by a sale he could have made it such. The same increase is as little income, even after it has passed to the donee, until he sells. However, it seems to me equally clear that when he does, there has been gain which is in every sense income to the extent of the difference between what the donor paid and the donee got. I am not concerned for the moment with whose gain it is, but that the whole gain is income can not, I submit, be disputed. If it is important, I suggest that the language of the amendment itself gives Congress power to lay "taxes on incomes," not on persons. Therefore, there is a subject matter which Congress may tax without

apportionment, and part of which, after *Eisner* v. *Macomber*, supra, it could not tax in any other way, except perhaps as an excise.

I can see no injustice in regarding the whole of this gain as income of the donee, and if there be no injustice certainly it is not within the fifth amendment. Suppose that the law charged the corpus of the gift while in the donor's hands with an inchoate tax at specified rates, to be calculated upon its increase whenever it was sold. The donee in accepting such a gift would take it subject to that charge, though its amount would remain undetermined until he sold. I can see nothing unconstitutional in that, nor in imposing upon him a corresponding duty in personam because of his acceptance. So far as that would involve uncertainty, arising from fluctuation in value of the gift after acceptance, it would be entirely within the donee's control, for he may sell when he likes, and could scarcely complain of any increase which might result from his delay. It is true that Congress has gone further than that, because it has made the whole gain a part of his income for the year in which he sells. But again, so far as that is dependent upon the amount of his other income, he can reckon with it when he accepts the gift, and of any subsequent fluctuation he takes his chance, precisely as he does of fluctuation in the value of the gift.

Therefore, I fail to see any oppression in this method of calculating the tax upon what, as I have said, appears to me an unquestionable subject matter for taxation. In *Lynch* v. *Turrish* (247 U. S., 221) the gain had accrued before the amendment went into effect. I read *Gray* v. *Darlington* (15 Wall., 63) in the same sense, though perhaps it was only a forerunner of *Eisner* v. *Macomber* (252 U. S., 189). *People ex rel. Brewster* v. *Wendell* (196 App. Div., 613) dealt with a statute which sought to tax the donor, and was void where *Eisner* v. *Macomber* is law. That the statute is reasonably ancillary to a valid constitutional purpose seems to me as plain as in *Rice* v. *Eisner* (16 Fed. (2), 358 (C. C. A., 2)); that the practice, if permissible, will become a common contrivance to frustrate that purpose, I have no doubt whatever.

I concur with my brother Manton.

ARTICLE 1566: Exchange of property which results in no gain or loss. VI–31–3343 G. C. M. 1977

REVENUE ACT OF 1921.

Section 202(c)3 of the Revenue Act of 1921, which deals with exchanges of property, is inapplicable to a transaction which reflects a transfer of property for a consideration in money which may properly be regarded as a sale.

An opinion has been requested of this office in the case of a taxpayer who is claiming a refund of tax paid for the year 1922 with respect to profits realized as a result of a transfer of certain real estate to a corporation, practically all the capital stock of which was owned by the taxpayer.

The pertinent facts in the case are as follows: In 1922 the taxpayer owned $98y$ shares of the total issue of $100y$ shares of the M Hotel Co., a corporation, and also owned real estate adjoining the hotel property which had been acquired prior to March 1, 1913, and which on that date had a value of $13x$ dollars. The real estate owned by the taxpayer was transferred to the M Hotel Co. for $25x$ dollars. The action of the M Hotel Co. in acquiring the real estate is reflected in a resolution of the board of directors passed at a meeting held on ——, 1922. The resolution reads as follows:

Resolved, That the company purchase lot — of section — of the city of —— for $15x$ dollars.

Lot — section — for $5x$ dollars.

Lot — section — for $5x$ dollars.

These lots are being purchased at the appraised value, and are purchased by the corporation in accordance with the representations made by the trustee and the desire to have this property all covered by the mortgage; the entire sum

in payment for these lots is to be immediately placed to the credit of A on the books, to be drawn by him at such time as funds are available from the bond issue or at his convenience.

It will be seen from the resolution quoted above that the consideration for the transfer of the real estate to the M Hotel Co. was a cash consideration of $25x$ dollars, and that, while such an amount was not paid over as cash in a lump sum at the time the transaction was completed, it was placed to the taxpayer's credit subject to withdrawal as he might desire. Sufficient funds were available for this purpose, and the taxpayer actually withdrew during the year 1922 the sum of $15x$ dollars, the balance of the purchase price remaining an open credit to his account.

It was contended by the taxpayer that only so much of the purchase price of the property transferred as was actually received in cash in the year 1922 should be taken into consideration in determining the amount of income taxable for that year. This contention is adequately disposed of by the provisions of article 52 of Regulations 62 and articles 51 of Regulations 65 and 69. It is provided in those articles that income which is credited to the account of, or set apart for, the taxpayer, and which may be drawn upon by him at any time, is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. The amount of the purchase price in the instant case was credited to the taxpayer without any limitation or restriction as to time, manner, or condition with respect to which such amount or any part thereof might be withdrawn by the taxpayer. Under such circumstances the entire amount of the purchase price of $25x$ dollars is considered to have been received by the taxpayer in 1922 for the reason that it was credited to his account and made available for his immediate use and disposal during that year.

The taxpayer also advanced the contention that under the provisions of section 202(c)3 of the Revenue Act of 1921 no taxable income was received as the result of the transfer of the real estate to the M Hotel Co. for the reason that the transaction was essentially an exchange of property, being merely the transfer of real property in return for an account receivable.

Section 202(c), Revenue Act of 1921, provides in part as follows:

> For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—
>
> * * * * * * *
>
> (3) When (A) a person transfers any property, real, personal or mixed, to a corporation, and immediately after the transfer is in control of such corporation, * * *.

The facts in the instant case do not warrant the view that there was an exchange of property but rather the conclusion that the transaction involved a conveyance of property for a consideration in money and therefore constituted a sale. A sale is a transfer of property or a right from one man to another, in consideration of a sum of money, as opposed to barter, exchange, or gift. (*Northern Pacific Railway Co.* v. *Sanders*, 47 Fed., 604; Words & Phrases (vol. 4, p. 436).) In the resolution of the board of directors of the M Hotel Co. quoted above, it is stated that the property is to be pur-

chased, and a cash consideration therefor is named. To hold that such a transaction was an "exchange" of property would be to run counter to the accepted understanding of the term "sale." The proper rule with respect to the proposition involved is succinctly stated in I. T. 1410 (C. B. I–2, 25), wherein it is provided that "to constitute an exchange within the meaning of section 202(c)1 and of article 1566(a), the transaction must be a reciprocal transfer of property for property as distinguished from a transfer of property for a money consideration."

The transaction in the instant case is designated as a purchase of property and contains every element of a sale. Therefore, section 202(c)3, which deals with exchanges of property, is obviously inapplicable, and the contention of the taxpayer in this respect must be denied for the reason that there was no exchange of property involved but a transfer of property for a money consideration.

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

SECTION 204.—NET LOSSES.

ARTICLE 1601: Net losses, definition and computation. VI–43–3481 G. C. M. 2463

REVENUE ACT OF 1918.

The taxpayer had many times more money invested in securities than in his other business, which consisted of manufacturing. He spent more than one-half his time in attending to his transactions in securities, and during a five-month period alone in 1919 he had more than 70 separate transactions. Securities were bought to be sold for a profit and not to be held as an investment.

Held, that such transactions in securities were sufficient to constitute a business regularly carried on, and a loss sustained therein in 1919 should be considered in determining a net loss which may be deducted from 1918 income.

An opinion is requested as to whether the loss sustained by A by his trading in securities during the year 1919 may be considered in determining a net loss which may be deducted from his 1918 income under the provisions contained in section 204 of the Revenue Act of 1918.

The facts briefly stated are as follows:

The taxpayer is engaged in manufacturing, maintaining a factory a short distance out of the city of ——— and general business offices at ——— Building, in the heart of the city's financial district. Prior to the inception of the income tax laws the taxpayer was engaged in buying and selling securities on his own account. During the year 1913 he had invested in securities the sum of $3x$ dollars, and since then the amount has varied from time to time, ranging between $3x$ dollars and $13x$ dollars. During the same period of time his average investment in his business was $2x$ dollars. The evidence shows that the taxpayer spent more than one-half of his time in attending to the buying and selling of securities. Records from the books of a concern of brokers are submitted to show that between May 1, 1919, and October 20, 1919, he purchased 38 different lots of securities and during the same period sold 25 different lots. The taxpayer states that he had many transactions other than above disclosed but is unable to produce the records for the reason that during the year

1919 he was dealing with three different stockbrokers, one of whom has since died and another become bankrupt. It is shown that the taxpayer was engaged in buying and selling securities for a profit rather than in buying securities and holding them as an investment. In the year 1919 the taxpayer suffered a loss of x dollars by and through his dealings in securities and contends that this loss should be considered in determining a net loss which may be deducted from 1918 income under the provisions of section 204 of the Revenue Act of 1918.

Section 204(a) of the Revenue Act of 1918 provides:

SEC. 204. (a) That as used in this section the term "net loss" refers only to net losses resulting from either (1) the operation of any business regularly carried on by the taxpayer, * * *.

Taxpayer's rights in the instant case will, therefore, be fixed by the determination of whether or not his dealings in securities during the time specified and in the manner described constitute a business regularly carried on within the meaning of the above section. It has been held that a man may be engaged within the period of one single year in several trades or different kinds of business at the same particular time. (*Black* v. *Bolen*, 268 Fed., 427.) In I. T. 1818, reported in Cumulative Bulletin II-2, page 39, the following opinion is found:

In the Act of September 8, 1916, the wording of the 1913 Act was slightly changed (sec. 5(a)fourth) to permit a deduction of "losses actually sustained during the year, incurred in his business or trade * * *." Under this more liberal provision, it has been uniformly held that where a taxpayer devoted all his time, or the major portion of it, to buying and selling securities on his own account, this occupation was his "business"; and therefore he was permitted to deduct losses sustained in such dealings as being "incurred in his business." Appeals and Review Recommendation 404 (C. B. 4, 157); *semble* Law Opinion 601. These rulings are inferentially supported by the definition of trade or business to comprehend "all his activities for gain, profit, or livelihood, entered into with sufficient frequency, or occupying such portion of his time or attention as to constitute a vocation," contained in article 8 of Regulations 41, relative to the war excess-profits tax (approved in *Woods* v. *Lewellyn* (1921), 289 Fed., 498).

The wording of section 204(a) of the Revenue Acts of 1918 and 1921, "* * * losses resulting from the operation of any trade or business regularly carried on by the taxpayer" ("trade or" omitted in 1918 Act), is similar to that of section 5(a)fourth of the 1916 Act as construed in these opinions. Accordingly, it has been held that a taxpayer may devote sufficient time and attention to the purchase and sale of securities for his own account only to constitute a business, and so entitle him to the benefits of section 204(a).

In the appeal of J. J. Harrington (1 B. T. A., 11), the Board of Tax Appeals states its idea of the meaning of the qualifying phrase "regularly carried on" as follows:

The expression trade or business as used in section 204 of the 1921 Act with reference to net losses is more limited and restricted than the word trade as used in the 1913 Act or the expression trade or business as used in the 1917 Act. The statute provides that the loss, in order to be deductible as a net loss, must not only have been incurred from the operation of a trade or business but from a trade or business regularly carried on. A trade or business regularly carried on *must be held to mean a vocation* and not occasional or *isolated transactions*. * * *. [Italics supplied.]

The only question herein involved is, therefore, one of fact, i. e., whether the security dealings of the taxpayer were such as to amount to a business or a trade regularly carried on. In view of the fact that the taxpayer had many times more money invested in securities

than in his other business; that he spent more than one-half his time in attending to his transactions in securities; that during a period of 5 months alone in the year 1919 he made more than 70 separate transactions; and that he bought securities to sell for a profit rather than to hold as an investment, it is the opinion of this office that the stock transactions of the taxpayer for his own account are sufficient to constitute a business regularly carried on, and that the loss sustained therein during 1919 should be considered in determining a net loss which may be deducted from 1918 income under the provisions of section 204 of the Revenue Act of 1918.

SECTION 206.—CAPITAL GAIN.

ARTICLE 1652: Returns of capital net gain. VI–40–3453
G. C. M. 2367

REVENUE ACT OF 1921.

The sale by taxpayer in January, 1922, of a right acquired in December, 1919, to take from certain land, upon payment of a stipulated royalty, all the gravel and gravel material therein for a term of years, constituted a sale of capital assets within the meaning of section 206(a)6 of the Revenue Act of 1921.

A taxpayer who has filed his original return using sections 210 and 211 of the Revenue Act of 1921 as his basis may file an amended return computing his tax under section 206 of said Act.

The case of A presents the following questions:

1. Did the sale by the taxpayer of the rights hereinafter described constitute a sale of capital assets?

2. The taxpayer having computed the tax on his return under sections 210 and 211, may he thereafter file an amended return and recompute the tax under section 206 of the Revenue Act of 1921?

The facts are briefly these:

On December —, 1919, the taxpayer acquired from B the right to take from certain described land all the gravel and gravel material lying, being, and situated in and upon said described land. A nominal consideration was expressed in the instrument granting to the taxpayer the right to take the gravel and gravel material, but this nominal consideration was never in fact actually paid. The taxpayer agreed to pay to C, owner in fee of the land, the sum of — cents per ton, and to B the sum of — cents per ton upon each and every ton of gravel or gravel material taken out of said land. The taxpayer further agreed to mine and remove from the said lands not less than y tons of gravel and gravel sand annually for a period of 10 years (with an option to extend the time for an additional period of 5 years). The taxpayer rented the machinery and no equipment was owned by him. On January —, 1922, the taxpayer sold his rights as held under the contract with B to D, for $4x$ dollars cash and a note due the following year in the amount of $4x$ dollars.

The taxpayer reported in his income tax return for 1922, $4x$ dollars profit derived from the sale of his rights as aforesaid, on which the tax was computed under sections 210 and 211 of the Revenue Act of 1921. Upon an examination by a revenue agent, a taxable profit of $8x$ dollars was arrived at instead of $4x$ dollars, as reported by the taxpayer. The taxpayer admits the $8x$ dollars profit, but now contends that this profit should be considered as a capital net gain

and the tax should be computed under section 206 of the Revenue Act of 1921.

Section 206(a)6 of the Revenue Act of 1921 defines capital assets in this manner:

> The term "capital assets" as used in this section means property acquired and held by the taxpayer for profit or investment for more than two years (whether or not connected with his trade or business), but does not include property held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

The first question, therefore, to be determined is whether or not the rights or lease which the taxpayer sold was property.

In the case of *Lynch* v. *Alworth-Stephens Co.* (267 U. S., 364; 45 Sup. Ct., 274; T. D. 3690, C. B. IV–1, 162), the United States Supreme Court had before it the question whether the interest of a lessee in ore deposits was property for the purpose of the deduction allowed by statute on account of the exhaustion, wear and tear of property. The court said:

> It is, of course, true that the leases here under review did not convey title to the unextracted ore deposits (*United States* v. *Biwabik Mining Co.*, 247 U. S., 116, 123), but it is equally true that such leases, conferring upon the lessee the exclusive possession of the deposits and the valuable right of removing and reducing the ore to ownership, created a very real and substantial interest therein. (See *Hyatt* v. *Vincennes Bank*, 113 U. S., 408, 416; *Ewert* v. *Robinson*, 289 Fed., 740, 746–750.) And there can be no doubt that such an interest is property. (*Hamilton* v. *Rathbone*, 175 U. S., 414, 421; *Bryant* v. *Kennett*, 113 U. S., 179, 192.)

See also appeal of Grosvenor Atterbury (1 B. T. A., 169, acquiescence in C. B. IV–2, 1), holding a leasehold to be property.

In view of the foregoing, it is the opinion of this office that the rights acquired by the taxpayer under the instrument executed between the taxpayer and B were property rights, and the subsequent sale by the taxpayer of these rights to D was a sale of property within the meaning of the word *property* as used in the above-quoted section of the law. As it appears that this property was not property held either for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer, or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, and as the taxpayer acquired and held this property for profit or investment for more than two years, the sale thereof constituted a sale of capital assets.

In I. T. 2132 (C. B. IV–1, 117), published in 1925, the facts and holding are as follows:

> The taxpayer segregated a certain item of capital gain from his ordinary income and computed the tax on such item under Schedule D of his return, Form 1040, but apparently failed to realize that by using Schedule D his tax liability would amount to 12½ per cent of his total net income, inclusive of the item of capital gain. Accordingly, while his return shows a tax liability of $426x$ dollars, his tax liability, by using Schedule D, would be $635x$ dollars, and if figured at the ordinary rates, without using Schedule D, would amount to $220x$ dollars.
>
> Held, a taxpayer, who has filed his original return, using the 12½ per cent basis, may file an amended return, computing his tax at the ordinary rates.

The facts in I. T. 2132, supra, clearly show that the taxpayer knew he had a capital net gain, and returned that capital net gain under

section 206. The ruling recognizes that no binding election exists when a taxpayer computes his tax under section 206 of the Revenue Act of 1921. If a taxpayer who has filed his original return using the 12½ per cent basis may file an amended return computing his tax at ordinary rates, consistency would seem to require the holding that a taxpayer who has filed his original return using sections 210 and 211 of the Revenue Act of 1921 as his basis may file an amended return computing his tax under section 206 of that Act.

It was evidently the purpose of section 206(b) of the Revenue Act of 1921 to allow taxpayers, with respect to capital gains, to compute the tax either under that section or under sections 210 and 211, whichever would produce the lesser tax. The parenthetical expression "at the election of the taxpayer" as used in section 206(b) carries out this purpose and does not imply a technical election which once made is binding on the taxpayer. No real election is involved; that is, no election between two desirable alternatives, since obviously *all* taxpayers will desire to avail themselves of section 206 if it results in a lesser tax. In such a case, if that section is not availed of, it must be through ignorance or mistake. (See also appeal of James F. Hoey, 4 B. T. A., 1043; report of Committee on Ways and Means of House of Representatives, August 16, 1921, on the revenue bill of 1921.)

Accordingly, it is the opinion of this office that the taxpayer in the instant case is not precluded from availing himself of the capital gain provisions of section 206 of the Revenue Act of 1921.

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

ARTICLE 1653: Partnerships, estates, and trusts. VI–49–3529
G. C. M. 2705

REVENUE ACT OF 1921.

Recommended that I. T. 1638 (C. B. II–1, 37) and I. T. 1719 (C. B. II–2, 45) be modified to the extent that they disallow, in the determination of the period for which property has been held by a decedent's estate for capital gain purposes, the inclusion of the period during which the property was held by the decedent.

An opinion is requested relative to (1) the basis to be used by an executor in determining gain or loss to a decedent's estate upon the sale by the executor of property which belonged to the decedent and (2) the method of computing the two-year period for capital gain purposes.

The basis to be used for determining gain or loss to a decedent's estate is now expressly prescribed by the regulations under the Revenue Act of 1918 as well as under the Revenue Acts of 1921, 1924, and 1926. See Treasury Decision 4012 (C. B. VI–1, 248), amending article 343 of Regulations 45 (1920 edition); Treasury Decision 4010 (C. B. VI–1, 249), amending article 343 of Regulations 62; and Treasury Decision 4011 (C. B. VI–1, 77), amending article 343 of Regulations 65 and article 343 of Regulations 69. The basis prescribed is that which would be used by the decedent if he had lived and made the sale himself. The reason for this rule is that the executor in making the sale is regarded as standing in the shoes of the decedent. (*May McKinney* v. *United States*, 62 Ct. Cl., 180;

certiorari denied, 273 U. S., 716.) As stated in a leading New York case, Matter of Francis L. Leland, Deceased (96 Misc., 419), an "executor is treated as 'eadem persona' as deceased for all juristic purposes."

As the underlying theory of Treasury Decisions 4010, 4011, and 4012 is that an executor in making a sale of estate property stands in the shoes of the decedent, it is believed that consistency requires, and it is recommended, that I. T. 1638 and I. T. 1719 be modified to the extent that they disallow, in the determination of the period for which property has been held by a decedent's estate for capital gain purposes, the inclusion of the period during which the property was held by the decedent. The theory of the above-mentioned Treasury decisions also requires that a decedent's estate be allowed depreciation deductions computed on the same basis as the decedent would be entitled to use had he survived. This requires no modification of I. T. 1370 (C. B. I-1, 172), as that I. T. relates solely to a devisee of real estate and does not purport to set forth the basis on which depreciation shall be computed in the case of estates in process of administration.

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

ARTICLE 1653: Partnerships, estates, and trusts. VI-49-3530
I. T. 2391

REVENUE ACT OF 1921.

Office decisions 1638 (C. B. II-1, 37) and 1719 (C. B. II-2, 45) are modified in so far as they are inconsistent with General Counsel's Memorandum 2705, page 174.

PART II.—INDIVIDUALS.

SECTION 212.—NET INCOME OF INDIVIDUALS DEFINED.

ARTICLE 22: Computation of net income. VI-51-3542
T. D. 4106

INCOME AND EXCESS PROFITS TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. INCOME—ACCRUAL BASIS.

Where a taxpayer's books of account, kept on the basis of cash receipts and disbursements, do not correctly reflect income, the Commissioner is authorized by section 212(b) of the Revenue Act of 1918 to compute the taxable income on the accrual basis.

2. ASSESSMENT—TAX LIABILITY—PRIMA FACIE PROOF.

In a suit against a former stockholder of a dissolved corporation for the recovery of taxes due from such corporation an assessment is prima facie evidence of the correct tax liability.

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, Fifth Circuit, in the case of *S. L. Becker, appellant*, v. *United States of America, appellee*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 9, 1927.

A. W. MELLON,
Secretary of the Treasury.

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UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT.

S. L. Becker, appellant, v. *United States of America, appellee.*

Appeal from the District Court of the United States for the Middle District of Georgia.

[October 28, 1927.]

OPINION.

BRYAN, Circuit Judge: This is a suit by the United States to collect a tax from the income and excess profits of the Union Furniture Co. for that part of the year ending September 30, 1918. On or about that date the company was dissolved and appellant, who was the sole stockholder, sold all its assets and received more than is sought to be recovered.

The following facts were either agreed to by stipulation or appear by uncontradicted evidence: The books of the company were kept on the basis of cash received and disbursed, but they did not correctly reflect the income. The assessment of the Commissioner of Internal Revenue was made on the accrual basis, which is the method adopted by accountants, and which, though not exact, was as nearly accurate as it was possible to make from the company's books, or as is usually obtained from the books of a small retail business. The company was engaged in selling furniture on the installment plan.

While appellant claims the assessment was erroneous, he fails to show that any part of it should be disallowed. Section 212(b) of the Revenue Act of 1918 (40 Stat., 1064) 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."

It follows that as the company's method failed to disclose its income, the assessment as made was authorized by law. The assessment was prima facie evidence of the amount due. Upon proof by appellant that it should be reduced by any particular amount, the Government would still be entitled to recover the remainder. (*United States* v. *Rindskopf*, 105 U. S., 418.)

As the assessment was not shown to be incorrect, the prima facie presumption that attached to it was not overcome, and the district court correctly sustained it as made.

The judgment is affirmed.

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

ARTICLE 31: What included in gross income. VI-27-3296
(Also Section 223, Article 401.) T. D. 4028

INCOME TAX—REVENUE ACT OF 1921—DECISION OF SUPREME COURT.

1. INCOME—UNLAWFUL BUSINESS.

Gains realized from illicit traffic in liquor are subject to the income tax. An unlawful or prohibited business is not exempt from the payment of taxes that if lawful it would have to pay.

2. CONSTITUTION — FIFTH AMENDMENT — SELF-INCRIMINATION — INCOME TAX RETURNS.

The protection against self-incrimination afforded by the fifth amendment to the Constitution is not infringed by the statutory requirement for a return of income derived from crime. The return is required by law and must be filed. A claim of privilege from answering any question on the return can not be determined finally by the taxpayer, but should be claimed in the return so that it may be passed upon.

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 *United States* v. *Manly S. Sullivan* is published for the information of internal revenue officers and others concerned.

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

Approved June 23, 1927.

A. W. MELLON,
Secretary of the Treasury.

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SUPREME COURT OF THE UNITED STATES. No. 851.—OCTOBER TERM, 1926.

The United States of America, petitioner, v. *Manly S. Sullivan.*

On writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[May 16, 1927.]

Mr. Justice HOLMES delivered the opinion of the court.

The defendant in error was convicted of willfully refusing to make a return of his net income as required by the Revenue Act of 1921 (Nov. 23, 1921, ch. 136, secs. 223(a), 253; 42 Stat., 227, 250, 268). The judgment was reversed by the circuit court of appeals. (15 F (2d), 809.) A writ of certiorari was granted by this court.

We may take it that the defendant had sufficient gross income to require a return under the statute unless he was exonerated by the fact that the whole or a large part of it was derived from business in violation of the National Prohibition Act. The circuit court of appeals held that gains from illicit traffic in liquor were subject to the income tax, but that the fifth amendment to the Constitution protected the defendant from the requirement of a return.

The court below was right in holding that the defendant's gains were subject to the tax. By section 213(a), gross income includes "gains, profits, and income derived from * * * the transaction of any business carried on for gain or

profit, or gains or profits and income derived from any source whatever." These words are also those of the earlier Act of October 3, 1913 (ch. 16, Sec. II, B; 38 Stat., 114, 167), except that the word "lawful" is omitted before "business" in the passage just quoted. By section 600 (42 Stat., 285) and by another Act approved on the same day Congress applied other tax laws to this forbidden traffic. Act of November 23, 1921 (ch. 134, sec. 5; 42 Stat., 222, 223). *United States* v. *One Ford Coupe* (272 U. S., 321, 327); *United States* v. *Stafoff* (260 U. S., 477, 480). We see no reason to doubt the interpretation of the Act, or any reason why the fact that a business is unlawful should exempt it from paying the taxes that if lawful it would have to pay.

As the defendant's income was taxed, the statute of course required a return. See *United States* v. *Sischo* (262 U. S., 165). In the decision that this was contrary to the Constitution we are of opinion that the protection of the fifth amendment was pressed too far. If the form of return provided called for answers that the defendant was privileged from making he could have raised the objection in the return, but could not on that account refuse to make any return at all. We are not called on to decide what, if anything, he might have withheld. Most of the items warranted no complaint. It would be an extreme if not an extravagant application of the fifth amendment to say that it authorized a man to refuse to state the amount of his income because it had been made in crime. But if the defendant desired to test that or any other point he should have tested it in the return so that it could be passed upon. He could not draw a conjurer's circle around the whole matter by his own declaration that to write any word upon the Government blank would bring him into danger of the law. (*Mason* v. *United States*, 244 U. S., 362; *United States ex rel. Vajtauer* v. *Commissioner of Immigration*, Jan. 3, 1927.) In this case the defendant did not even make a declaration; he simply abstained from making a return. See further the decision of the Privy Council, *Minister of Finance* v. *Smith* (1927) (A. C., 193).

It is urged that if a return were made the defendant would be entitled to deduct illegal expenses, such as bribery. This by no means follows, but it will be time enough to consider the question when a taxpayer has the temerity to raise it.

Judgment reversed.

ARTICLE 31: What included in gross income. VI–33–3367
T. D. 4058

INCOME TAX—REVENUE ACTS OF 1917 AND 1918—DECISION OF COURT.

1. INCOME—MINERAL LEASE—AMOUNTS RECEIVED BY BENEFICIARY.

Amounts received by a beneficiary from the trustee under a will as a distribution of royalties paid to the trustee under a lease of coal lands executed by the testator are income within the meaning of the Income Tax 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 District Court of the United States for the Eastern District of Pennsylvania in the case of *Kate W. Rosenberger* v. *Blakeley D. McCaughn, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 5, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

Kate W. Rosenberger v. *Blakeley D. McCaughn, Collector.*

[June 1, 1927.]

OPINION.

DICKINSON, J.: The conclusion reached in this case is in effect to sustain the demurrer.

This step in the pending cause is to take advantage of the opportunity afforded by the Pennsylvania practice act of 1915 to have questions of law which arise out of the statement of claim determined in advance of trial. The question here raised is a very definite and clear-cut one but it is the kind of a question which some would look upon as a question of fact and others as a question of law, and again one which is often characterized as a mixed question of law and fact. It is really one of those questions which has a double aspect and may be viewed either as a question of fact or of law accordingly as you choose your viewpoint. Trial fact findings may be well analyzed into findings of evidentiary facts and ultimate fact findings inferred therefrom. The latter class are essentially facts although inferred by being logically deduced from the evidentiary facts. If the evidentiary facts are in controversy, the ultimate facts must be found by the trier of facts, but if the evidentiary facts are admitted, then the inference to be drawn therefrom may be regarded as a question of law, if only one inference is permissible. The practical test of this is that in the latter case there might be a directed verdict. It is in this narrow sense that the question is one of law but it is such in a very practical sense. Here the evidentiary facts are not in dispute and the question becomes the kind of a question of law. Stated in the form of a question of law, it is whether a verdict should be directed for the plaintiff or defendant, it being conceded that it should be for one or the other. Stated in the form of an ultimate fact finding, it is whether the moneys which came to the plaintiff came as income from a capital investment or came as the return or restoration of a capital sum which had been put out for employment. More concisely stated, did the money come as the return from capital or the return of the capital itself?

The controlling question as presented by the plaintiff is whether a coal operating company pays what it pays for coal purchased in place or pays as lessee rent for the land from which the coal is taken?

The question as presented by the defendant is whether the moneys received by this plaintiff under the special facts of this case is taxable net income within the meaning of the tax laws?

One difficulty in finding the meaning of the law we are now considering is that, being addressed to people in general, its language must be construed as that of common speech, and in common speech the word "income" has no definite meaning. This in turn is because the same word is used by different people under different circumstances and at different times to convey different meanings. The thought common to all uses of the word is that of product, but what is product is sometimes found in the light of a theory of sound economics and sometimes without it. The differentiation seems to be dictated by the source of the income. The man in trade, manufacturing or commercial, who withdrew from his business all the profits without withholding something for amortization, depreciation, wear and tear, reserve, or other assurance of the integrity of his capital, would be said by any business man to be withdrawing more than the net income from the business and to be making inroads upon his capital, and results would soon confirm this judgment. When, however, a man who is in the receipt of interest on so-called "investments" or "personal earnings," does precisely what the prudent business man does by providing through insurance or a saving fund protection from depletion of investments or loss of earning power or other cause of diminution of his "product," everyone would say that he was making a provision for the future out of his "income." It can not be said that the distinction is wholly arbitrary, but the line is often difficult to draw as when any one is called upon to determine what is income and what is capital when accretions come to be awarded to a life tenant or a remainderman. The real truth is that there is much of the ipse dixit in every such ruling but at the same time it is guided by

the conditions under which it is made. In a broad general view of the question in the abstract, what is income would seem to lend itself to an easy answer, but difficulties arise when we come to the particular and the concrete under practical conditions. The man who lays out his capital in such a way as that the return he gets exhausts in a shorter or longer time his entire investment makes a mistake if he deems the whole return to be net income and allows nothing for amortization purposes because he finds that what he had been receiving was not all a return received from his capital but was also in large part a return of his capital. This, however, is not always true under what may seem to be like conditions. The owner of land of no value except for oil, coal, or other mineral which may be taken from it, who turns it over to an operating company finds when it is turned back to him that he has been receiving not a rent or other return for the use of his land but has been getting in installments the purchase price of what he had sold. On the other hand, an owner of timberland which had a high value for agricultural or residential purposes might sell the standing timber to a lumber company to be taken off and receive back land of as high or higher value than before. So likewise the owner of land having a deposit of brick clay but which had become "ripe for development" purposes might sell the clay in order by its removal to bring his lands to the level of the streets ready to be laid out through it. Every landowner who sells the material in a building which is in the way of a full utilization of the land does so in the economic belief that the work of removal is an improvement. The economic test would doubtless be whether the timber, clay, buildings or their material was worth more or less than the cost of removal or, expressed in other terms, whether the land cleared was worth more or less than before. As between a possessor and a reversioner or remainderman the legal question would perhaps be one of waste. Assuming an economic gain from the two sources of an enhanced value of the land, because of the new use, and the proceeds of what was taken from the land to adapt it to the new use, is the latter an "income" or the purchase price of what was sold? Precisely the same question is presented in reverse when a landowner lays out money on the land. The test here commonly applied is whether the money expended was laid out in "improvements" or for "repairs."

Every manufacturer uses the same kind of judgment when he figures on the cost of his product. The question of whether the profit is large or small, how much is the income or whether there is any, is largely in the hands of him who figures. There is no escape from this arbitrary element in the judgment reached. We get what is again essentially the same kind of a question (and indeed it is presented in the instant case) where one receives an "income" from an investment in a mining or other company the source of whose "income" may dry up. The source of the income of the stockholder is the dividend declared on the stock and this in turn is declared out of the net profits of the company which is only another name for its net income. We thus get the thought that what is net income in the tax sense when received by one person may not be net income as it reaches the hand of another. This distinction has likewise an almost wholly arbitrary basis, but we do not see how it could be held otherwise without holding that not to be income which is derived from a source which may cease to yield.

This is akin to the distinction made in *Heiner* v. *Beatty* (third circuit ruling, not yet reported), where it was held that moneys received were not income if they had come from one source but were income because received from another.

The direction by a testator to his executors to pay successive annual sums to named beneficiaries is a gift or a series of gifts but a direction to invest moneys sufficient to yield the same annual sum to be received by the same beneficiaries works the change of the receipt by them not of a gift but of an income from a gift. We interpret this to mean that as long as this "income" is received the tax must be paid. If the income ceases the tax payment would likewise cease, but the "income" is none the less income because the source of it may be exhausted.

We read the will in the instant case to put this plaintiff in the receipt of income and this in the taxing sense is unaffected by the fact (if it be one) that the coal company will sooner or later exhaust the coal deposits in the "leased" lands and cease to pay either royalties or dividends.

As the tax is upon "net income," this may be found as a fact to be what a proper deduction and allowance for amortization purposes may show it to be.

but this is a mere finding of how much the "net income" is, not whether it is taxable income. (*New Creek* v. *Ledcrer*, 295 Fed. Rep., 433.)

Such a question of fact could not be determined as a question of pleading. The statement of claim suggests no such question to be in the case. If it is, it can be taken care of in the order made. The question we are asked to rule we understand to be whether under the pleaded facts that for which the plaintiff has been taxed was received by her as a "gift of property" or whether it was received as income from property. Our finding is that it was received as income. Upon the underlying question of whether the contract between the plaintiff's testator and the coal company was a lease of land, reserving rent, or a sale of coal in place, counsel for plaintiff has cited (among others) two Pennsylvania cases, *Sanderson* v. *Scranton* (105 Pa., 469), *Hosack* v. *Grill* (18 Sup. Ct. (Pa.), 90).

The opinion in the one case was written by Mr. Justice Clark and in the other by President Judge Rice. These names stand at the very top of the list of distinguished Pennsylvania jurists. Moreover, each of them had an intimate knowledge born of long association with the subject matter of these cases. We would not for a moment entertain the thought of dissent from any view of Pennsylvania law which they held. We in consequence accept the proposition that the contract here was, under the law of Pennsylvania, one of sale of coal in place. The right which Weiss had was to receive moneys limited in the annual sums paid by the tonnage of coal mined and in the aggregate by the supply in the ground and also whatever dividends the company paid on his stock holdings. This right he passed on to the trustees under his will, with directions to pay over what was received (in part) to this plaintiff as "net income or rents." The question recurs whether what the plaintiff thus received is taxable income. The fact that the testator called it "income" or "rents" is of no more significance than if he had called it by some other name, but the words he employed do bear upon the usages of common speech. The question is one of the judicial construction of the Act of Congress and this, as we have seen, becomes necessarily one more or less arbitrary.

This takes us for a guide to the adjudged cases. Each is again necessarily ruled upon its special facts and is sui juris but the doctrine is applicable et id genus omne. Very little help is to be had from the line of cases which turn upon the enhancement in market price of capital assets. Income implies actual receipt and market price is nothing more than the opinion of the market of the price which anything will command in the market based upon the fact that a like thing has been sold at that price. The owner of anything "receives" nothing because of this unless he sells.

The latitude which the question of what is income affords for difference of opinion is illustrated by the case of *Stratton* v. *Howbert* (231 U. S., 399). There the question arose under a law which imposed an excise tax upon corporations "doing business" measured by the "net income" derived, and it was held that mining companies were within the Act and the proceeds of sales of coal was "income." The specific question was whether the value of coal in place should be deducted from the proceeds of the sale of mined coal before the "net income" could be found. This question was ruled in the negative, but four justices dissented. It was moreover ruled expressly as not an "income tax" question.

Stanton v. *Baltic* (240 U. S., 103) was the case of a bill to restrain payment of a tax levied as an "income tax" under the Act of 1913. The discussion was almost wholly confined to constitutional questions. The view, however, is expressed that a tax on income derived from sales of mine products is not a direct tax on property.

Von Baumbach v. *Sargent* (242 U. S., 503) was the case of a corporation owner of lands with the possession of which it had parted under a form of conveyance which in the Pennsylvania view would have been a sale of ore in place but under the Minnesota (where the lands lay) rule was a mining "lease" of the land, reserving royalties as rent. The court saw no need to decide the question as one of Minnesota law but held that the "so-called royalties" were "income" within the meaning of the corporation tax law of 1909.

United States v. *Biwobik* (247 U. S., 116) was the like case but of an operating lessee corporation.

Goldfield v. *Scott* (247 U. S., 126) records a like ruling.

The conclusion reached is that the courts of the United States do not accept the Pennsylvania view of "so-called mining leases" and that in the construc-

tion of a tax law of the United States the law of the State in which the land is situate need not be followed and that "so-called royalties" are income.

Leave is given for the entry of an appropriate order in accordance herewith.

ARTICLE 45: Sale of real estate on installment plan.

VI-44-3488
G. C. M. 2042

REVENUE ACT OF 1921.

A transaction under which a deed of lease reserving a "ground rent" under the laws of Maryland was executed, held, for income tax purposes, to be a deferred-payment sale of real estate on the installment plan, the redeemable ground-rent lease being in substance a mortgage. Recommended that Office Decision 1089 (C. B. 5, 98) be revoked.

The following facts in regard to the income tax liability of A have been submitted to this office:

It appears that A did not report in his income tax return for the fiscal year ended January 31, 1921, any income from a transaction negotiated during that year, involving a piece of property located at ——— Street, Baltimore, Md.

The taxpayer purchased in fee the property in question in 1919 for $18x$ dollars and improved the same at a cost of $5x$ dollars. On October —, 1920, the taxpayer entered into an agreement with B, the principal part of which reads as follows:

WITNESSETH, That the said party of the first part does hereby bargain and sell unto the said party of the second part, and the latter does hereby purchase from the former, the following described property, situate and lying in Baltimore City, Md., and known as —— Street, subject to a subsisting mortgage of $12x$ dollars and subject also to a ground rent to be created between the parties hereto of $1.2x$ dollars per annum redeemable at the end of 20 years at 6 per cent at the option of the party of the second part, at and for the price of $9x$ dollars of which x dollars have been paid prior to the signing hereof and the balance is to be paid as follows: $4x$ dollars cash, on the date of settlement which is to take place within 30 days from the date hereof, and $4x$ dollars to be represented by a mortgage to be executed by the party of the second part to the party of the first part of the property aforesaid, payable $2x$ dollars one year from the date thereof and $2x$ dollars at the end of the two years from the date thereof, with interest at the rate of 6 per cent per annum, and upon payment as above of the unpaid purchase money, and the execution of a mortgage, a lease for the property shall be executed at the vendee's expense by the vendor, which shall convey a good and marketable title to the property to the vendee.

On January —, 1921, the taxpayer and his wife executed a ground-rent lease to B and his wife for a term of 99 years, renewable forever, with an annual rental of $1.2x$ dollars, in consummation of the above agreement. The lease provides for reentry by the lessor in case of nonpayment of rent for six months. The lease itself does not provide for redemption, but the agreement of October —, 1920, provides that the ground rent shall be redeemable at the end of 20 years. The property sold was a business property. It should be noted that under the laws of Maryland a lease of business property exceeding 99 years (which has been held to include a lease for 99 years, renewable forever) is redeemable after the expiration of the first 5 years. (See section 93 of article 21, Annotated Code of Maryland, and chapter 384, Laws of Maryland, 1922.) These provisions of statute may also be taken to control this lease, since it has been held in *Stewart* v. *Gorter* (70 Md., 242, 16 Atl., 644) that a lessee can not by covenant estop himself to take advantage of the statutory

provisions, because the law was not enacted merely for his benefit, but from considerations of public policy.

The revenue agent, in his report of August —, 1925, considered the transaction as a closed one and made a determination of gain. It will be noticed that he treats the consideration as divided into three parts, viz: (1) First mortgage assumed, $12x$ dollars; (2) x dollars in cash payable at once, $4x$ dollars in cash payable in 30 days. $4x$ dollars represented by notes payable in one and two years in installments of $2x$ dollars each, secured by a second mortgage; and (3) the capitalized amount of the annual ground rent, i. e., $1.2x$ dollars capitalized at 6 per cent, or $20x$ dollars.

The taxpayer, relying on Office Decision 1089, did not report any income from the transaction in his return for the fiscal year 1921, on the ground that such a transaction in the State of Maryland is not a closed transaction for the purpose of a determination of profit or loss, since it was held in Office Decision 1089 that "leases reserving such ground rent do not constitute sales and, therefore, do not result in a closed transaction resulting in gain or loss prior to the time the ground rents covered thereby are redeemed."

In each of the two sales of property presented in Office Decision 1089, the purchaser paid a substantial cash payment (three-fourths of the price in one case and one-half in the other), and agreed to pay an annual ground rent equal to 6 per cent of the unpaid portion of the purchase price, with the right at any time after five years to redeem the ground rent by the payment of the remainder of the price due. The case at hand is of a similar kind and is described in the agreement of October —, 1920, as a "bargain and sale." Should transactions of this kind, which the parties thereto have described as sales, be held to be only leases because the deal is so arranged that a portion of the purchase price is covered by a so-called ground-rent lease? In these cases one party has agreed to sell and another has agreed to buy the property at an agreed purchase price. A substantial part of that price has been paid in cash. Under the agreements these payments do not purport to be payments of advance rental, or for an option, but purport to be payments of purchase price. There is no evidence in this case, nor does there appear to have been in the cases considered in Office Decision 1089, to indicate that such payments were not directly and presently in reduction of the agreed purchase price. It seems inconsistent, therefore, to consider the transaction a lease with option to buy, merely because a portion of the agreed purchase price is covered by a ground-rent lease. Such so-called leases clearly fill the office of a mortgage, and from a practical point of view they have the effect of mortgages, even though the lessee (purchaser) is at liberty to determine when he shall redeem. Having paid a substantial part of the purchase price, the purchaser will determine the time of redemption depending upon his financial circumstances. The arrangement is one under which extended credit may be had.

In *Bosley* v. *Bosley's Executrix* (14 How. (U. S.), 390) the testator had entered into a contract whereby he agreed in consideration of the payment of $2,000, payable at specified times, and an annual ground rent of $210, to lease 50 acres of land in Baltimore County

to one Armstrong for 99 years, renewable forever, with the right in Armstrong to extinguish the ground rent upon payment of $3,000 at any time (annual rent capitalized at 7 per cent). The question was whether the testator's interest in respect of the land passed under his will as real estate or personalty. If the contract was a lease, the interest of the testator at his death was that of the owner of realty; if the contract was a mortgage, the testator's interest had become personalty. The Supreme Court of the United States said:

> The form of the contract adopted in this instance, between the testator and Armstrong, is in familiar use in the sale of lots in the city of Baltimore and the adjacent country. It has nearly if not altogether superseded the old forms of contract where the vendor conveyed the lands and took a mortgage to secure the payment of the purchase money—or gave his bond for the conveyance and retained the legal title in himself until the purchase money was paid. And it has taken the place of these forms of contract, because it is far more convenient, both to the seller and the purchaser. For it enables the vendee to postpone the payment of a large portion of the purchase money until he finds it entirely convenient to pay it; and at the same time it is more advantageous to the vendor, as it gives him a better security for the punctual payment of the interest; and while an extended credit is given to the vendee, it is to the vendor a sale for cash. For if his ground rent is well secured, he can at any time sell it in the market, for the balance of the purchase money left in the hands of the vendee. It will be observed that the rent reserved is precisely the interest on the amount of the purchase money remaining unpaid. And when it must be admitted that a sale in which a bond of conveyance is given, and the title retained by the vendor to secure the payment of the purchase money, is in equity a revocation [of a devise of real estate], there would seem to be no good reason for holding otherwise in the case before us, where the vendor is equally bound to convey when the whole purchase money is paid. A distinction between the cases would rest *on a difference in form rather than of substance* and principle. [Italics supplied.]

A comparison of the facts in the Bosley case with the facts in the two cases illustrated in Office Decision 1089 will show that they are substantially identical.

It is true that the Court of Appeals of Maryland, in *Packard* v. *Corporation* (77 Md., 240, 26 Atl., 411, at page 415), has said that the Supreme Court in the Bosley case did not "hold that the lease was not what, on its face, it purported to be." But it can not be overlooked that the Supreme Court referred to the parties in the Bosley case as "seller" and "purchaser" and as "vendor" and "vendee"; to the principal of the lease as the postponed "payment of a large portion of the purchase money"; to such postponed payment as "an extended credit * * * given to the vendee"; and to the transaction as one that "is to the vendor a sale for cash." The court said that a distinction between such a case and a sale where "a bond for conveyance is given, and the title retained by the *vendor*, to secure the payment of the purchase money * * * would rest on a difference in form rather than of substance and principle." If it be conceded, arguendo, that the Supreme Court stopped short of holding the contract to be a mortgage, there appears to be little doubt that its reasoning leads logically to the conclusion that under the circumstances it was a mortgage. Indeed, the contract was either a mortgage or a lease; if it were a mortgage, the devise of the land involved had been revoked before the will became effective; if it were a lease, there had been no revocation. The court held there was a revocation and that the testator's interest concerning the land passed as personalty. So it must follow that the court held the contract to be a mortgage.

The lease in *Packard* v. *Corporation*, supra, was for 99 years, renewable forever, redeemable at the "expiration of 10 years from date hereof, and within one year thereafter, and during the continuance of this demise." The Maryland court construed this redemption provision to provide for redemption only in the period of 1 year after the expiration of 10 years, and held that such a limited right of redemption indicated that the parties intended that the contract should be what on its face it purported to be, namely, a lease. Thus construed the case presented a very different problem from the one in the Bosley case, where the right to redeem once in effect was not limited. The court in the Packard case also said that:

It is true that a ground rent redeemable at a definite future is in Baltimore "a common and ordinary form of securing a loan of money," and also has many features in common with those of a mortgage; indeed, is often practically nothing more than a mortgage to secure a principal sum, the interest of which is placed in the form of an annual rent. (*Posner* v. *Bayless*, 59 Md., 60.) [Italics supplied.]

As between the two cases illustrated in Office Decision 1089 and the case of the taxpayer now at hand, the only difference is in the method of payment. In the first two a half or more of the purchase price was paid at once, the balance being secured by a ground-rent lease redeemable after five years. In the case at hand a first mortgage of $12x$ dollars was assumed by the purchaser; $5x$ dollars was payable in cash in 30 days; $4x$ dollars in installments of $2x$ dollars each in one and two years, secured by a second mortgage; and the balance of $20x$ dollars was secured by a ground-rent lease redeemable by agreement after 20 years. There is no distinction of substance between them and the Bosley case. Whatever doubt may have been suggested in *Packard* v. *Corporation*, supra, this office is of the opinion that the Supreme Court has held that redeemable ground-rent leases created under the circumstances appearing in the instant case are in truth and substance mortgages. They should be considered in income tax matters "according to truth and substance, without regard to form." (*Eisner* v. *Macomber*, 252 U. S., 189; T. D. 3010, C. B. 3, 25.)

In the case at hand, the purchase price was $41x$ dollars. The initial payment, being the total amount payable in cash in 30 days, was $5x$ dollars, the balance being payable in one, two, and five or more years. The initial payment was therefore less than 25 per cent of the purchase price. The transaction should accordingly be treated as a deferred-payment sale of real estate on the installment plan. See Treasury Decision 3921 (C. B. V–2, 24) and articles 44 and 45, Regulations 69.

It is recommended that Office Decision 1089 be reversed. Article 121 of Regulations 45, 62, 65, and 69 is not to be taken as applying to ground-rent leases made in cases where the facts are similar to the facts considered in this memorandum.

ARTICLE 45: Sale of real estate on installment plan. VI–44–3489 I. T. 2385

REVENUE ACT OF 1921.

Office Decision 1089 (C. B. 5, 98) is revoked, in view of General Counsel's Memorandum 2042, page 182.

ARTICLE 51: When included in gross income. VI-37-3424
T. D. 4082

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. INCOME—COMPENSATION—RECEIVER'S FEE.
A receiver's fee is income to the receiver when the amount thereof is determined by the court and paid.

2. DECISIONS FOLLOWED.
The decisions in *Jackson* v. *Smietanka* (267 Fed., 932 (T. D. 2960 [C. B. 2, 80]), and 272 Fed., 970 (T. D. 3159 [C. B. 4, 96])) 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 District Court of the United States, District of Massachusetts, in the case of *William C. Forbes* v. *Malcolm E. Nichols* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 30, 1927.
OGDEN L. MILLS,
Acting Secretary of the Treasury.

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DISTRICT COURT OF THE UNITED STATES, DISTRICT OF MASSACHUSETTS.

William C. Forbes v. *Malcolm E. Nichols.*

[July 27, 1927.]

MEMORANDUM.

LOWELL, J.: This was an ingenious attempt by a taxpayer, acting under the advice of skillful counsel, to distribute a large fee which he received at the end of receivership proceedings over the years in which the services were rendered in order to reduce the amount of his income tax. In carrying out this scheme the taxpayer kept his books during the year in which the fee was received on an accrual basis, and distributed the fee among the preceding years. The trouble with the books was that they were not kept on the accrual basis during the years when the income from fees was alleged to have accrued, but were so kept afterwards in a belated endeavor to account for the large fee received as having accrued during the previous years.

I have given this case sympathetic attention, but in my opinion the attempt to reduce the size of the income tax was unsuccessful—not from any lack of ingenuity or any defect in the bookkeeping, but from the fact that the taxpayer was not compensated for his services as receiver by a salary paid (or earned) at stated periods but by a fee paid at the close of the proceedings, the size of which was dependent upon the outcome of the proceedings. (*Jackson* v. *Smietanka*, 267 F. R., 932, 272 F. R., 970.)

The fee must therefore be treated as income of the year in which it was received.

The plaintiff's requests for rulings and the first five of the defendant's requests are denied. The last two requests of the defendant are granted.

Judgment may be entered for the defendant.

ARTICLE 51: When included in gross income. VI-48-3520
G. C. M. 2612

REVENUE ACT OF 1921.

An assignment was made of a right to receive moneys due over a term of years under a contract for the sale of stock. The assignor received the full amount of the unpaid balance due under the contract at the time of the assignment, less discount, and guaranteed the fulfillment of the terms of the contract by the purchaser of the stock mentioned therein.

Held, that the full amount received by the assignor from the assignment represented income for the year in which received and that the transaction represented a completed sale rather than the pledging of the contract as security for a loan.

An opinion is requested as to the year in which the income which results from the transaction described below should be reported.

In 1920 the taxpayer entered into a contract for the sale of certain shares of stock to A. The contract provided that the purchase price of the stock should be $67x$ dollars, payable as follows: $27x$ dollars in cash and securities at the time of the execution of the contract and four annual payments of $10x$ dollars each, to be made on or before July 1, 1922, July 1, 1923, July 1, 1924, and July 1, 1925. No income was reported by the taxpayer in 1920 as a result of the transaction, since the cost of the stock to the taxpayer was $27x$ dollars. The stock was transferred to A and by him assigned in blank to the M Company as trustee for both parties to the contract, to be held until final payment under the contract was made. The contract contained appropriate recitals covering the contingency of default by the purchaser.

On November —, 1922, the taxpayer assigned his rights under the contract of sale described above to the M Company, the instrument of assignment providing as follows:

For value received I hereby assign unto the M Company, all moneys due or to become due, and guarantee the payments thereof under the annexed contract, and also assign to it all the securities held by M Company, trustee, in connection with said contract.

As a consideration for the assignment of the contract of sale the taxpayer received from the M Company the net amount of $29x$ dollars on November —, 1922, such amount being made up as follows:

	Dollars.
Amount still due under contract of sale as at date of assignment, November —, 1922	$30x$
Plus accrued interest to date of assignment	x
Total	$31x$
Less discount	$2x$
Net proceeds received from assignment	$29x$

Advice is requested as to whether there should be reported by the taxpayer as income for the year 1922 the total amount received from the M Company as a result of the assignment of the contract, or if there should be reported for the year 1922 and subsequent years the amount of payments made by A to the M Company.

Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer unless they are included as of a different period in accordance with the approved method of accounting followed by him. The taxpayer

in the instant case was on a cash receipts and disbursements basis. In the case of a casual sale or other casual disposition of personal property having a price exceeding $1,000 income may be returned on the installment basis, provided the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale or other disposition is made do not exceed one-fourth of the purchase price. (Sections 212(d) and 1208, Revenue Act of 1926.) In the instant case the taxpayer received at the time of the execution of the contract of sale $27x$ dollars in cash and securities, an amount in excess of one-fourth of the agreed purchase price of the stock sold. Since the initial payment received under the contract of sale was in excess of one-fourth of the total amount agreed to be paid for the stock, the case does not fall within the provisions of the statute relating to the reporting of income from a casual sale of personal property on the installment basis. (Appeal of George Antonoplos, 3 B. T. A., 1236; appeal of Anton M. Meyer, 3 B. T. A., 1329.)

The taxpayer contends that the transaction whereby his right to receive the balance of the moneys due under the contract of sale was assigned to the M Company was not a sale and that he is in the same position as though he had simply borrowed the money from the M Company, giving the contract of sale between himself and A as collateral security. The taxpayer further contends that he can be considered as having received a payment only when the original debtor makes the payments provided under the contract of sale to the M Company. It is pointed out by the taxpayer that when an outright sale is made the seller ordinarily relinquishes all rights in the property sold and is in no way responsible for the payment of amounts subsequently due, as in the instant case.

With respect to the contention that the transaction between the M Company and the taxpayer should be regarded as the making of a loan by the M Company and the assigning of the contract as security therefor, it seems proper to state that such transaction lacks every essential detail of the manner in which loans are ordinarily effected and evidenced. On the other hand, the transaction seems to possess the fundamental characteristics of a sale of the taxpayer's interest in the contract assigned. The fact that the taxpayer may have guaranteed the payment by A of the outstanding balance due under the contract of sale between the taxpayer and A would not result in changing the nature of the transaction.

This office is of the opinion that in the assignment of the contract of sale to the M Company and the receipt of a stipulated amount in return for such assignment the taxpayer parted with his property interest in the contract, and there was a sale of such interest completed at the time such assignment was effected and the consideration therefor received. The situation is not unlike that which exists in a case where the purchaser of a promissory note indorses and sells the same to another, receiving therefor the face value of the note less discount. The mere fact that the taxpayer in the instant case guaranteed the fulfillment of the contract by the purchaser named therein would not operate to convert the assignment of the contract into a pledge of the contract as security for a loan. As a result of the assignment the taxpayer divested himself of all his interest in the

proceeds to be received under the contract of sale, and in so far as he was concerned the transaction was completed. The amount received as a consideration for the assignment of the contract may not be regarded as a loan, but the assignment agreement between the M Company and the taxpayer must be construed to be what it purports to be, namely, an assignment of all interest in the contract of sale for an immediate cash consideration, resulting in the receipt of income during the year 1922.

For the reasons above stated it must be concluded that the entire amount received by the taxpayer as a result of the assignment of the contract of sale on November —, 1922, should be reported as income received during the year 1922.

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

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

ARTICLE 88: Compensation of State officers and employees. VI-30-3336 T. D. 4045

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. INCOME—EXEMPTION—OFFICERS AND EMPLOYEES—GOVERNMENTAL FUNCTION.

A New York corporation authorized by the laws of that State to act as administrator and executor of decedents' estates, guardian of minors and incompetents, testamentary trustee and trustee under trusts created inter vivos, whose compensation is not paid by the State but indirectly by the private person or persons interested in the estate in each case, is not an officer or employee of the State nor engaged in the exercise of a governmental function and the fees and compensation received by it in those capacities are not exempt from taxation under section 213(b) of the Revenue Act of 1918.

2. SAME—BURDEN OF PROOF.

The plaintiff claiming the benefit of an exemption from taxation has the burden of showing clearly that it is within the exemption.

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 New York Trust Co.* v. *The United States* is published for the information of internal revenue officers and others concerned.

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

Approved July 18, 1927.

CARL T. SCHUNEMAN,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

The New York Trust Co. v. *The United States.*

[February 14, 1927.]

GRAHAM, Judge, delivered the opinion of the court.

This case comes on to be heard on a demurrer to the petition.

Plaintiff is a corporation organized and existing under and by virtue of the banking laws of the State of New York and, as such, is authorized by the laws of that State to act as administrator and executor of decedents' estates, guardian of minors and incompetents, testamentary trustee, and trustee under trusts created inter vivos.

During the year commencing January 1, 1918, plaintiff, acting under due appointment by the courts of the State of New York in the following capacities, received as its fees and compensation the sum of $51,317.81, covering the following items:

As executor of decedents' estates	$419.06
As administrator of decedents' estates	181.22
As committee of the property and person of insane people	4,003.06
As guardian for infants	405.96
As trustee under testamentary provisions	27,143.14
As trustee under voluntary trusts created inter vivos	19,165.37

The plaintiff, pursuant to the requirements of the Revenue Act of 1918 (40 Stat., 1056), sections 232 and 233 in connection with section 213, filed its income-tax return and paid upon the said amount of $51,317.81, as income tax, $19,706.03.

On the 15th of March, 1924, plaintiff filed with the collector of internal revenue its claim for refund of $51,000, which claim, as amended May 20, 1924, was for $19,706.03. The Income Tax Bureau denied this claim, and, on appeal to the Committee of Appeals and Review, the ruling was affirmed on January 24, 1925.

The plaintiff avers in its petition as follows:

"Upon information and belief, the claimant, acting in the capacities of administrator, executor, testamentary trustee, committee of incompetents, and guardian of infants, is an officer, agent, or instrumentality of the government of the State of New York in the performance of governmental functions, and that the Government of the United States is without power to tax income received by the claimant acting in these capacities and as such State officer, agent, or instrumentality."

It is conceded that if the said income arose in the shape of a compensation by reason of the fact that it was an officer or employee of the State of New York, its income, under the decisions of the courts, which are fully set out and discussed in the case of *Metcalf & Eddy* v. *Mitchell* (269 U. S., 514 [T. D. 3824 C. B. V–1, 218]), would be exempt from the tax levied by the aforesaid Act.

We are of opinion that plaintiff was not an officer or employee of the State of New York.

The court in the Metcalf case said:

"An office is 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 terms, its duties, and its compensation * * *. The term 'officer' is one inseparably connected with an office: * * *."

See also *United States* v. *Hartwell* (6 Wall., 385, 393) and *United States* v. *Germaine* (99 U. S., 508, 511, 512), in which latter case it was held that the position must be "continuing and permanent, and not occasional or temporary." In the same case also the court mentions, as indicating that the plaintiff, Germaine, was not an officer, that he was "required to keep no place of business for the public use. * * * No regular appropriation is made to pay his compensation * * * but it is paid out of money appropriated for paying pensions in his district" and that there was "no penalty for his absence from duty or refusal to perform, except his loss of the fee in the given case."

In *Louisville, Evansville & St. Louis Railroad Co.* v. *Wilson* (138 U. S., 501, 505) the court said:

"The terms 'officers' and 'employees' both alike, refer to those in regular and continuous service. Within the ordinary acceptation of the terms one who is engaged to render service in a particular transaction is neither an officer nor an employee. They imply continuity of service and exclude those employed for a special or single transaction."

But the plaintiff urges that if it is not an officer or employee it is an instrumentality of the government of the State of New York employed in carrying into effect some of the powers of government which could not be interfered with by taxation upon the part of the United States, and in effect that it is a constitutional means employed by the government of the State to execute its constitutional powers. We are of opinion that it is not such an instrumentality.

The plaintiff, while acting in the different capacities named in the petition, was discharging no function pertaining to the sovereign power of a State; it was not engaged in the civil service of the State. Its compensation was not paid by the State but indirectly by the private person or persons interested in the estate in each case, and it was accountable to them for a faithful discharge of its trust. It performed no duties which affected the welfare of the general public.

Plaintiff is claiming the benefit of an exemption from taxation, and the burden is upon it to show clearly that it is within the exemption claimed. (*Phoenix Fire & Marine Insurance Co.* v. *Tennessee*, 161 U. S., 174; *Chicago, Burlington & Kansas City R. R.* v. *Guffey*, 120 U. S., 569, 575; and *Metcalf & Eddy* v. *Mitchell*, 269 U. S., 514.)

The plaintiff has not clearly established that it is entitled to exemption from taxation under the statute.

The demurrer should be sustained and the petition dismissed, and it is so ordered.

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACTS OF 1918 AND 1921.

Compensation received by the New Jersey and New York Sandy Hook pilots not exempt from tax. (See G. C. M. 1867, page 39.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1921.

Compensation of branch pilots, port of M, Texas. (See I. T. 2371, page 120.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACTS OF 1918 AND 1921.

Compensation of pilots, Boston Harbor. (See G. C. M. 1832, page 44.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1921 AND PRIOR ACTS.

Compensation of bar pilots, New Orleans. (See G. C. M. 211A, page 49.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1921.

Compensation of pilots licensed under laws of Pennsylvania. (See G. C. M. 1833, page 51.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACTS OF 1918 AND 1921.

Compensation of pilots licensed under laws of Delaware. (See I. T. 2372, page 53.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACTS OF 1918 AND 1921.

Compensation of pilots licensed under the laws of Georgia is not exempt from income tax. (See I. T. 2387, page 56.)

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 France 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. 4098, page 58.)

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

ARTICLE 109: Rentals. VI–48–3521
I. T. 2390

REVENUE ACT OF 1921.

The taxpayer was the owner of a long-term lease on certain property for which he paid a yearly rental. He organized a corporation, becoming the sole stockholder, which purchased the property for cash obtained from him in payment for the corporation's stock. Simultaneously the lease was canceled. The cost of improvements made subsequent to March 1, 1913, by the taxpayer, unrecovered when the lease was canceled, was x dollars.

Held, that the unrecovered cost of the improvements should be added to the cash paid for the stock, and a pro rata part of the aggregate sum will represent the cost of each share of stock in determining the gain or loss on its subsequent sale.

It appears that in 1923 a taxpayer owned a long-term lease on certain property which had eight more years to run. The property in question originally consisted of a 5-story brown stone residence, which subsequent to February 28, 1913, the taxpayer had converted into a 6½-story business building with an elevator. These altera-

tions included extending the building 7½ feet to the building line. He paid a net rental to the owner in addition to paying city taxes and all other expenses connected with the property. In 1923 the owner decided to sell the property and gave the taxpayer the opportunity to purchase it. He was not in a position to make this purchase, but realized that his lease which would expire in 8 years contained no renewal privileges and that he had placed permanent improvements on the property, the cost of which would be lost to him at the termination of the lease. The taxpayer, therefore, organized a corporation, known as the M corporation, for the purpose of purchasing the property and holding title to it. He borrowed money to buy stock in the corporation for which he paid z dollars a share in cash, and the corporation purchased the property directly from the owner for cash. As the taxpayer was the sole stockholder of the corporation, he caused the lease to be canceled.

At the time of such cancellation the cost of improvements which he had placed on the leased property and had not recovered through annual deductions under article 109 of Regulations 62 was x dollars. Article 109 provides that the cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is considered as a capital investment and is not deductible as a business expense, but that the lessee in such case may deduct from his gross income each year an amount equivalent to the total cost of the improvements divided by the number of years remaining of the term of the lease unless the life of the lease is greater than the probable life of the building erected or of the improvements made, in which case the deduction takes the form of an allowance for depreciation.

Under the circumstances outlined and in view of the fact that the taxpayer's acquisition of the capital stock of the M corporation, the purchase of the building by the corporation, and the cancellation of his lease took place simultaneously, it is held that the unrecovered cost of the improvements did not constitute a loss to the taxpayer but represented an additional amount paid by him for his stock in the corporation. The amount of such unrecovered cost should be added to the cash paid for his stock, and a pro rata part of the aggregate sum will represent the cost of each share of stock in determining the gain or loss on its subsequent sale.

ARTICLE 111: When charges deductible. VI–47–3514
T. D. 4099

INCOME TAXES—REVENUE ACT OF 1917—DECISION OF SUPREME COURT.

1. DEDUCTIONS—BUSINESS EXPENSES—ACCRUALS—BONUS CONTRACT.

Under the Revenue Act of 1917 the liability under an agreement to pay a purchaser of a mortgage note a bonus of 1 per cent per annum during the life of the note in addition to the interest carried by the note may be accrued as an ordinary and necessary expense of doing business by a taxpayer keeping his books on an accrual basis, although the total amount of the bonus is uncertain because the maker of the note may pay it in full before maturity.

2. DECISION FOLLOWED.

The case of *United States* v. *Anderson* (269 U. S., 422 (T. D. 3839 [C. B. V–1, 179])) 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 Supreme Court of the United States in the case of *American National Co., as Receiver for the F. B. Collins Investment Co., appellant*, v. *The United States of America* is published for the information of internal revenue officers and other concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved November 12, 1927.

A. W. MELLON,
Secretary of the Treasury.

SUPREME COURT OF THE UNITED STATES.

American National Co., as Receiver for the F. B. Collins Investment Co., appellant, v. *The United States of America.*

Appeal from the District Court of the United States for the Western District of Oklahoma.

[April 11, 1927.]

Mr. Justice SANFORD delivered the opinion of the court.

The receiver of the F. B. Collins Investment Co., proceeding under section 24, paragraph 20, of the Judicial Code, brought this suit against the United States to recover an additional income and excess profits tax of $4,287.64 that had been assessed against the company for the year 1917 under the Revenue Act of 1916 and the War Revenue Act of 1917, and paid by it under protest. The district court, sitting as a court of claims, on its findings of fact, entered judgment in favor of the United States, before the effective date of the Jurisdictional Act of 1925. And this direct appeal was allowed. (*J. Homer Fritch, Inc.*, v. *United States*, 248 U. S., 458.)

The question here presented is whether, under the provisions of the Revenue Act of 1916, the company in computing its taxable net income for 1917 was entitled to deduct from its gross income the amount of certain obligations for the payment of money which it claimed were "expenses" incurred in the operation of its business within that year.

The Revenue Act of 1916 provided, in sections 12(a) and 13(a), that the net income of a corporation should be ascertained by deducting from its gross income received within the year, first, the "ordinary and necessary expenses paid within the year in the maintenance and operation of its business"; and, in section 13(d), that a corporation "keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, * * * make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned." In Treasury Decision 2433, issued in January, 1917, dealing with the latter provision, the Commissioner ruled that:

"Under this provision it will be permissible for corporations which accrue on their books monthly or at other stated periods amounts sufficient to meet fixed annual or other charges to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis * * *. This ruling contemplates that the income and authorized deductions shall be computed and accounted for on the same basis and that the same practice shall be consistently followed year after year."

The findings of fact show that the company, an Oklahoma corporation, had been engaged since 1908 in the business of making loans secured by mortgages upon real estate, which it negotiated and sold to investors. Under its usual course of business the borrower, upon the making of a loan, executed to the order of the company his note for the amount loaned, due in five years, with interest at 5 per cent per annum, payable semiannually, with the privilege of paying $100 or any multiple thereof on the principal, on or after two years, at the maturity of any interest payment. At the same time the borrower executed to the company another note due in two years, without interest, for 10 per cent of the total amount of the loan, as the company's commission or compensation for making and negotiating the loan. From these commission notes the company derived its income.

At first the company negotiated and sold the loan notes to investors entirely through brokers or agents, to whom it paid fees or commissions. But from and after 1916 it sold many of these notes direct to investors; and being thus relieved from payment of these fees or commissions, and as an inducement to investors to purchase from it direct, agreed to pay them bonuses upon the notes as added consideration for the purchases; this being evidenced by a contract, styled a guarantee, which the company gave the investor, agreeing to pay him during the life of the loan, according to the terms of the note, 1 per cent per annum of its amount, in addition to the 5 per cent per annum that the borrower was to pay.

The company consistently kept its books of account from year to year on an "accrual basis." Under the practice followed from the inception of its bonus method of doing business, whenever a loan note was sold it charged on its books, as an expense incurred in the sale, the aggregate amount of the payments called for in the bonus contract, computed at 1 per cent per annum to the maturity of the note, and credited the investor on its books with a like amount, in a subsidiary bills payable ledger. The total amount of this liability on the bonus contracts was carried on its general ledger under a control account called the guarantee fund account.

In the year 1917, in accordance with this practice, the company accrued and set up on its books as a liability and charged to expense the aggregate amount of the payments called for in the bonus contracts given investors during that year. And it made its tax return for that year upon the basis upon which the accounts were kept, claiming as an expense the aggregate amount of these bonus contracts, as set up on its books. And, as admitted in argument, although not shown specifically by the findings of fact, it also entered on its books and returned as income received during the year, the aggregate amount of the commission notes given by the borrowers when it made the loans.

Furthermore, under the company's practice, if any loan note was paid by the borrower before maturity, the difference between the amount of the bonus contract credited to the investor's account and the payments that had been made on the contract was credited back to profit and loss, and treated as income of the company for the year in which the note was paid.

The Commissioner of Internal Revenue disallowed the claim of the company for the deduction of the total amount of the bonus contracts issued in 1917, and allowed the deduction only to the extent of the installments called for by such contracts which matured in 1917; and in accordance with this ruling made the additional assessment which is here involved. And the sole question here is whether the company was entitled to deduct the entire amount of the bonus contracts, as it claimed, or merely such portion thereof as became due within the year, as ruled by the Commissioner.

The Government, although conceding that the bonus contracts "represented an expense" of the company's business, contends that their total amount was not deductible as an expense "incurred" in 1917, on the grounds that only a part of the obligations "accrued" within that year, and that the method used by the company in keeping its books did not clearly reflect its true income. We can not sustain this contention.

In *United States* v. *Anderson* (269 U. S., 422, 437) we held that where a corporation kept its books on an accrual basis, the amount of a reserve entered thereon for taxes imposed by the United States on the profits of munitions made and sold during the taxable year should be deducted from its gross income for that year, although they were not assessed and did not become due until the following year. The court said:

"While section 12(a) taken by itself would appear to require the income tax return to be made on the basis of actual receipts and disbursements, it is to be read with section 13(d) * * * providing in substance that a corporation keeping its books on a basis other than receipts and disbursements may make its return on that basis, provided it is one which reflects income. * * * Treasury Decision 2433 * * * recognized the right of the corporation to deduct all accruals * * * made on its books to meet liabilities, provided the return included income accrued and, as made, reflected true net income. * * * A consideration of the difficulties involved in the preparation of an income account on a strict basis of receipts and disbursements * * * indicates with no uncertainty the purpose of sections 12(a) and 13(d) * * * to enable taxpayers to keep their books and make their returns according to scientific accounting principles, by charging against income earned during the taxable period, *the expenses incurred and properly attributable to the process of earning income during that period;* and indeed, to require the tax return to be made on that basis, if the taxpayer failed or was unable to make the return on a strict receipts and disbursements basis. * * * The (corporation's) true income could not have been determined without deducting from its gross income during the year the total cost and expenses attributable to the production of that income during the year. * * * In the economic and bookkeeping sense with which the statute and Treasury decision were concerned, the (munitions) taxes had accrued. It should be noted that section 13(d) makes no use of the words 'accrue' or 'accrual' but merely provides for a return upon the basis upon which the taxpayer's accounts are kept, if it reflects income. * * * We do not think that the Treasury decision contemplated a return on any other basis when it used the terms 'accrued' and 'accrual' and provided for the deduction by the taxpayer of items 'accrued on their books.'"

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

We conclude that the assessment of the additional tax, having been based upon an erroneous disallowance of the deduction claimed by the company, was invalid; and that the receiver was entitled to recover the amount paid, with interest.

The decree of the district court is accordingly reversed.

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

ARTICLE 134: Federal estate and State inheritance taxes.

REVENUE ACT OF 1918.

Deduction of New York State inheritance tax in return filed by executor for decedent. (See T. D. 4056, page 239.)

SECTION 214(a)4, 5, 6.—DEDUCTIONS ALLOWED: LOSSES.

ARTICLE 141: Losses.

VI-29-3316
T. D. 4036

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. LOSS—GOOD WILL—SALE OF TANGIBLE ASSETS.

Where two companies possessing separate plants merge into a new corporation which retains the combined names of the old companies, no deductible loss of good will results from the subsequent sale of one of the plants where it appears that the business formerly conducted at such establishment is continued at its remaining plant. In such a case the good will, if any, attaching to the location was reflected in the sales price of the premises and the good will, if any, attaching to the name and established business was retained by the vendor.

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 in the case of *Acme, Palmers & DeMooy Foundry Co.* v. *Weiss, Former Collector*, is published for the information of internal revenue officers and others concerned.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

Approved July 6, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

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DISTRICT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION.

The Acme, Palmers & DeMooy Foundry Co., plaintiff, v. *Harry H. Weiss, Former Collector of Internal Revenue, defendant.*

[January 31, 1927.]

MEMORANDUM ON DECREE.

JONES, J.: This is a suit to recover $19,965.45 of income taxes paid for the taxable year 1920. Application for refund made to the Commissioner of Internal Revenue was denied. This case was tried to the court without the intervention of a jury.

Plaintiff corporation was organized under the laws of Ohio in July, 1919, with a capital stock of $400,000 for the purpose of acquiring, through exchange of stock, two existing corporations—The Palmers & DeMooy Foundry Co., having an authorized capital stock of $100,000, and the Acme Foundry Co., with an authorized capital stock of $150,000. The plant of the former corporation was located for a great number of years on what has been called "The Flats" in the city of Cleveland, and engaged in the manufacture of special grey iron castings and in the repair of castings; the latter company's plant was located in Cleveland, and engaged in the manufacture of grey iron castings. The stock in these two companies was all transferred to this plaintiff and it became thereafter the owner of both properties. A certificate of convenience and necessity was shortly thereafter issued for the construction of a terminal building at the

public square, in Cleveland. The plant and property of The Palmers & DeMooy Foundry Co. was located on lands necessary to be acquired for the purpose of constructing the terminal building. A contract of sale was consummated without resort to condemnation proceedings, whereby the land, leaseholds, buildings, machinery, and equipment of the Palmers & DeMooy Foundry Co. were sold to the Van Sweringens as of January 1, 1920, for $91,600. As modified by the Board of Tax Appeals, the Commissioner of Internal Revenue computed and determined a net taxable profit on this sale in the sum of $25,180.61. The taxpayer contends that neither the Commissioner nor the Board of Tax Appeals took any account of the loss of good will sustained as the result of the sale of its property for the terminal construction, which, if allowed, would reflect a net taxable loss in excess of $60,000.

The only question here is whether this taxpayer sustained a loss of good will as the result of the sale of the capital assets of the Palmers & DeMooy Foundry Co. as to which it is entitled to a deduction in the determination of its net taxable income for the taxable year 1920.

A summary of accepted definitions and judicially determined meanings would seem to construe good will as "The advantage or benefit which is acquired by an establishment, beyond the mere value of the capital, stocks, 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 necessities, or even from ancient partialities, or prejudices." (Bouvier's Law Dictionary, third revision, vol. 2, p. 1360.)

In so far as location may be included and considered as an element of good will, it would seem to me that it should relate to accessibility to customers and general public patronage, rather than to any consideration of economic production. Upon that basis, there is no evidence here that location of the plant of the Palmers & DeMooy Foundry Co. in some other part of the city of Cleveland would impair or destroy the continuation and improvement of its business, the name remaining the same. There was nothing about the location of the plant in "The Flats" that made and held its good standing and reputation with the trade. Its standing and advantage with customers old and in prospect had no relation to its location. It can be conceived how, with a particular character of business, location might be an element of good will, as, for instance, a cigar store on a particular corner, street, or building, or, in fact, in the case of most retail businesses whose advantage, standing, and reputation were partially created and dependent upon accessibility to customers and the trading public.

Whatever good will the Palmers & DeMooy Foundry Co. had built up in the years of its operation still largely remained and inured to the benefit of this taxpayer in the retention of the name, "The Palmers & DeMooy Foundry Co." If any part of good will could be held to have attached to the tangible assets and location of the plant, the loss of it was reflected in the compromise payment for the whole property under the sale of January 1, 1920. (Appeal of Acme, Palmers & DeMooy Foundry Co., Third United States Board of Tax Appeals Reports, page 1126, March 31, 1926; *Red Wing Malting Co.* v. *Willcuts* [T. D. 3980, C. B. VI-1, 225], 15 F. (2d), 626, at page 633.)

Judgment may be entered for the defendant and for costs.

ARTICLE 144: Shrinkage in value of stocks. VI-33-3368
T. D. 4059

INCOME TAX—REVENUE ACT OF 1918—DECISION OF SUPREME COURT.

DEDUCTIONS — LOSS — WORTHLESS STOCK — BAD DEBT — PROPERTY SEIZED BY GERMAN GOVERNMENT.

The amount of an investment, represented in part by capital stock in a subsidiary German corporation and in part by an account due from it, which was no more than the fair value of the net assets of the subsidiary, was deductible from gross income in 1918, in which year the entire property of the German corporation was seized by the German Government as enemy property and the investment was charged off as a loss on the books of account of the taxpayer.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the Supreme Court of the United States in the case of *United States, Petitioner*, v. *S. S. White Dental Manufacturing Co. of Pennsylvania* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 5, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

SUPREME COURT OF THE UNITED STATES.

United States, Petitioner, v. *S. S. White Dental Manufacturing Co. of Pennsylvania.*

[May 16, 1927.]

Mr. Justice STONE delivered the opinion of the court.

This case comes here on writ of certiorari to the Court of Claims (sec. 240, sec. 3(b), Jud. Code, as amended) to review a judgment of that court allowing recovery by respondent of income taxes paid for the year 1918. The sole question presented is the right of the respondent, upheld below, to deduct from its gross income for 1918 the amount of its investment in a subsidiary German corporation whose entire property was seized in that year by the German Government as enemy property.

Respondent is a Pennsylvania corporation, engaged in the manufacture and sale of dental supplies. Before 1918 it had organized and controlled, by ownership of all the capital stock, the S. S. White Dental Manufacturing Co., m. b. h. of Berlin, Germany, a German corporation. Its investment in the German corporation in 1918, as carried on its books, aggregated more than $130,000.

The agreed statement of facts adopted as findings by the court below are so vague as to leave it uncertain whether this investment was represented on the books of respondent by the capital stock alone, or in part by the capital stock and in part by an open account between it and the German corporation. The case was argued on the assumption, which we make, that the investment was represented by both the capital stock and an open account, due to respondent from the German company. The total is conceded to be no more than the fair value of the net assets of the German corporation.

In March, 1918, the sequestrator appointed by the German Government took over the property of the German corporation and the management of its business. It is inferable from the findings, as the Government concedes, that the sequestration was similar in purpose and legal effect to that authorized under the Trading with the Enemy Act of the United States (October 6, 1917, ch. 106, 40 Stat., 411; March 28, 1918, ch. 28, 40 Stat., 459; July 11, 1919, ch. 6, 41 Stat., 35; June 5, 1920, ch. 241, 41 Stat., 977; March 4, 1923, ch. 285, 42 Stat., 1511; May 7, 1926, ch. 252, 44 Stat., 406), and we shall deal with the case on that basis.

In March, 1920, the possession of the seized assets and business was relinquished to the German corporation by the sequestrator. As a result of the mismanagement of its affairs while in his custody, and investments of its funds by him in German war loans, the value of its assets was seriously impaired. In 1922 its tangible assets and its lease were sold for $6,000. This sum was included in respondent's income tax return for that year. Later respondent filed a claim with the Mixed Claims Commission which was allowed in 1924 to the extent of $70,000. What if anything may ultimately be realized from this award remains uncertain.

In 1918 the respondent charged off as a loss the entire amount of its investment in the German corporation as shown by its books, and in July of that year passed a resolution authorizing the establishment of a reserve against this loss at the rate of $15,000 quarterly, beginning March, 1918. In making its income tax return for 1918 respondent deducted from gross income the amount of its investment in the German corporation. The deduction was disallowed by the Commissioner of Internal Revenue, on the sole ground that the loss was not evidenced by a closed and completed transaction in the year for which it was deducted. The tax so assessed was paid under protest and this suit followed.

Section 234 of the Revenue Act of 1918 (ch. 18, 40 Stat., 1057, 1077, 1078), authorizes the deduction in the computation of income taxes of "Losses sustained during the taxable year and not compensated for by insurance or otherwise." In explaining this section, article 141 of Treasury Regulations 45 provides that losses incurred in the taxpayer's trade or business or in any transaction entered into for profit may be deducted but such losses "must usually be evidenced by closed and completed transactions." Article 151 provides in part: "Where all the surrounding and attendant circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction." And article 144 reads in part: "if stock of a corporation becomes worthless, its cost or its fair market value as of March 1, 1913, if acquired prior thereto, may be deducted by the owner in the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness be made as in the case of bad debts." See article 561, making these provisions applicable to corporations.

The case turns upon the question whether the loss, concededly sustained by the respondent through the seizure of the assets of the German company in 1918, was so evidenced by a closed transaction within the meaning of the quoted statute and Treasury regulations as to authorize its deduction from gross income of that year. The statute obviously does not contemplate and the regulations (art. 144) forbid the deduction of losses resulting from the mere fluctuation in value of property owned by the taxpayer. (*New York Ins. Co.* v. *Edwards*, 271 U. S., 109, 116; cf. *Miles* v. *Safe Deposit Co.*, 259 U. S., 247.) But with equal certainty they do contemplate the deduction from gross income of losses, which are fixed by identifiable events, such as the sale of property (art. 141, 144), or caused by its destruction or physical injury (art. 141, 142, 143) or, in the case of debts, by the occurrence of such events as prevent their collection (art. 151).

The transaction evidencing the loss here was the seizure of the property of the German company. The loss resulted to the respondent because it was a creditor and stockholder of that company, which, as a result of the sequestration, was left without property or assets of any kind. The sequestration of enemy property was within the rights of the German Government as a belligerent power and when effected left the corporation without right to demand its release or compensation for its seizure, at least until the declaration of peace. See *Littlejohn & Co.* v. *United States* (270 U. S., 215); *White* v. *Mechanics Securities Corp.* (269 U. S., 283, 300, 301); *Swiss Insurance Co.* v. *Miller* (267 U. S., 42); *Stoehr* v. *Wallace* (255 U. S., 239, 242–244); *Central Trust Co.* v. *Garvan* (254 U. S., 554); *Brown* v. *United States* (8 Cranch., 110, 122). What would ultimately come back to it, as the event proved, might be secured not as a matter of right, but as a matter either of grace to the vanquished or exaction by the victor. In any case, the amount realized would be dependent upon the hazards of the war then in progress.

That legal action by respondent upon its open accounts against a corporation thus despoiled would have been fruitless within the meaning of article 151 seems not open to question. No distinction is urged by the Government between respondent's investment in the stock of the German company and in its open accounts. It is equally apparent that the stock after the seizure was as worthless as the obligations of the German company and was deductible under article 144 on the same basis as bad debts.

If the seized assets are viewed as the property of respondent, ignoring the entity of the German company, the result is the same. The quoted regulations, consistently with the statute, contemplate that a loss may become complete enough for deduction without the taxpayer's establishing that there is no possibility of an eventual recoupment. It would require a high degree of optimism

to discern in the seizure of enemy property by the German Government in 1918 more than a remote hope of ultimate salvage from the wreck of the war. The taxing Act does not require the taxpayer to be an incorrigible optimist.

We need not attempt to say what constitutes a closed transaction evidencing loss in other situations. It is enough to justify the deduction here that the transaction causing the loss was completed when the seizure was made. It was none the less a deductible loss then, although later the German Government bound itself to repay and an award was made by the Mixed Claims Commission which may result in a recovery.

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

ARTICLE 151: Bad debts. VI–36–3412
(Also Section 234, Article 566.) T. D. 4078

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. DEDUCTIONS—BAD DEBTS—PROMISSORY NOTES.

Loans made by a bank evidenced by promissory notes which are not repaid by the borrowers are debts within the meaning of section 234(a)5 of the Revenue Act of 1918, and no deduction on account thereof may be taken until same are ascertained to be worthless and are charged off.

2. SAME—TAX ON BANK STOCK.

State and county taxes imposed upon the stockholders of a bank on account of their ownership of such stock are not deductible by the bank notwithstanding the bank is required by the State law to pay such taxes on behalf of its stockholders.

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, District of Idaho, Southern Division, in the case of *E. W. Porter, Commissioner of Finance of the State of Idaho, as Liquidating Agent of the Citizens State Bank of Buhl, Idaho, an Insolvent Banking Corporation, plaintiff*, v. *United States of America, defendant*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 26, 1927.

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

UNITED STATES DISTRICT COURT, DISTRICT OF IDAHO, SOUTHERN DIVISION.

E. W. Porter, Commissioner of Finance of the State of Idaho, as Liquidating Agent of the Citizens State Bank of Buhl, Idaho, an Insolvent Banking Corporation, plaintiff, v. *United States of America, defendant.*

[June 23, 1927.]

OPINION.

CAVANAH, District Judge: The essential facts are that the Citizens State Bank, a corporation of which the plaintiff as commissioner of finance of the State is now liquidating for the taxable years 1918, 1919, and 1920, made and filed its income tax returns with the collector of internal revenue and paid

thereon, after certain changes were made as to the amounts of income and profit taxes, the amounts involved here. Thereafter, in December, 1921, the bank closed its doors and the plaintiff, as such liquidating agent, proceeded to liquidate its affairs. The claims in question for refund were then filed by plaintiff. He asserts that the bank has suffered a deductible loss of $81,147.32 for the taxable year 1918, $163,129.35 for the year 1919, and $100,083.07 for the year 1920, which were not deducted as a loss for said years in the original returns filed, but, on the contrary, said amounts were reported in the returns as "gross income." These items consisted of loans made by the bank to borrowers during the respective years, and which were evidenced by promissory notes, executed by the borrowers, which included the principal and in some instances interest, and were not paid to the bank. The bank during these three years paid certain amounts upon bank stock taxes, for which it was not reimbursed by the stockholders, and did not include such amounts in its returns as deductions, nor in its claims for refund.

Considerable evidence was introduced by plaintiff relating to the conduct and acts of certain officers of the bank in failing to secure proper security for the loans made to themselves and others, and in allowing overdrafts and loans to those who were not able to repay the bank, which it is claimed by the plaintiff to be in violation of the banking laws of the State, and therefore constituted "constructive embezzlement."

The principal contention of plaintiff is that these loans which were not paid back to the bank, and the uncollected interest thereon, were all losses to the bank and are not to be considered as worthless debts to be charged off within the taxable year.

The question then is whether or not these so-called losses come within subdivisions 4 and 5 of section 234 (a) of the Revenue Act of 1918. The Act provides, section 234 (a), that in computing the net income of the 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;

"(5) Debts ascertained to be worthless and charged off within the taxable year." (40 Stat., 1057.)

It would seem clear that a note due a bank for a loan is a "debt," and comes within the definition of that term. Bouvier says, "A sum of money due by a certain and expressed agreement" is a debt. "In a purely technical sense, it is * * * a sum of money due upon contract, express or implied. In a large sense, the word means that which one person is bound to pay to another, or to perform for his benefit; a sum of money due from one person to another, whether money, goods or services; due; all that is due under any form of obligation or promise." (17 C. J., 1373.)

There appear to be two classes of deductions under the statute: "(1) Losses sustained during the taxable year and not compensated for by insurance or otherwise. (2) Bad debts ascertained to be worthless and charged off during the taxable year." The inquiry then presents itself, Why did Congress find it necessary to specify these two classes of allowable deductions if it did not have in mind a distinction between a worthless debt and a loss? A loss and a worthless debt may amount to the same thing, if the debt is charged off in time as required by statute, but Congress has said that to entitle one to a deduction for a worthless debt it must be ascertained and charged off during the taxable year.

This same interpretation was given to these two provisions of the Act in a learned discussion by Judge Davis in the case of *Electric Reduction Co.* v. *Lewellyn* (11 Fed. (2d), 493 [T. D. 3739, C. B. IV–2, 208]), where it was said:

"If the $27,205.38 is a 'loss' within the meaning of subdivision (a) (4), it may be deducted from the income of 1918, as it was actually 'sustained' in that year. If it was a bad 'debt' within the meaning of subdivision (a) (5), it may not be deducted from the income of that year because it was not 'ascertained to be worthless and charged off within the taxable year' of 1918 * * *. Congress doubtless had in mind a distinction between a loss and a worthless debt. Every worthless debt is a loss, but not every loss is a worthless debt. Every worthless debt is allowed as a deduction, if it is ascertained to be worthless, and is charged off within the taxable year. So far as allowance as a deduction is concerned, a loss and a worthless debt amount to the same thing, if the latter is charged off in time."

Although the trial court was reversed in that case, yet the same interpretation of this Act was given by both courts, the reversal being based upon a differ-

ence of view as to whether the item of $27,205.38 was a loss or a debt—the trial court holding that it was a debt, while the circuit court, taking the opposite view, held that it was a loss. (*Electric Reduction Co.* v. *Lewellyn*, 8 Fed. (2d), 91.)

The losses in the present case were nothing more than sums of money due upon express contracts, which the borrowers were bound to pay to the bank, and fall within the provisions of section 234(a)5 of the Revenue Act of 1918, which brings them under the class of "debts." If Congress had intended that worthless debts not ascertained and charged off during the taxable year should include "losses," it would have been very easy to have said so, and where such intention is not so expressed, the difficulty in attempting to apply the provision of the statute as to "losses" to "debts" is that we are confronted with the other express provision of the statute requiring the taxpayer, before deductions can be allowed, to first ascertain and charge them off as worthless within the time. It would seem impossible to take any other view and at the same time recognize the force and effect of section 234(a)5.

While I recognize the general rule of construction of a taxing statute to be that doubts should be resolved in favor of the taxpayer and against the Government (*Am. Net. & Twine Co.* v. *Worthington*, 12 S. Ct., 55, 141 U. S., 468; *Gould* v. *Gould*, 38 S. Ct., 53, 245 U. S., 151), yet it seems clear to me that these loans involved are "debts," and as they were not ascertained to be worthless and charged off during the taxable years in question, the plaintiff is not entitled to have them classed as deductions.

The second observation to be made is that plaintiff contends that the State and county taxes paid by the bank during these years on bank stock of stockholders should have been included in the bank's returns as deductions as taxes paid. The Revenue Act allows as a deduction taxes assessed against a bank or on its property. The test, then, here is, Were these taxes assessed against the bank itself or against the stockholders? The taxes were levied under the State law, which provides that the stockholders of every banking association must be assessed and taxed in the county and city where such bank is located on the value of their shares of stock therein, and the bank must furnish to the assessor a full and correct list of names of its stockholders, and the tax must then be assessed against the holder appearing in the list as personal property, and must be paid by the bank, but the owners of such shares are liable for the taxes paid by the bank. (Secs. 3299, 3302, 3303, Comp. Stats. of Idaho, 1919.) The supreme court of the State in considering this statute has held that the shares of stock in banks must be assessed against the owners of such stock, and the tax thereon must be paid by the bank, and when so done the bank has a lien against the stock and the earnings, dividends, and profits derived therefrom, for reimbursements in the sum so paid, but it can not charge the same up against the aggregate earnings of the bank as current expense or otherwise, as the same must be charged against the shares of stock upon which such payment was made or against the owner of the stock. (*Shainwald* v. *First Nat'l Bank of Weiser*, 18 Ida., 290, 109 Pac., 257.) A similar statute has been construed by the Circuit Court of Appeals of the Fifth Circuit, where it was said:

"The statute * * * imposes the tax, not on the bank or its capital, but upon the shareholders, the bank being required to pay for them. * * * The conclusion is that the payment in question was not for 'taxes imposed' within the meaning of those words as used in the provision of the Corporation Tax Act as to the deductions allowable in ascertaining the corporation's net income, as the tax in question was imposed, not on the corporation, but upon its shareholders." (*First Nat'l. Bank of Jackson, Miss.*, v. *McNeel*, 238 Fed., 559.)

The Revenue Act permits as a deduction from gross income the payment of taxes made within the year by the corporation, being such tax liability assessed solely upon the corporation or its property, and not to discharge liabilities for which others would be ultimately responsible. "Though payment of such taxes is a duty imposed upon the bank, it can not be said that the taxes are imposed either upon it or its property. The taxes are imposed upon the shareholders and their property, and the payment is by the bank only as their representative." (*Eliot Nat'l. Bank* v. *Gill*, 218 Fed., 600, 602; *Nat'l. Bank of Commerce* v. *Allen*, 223 Fed., 472; *Northern Trust Co.* v. *McCoach*, 215 Fed., 991.)

It seems well settled by the authorities that under statutes similar to the Idaho one under consideration the payment of such taxes on bank stock is a tax assessed on the stockholders of the bank and not upon the bank itself, and is not allowed as a deduction from the gross income of the bank. In this con-

nection it may be further said that if the claim of the parties for a refund, filed with the Commissioner, does not contain this ground, it would seem that it can not be considered at this time, as this action should be based upon the same grounds and only such as were presented to the Commissioner of Internal Revenue in the claim for refund. The purpose of this condition is to afford the Commissioner an opportunity to correct errors, if any, and to spare the parties the burden of litigation. (*Tucker* v. *Alexander*, Eighth Circuit; Op. filed October 27, 1926 [T. D. 3973, C. B. VI–1, 287]; *Red Wing Malting Co.* v. *Willcuts*, 15 Fed. (2d), 626 [T. D. 3980, C. B. VI–1, 225].)

Finally we come to the question whether the facts of the case bring the conduct of certain officers of the bank during these years, in negotiating these loans, under the charge of the plaintiff that it constituted "constructive embezzlement," entitling the plaintiff to deductions arising out of the financial inability of certain borrowers of the bank to meet their obligations, it being urged by plaintiff in his complaint and on the argument that he is entitled to have allowed as a deduction those loans which were not paid back to the bank for the reason that they and certain overdrafts were made to officers and stockholders of the bank who were insolvent and without property security, and their failure to charge off overdue and unsecured loans were all in violation of the banking laws of the State. To bring this contention under the provision of the statute relating to "losses" or "embezzlement" it must appear from the evidence that the conduct of the officers of the bank in negotiating these loans was with the fraudulent intent to either appropriate the funds represented by the loans to their own use or with the fraudulent intent of depriving the bank of the funds. Section 8450 of the Compiled Statutes of Idaho defines embezzlement to be "the fraudulent appropriation of property by a person to whom it has been intrusted." The mere fact that errors were made or bad judgment exercised in negotiating these loans by officers of the bank, or a disregard of some of the requirements of the banking laws of the State, without evidence showing fraudulent intent, would not seem to be sufficient to establish that they were done with the intent to injure or defraud the bank. I am not impressed with this contention under the evidence, as this record is silent as to there being established any intent upon the part of those who negotiated these loans on behalf of the bank to appropriate the funds to their own use, or to injure or defraud the bank. It may be that they did not use the best judgment in passing upon the financial ability of the borrowers to repay the bank, yet that would not constitute embezzlement or theft. After all, the contention takes us back to the claim that the conduct of the officers of the bank in making these loans resulted in nothing more than "bad debts," which, as has been stated, are not allowable as deductions.

These considerations lead to the granting of the motion for nonsuit and a dismissal of the complaint.

ARTICLE 154: Worthless securities. VI–41–3466
T. D. 4094

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. DEDUCTION—LOSS—DEPRECIATED VALUE—CLOSED TRANSACTION—LOAN REPAYABLE IN GERMAN MARKS.

Reduction in the value of a loan repayable in German marks is not deductible from gross income until a loss thereon is realized by repayment or other final disposition.

2. DECISION AFFIRMED.

The decision of the District Court (15 Fed. (2d), 445, T. D. 3932 [C. B. V–2, 169]) 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 Second Circuit, in the case of *George Haviland* v.

Edwards, is published for the information of internal revenue officers and others concerned.

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

Approved October 5, 1927.

A. W. MELLON,
Secretary of the Treasury.

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UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

George Haviland, plaintiff in error, v. *William H. Edwards, defendant in error.*

[July, 1927.]

OPINION.

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 for insufficiency on its face.

The complaint alleged that the plaintiff was a member of a New York firm, doing business not described. Before January 1, 1918, this firm had lent to one Johann Haviland 1,110,000 German marks, equal in value to more than $260,000, but payable in marks. During the year 1919 it lent Haviland a further sum of 400,000 marks, equal to over $16,000. In filing amended income tax returns for the year 1919 the firm, and the plaintiff, in stating the firm income, credited themselves with the depreciation in value of these marks up to December 31, 1919. This was disallowed, and the tax assessed in disregard of any depreciation. The complaint alleged nothing about the nature of the loan, or its relation to the business, except that it was entered on the firm books as an "account receivable, or current asset." A similar claim arose for the year 1920. Being forced to pay the full amount of each tax on his share of the firm's income, the plaintiff sued the collector for the difference.

L. HAND, Circuit Judge: That the depreciation in the value of Johann Haviland's debt to the firm was not, standing alone, a loss which could be credited as such, the plaintiff does not claim. In any event, it would be an untenable position. (*N. Y. Ins. Co.* v. *Edwards*, 271 U. S., 109, 116; *Eisner* v. *Macomber*, 252 U. S., 189, T. D. 3010 [C. B. 3, 25].) The theory of the complaint was that in estimating the firm income it was proper, and indeed necessary in order to ascertain what the profits had been, to appraise the current assets, and that this could only be done by converting the value of the debt in marks into its value in dollars at the end of the taxable year. This really is the same proposition in another form, unless there be some distinction between this debt and an ordinary investment or loan.

The argument therefore proceeds upon section 203 of the Act of 1919, which provides that the Commissioner may require inventories to be used whenever in his opinion they are necessary. These are to be taken "upon such basis as the Commissioner * * * may prescribe as conforming as nearly as may be to the best accounting practice." The Commissioner, by article 1581 of Regulations 45, provided for inventories "in every case in which the production, purchase, or sale of merchandise is an income-producing factor." By article 1585 he also ruled that "a dealer in securities, who in his books of account regularly inventories unsold securities on hand * * * may make his return upon the basis upon which his accounts are kept. * * * Taxpayers who buy and sell or hold securities for investment or speculation * * * are not dealers in securities." Plainly, not only does any right whatever to use inventories rest in the hands of the Commissioner, but the instances in which they may be used. He has decided to allow them, as regards merchandise, when its production or traffic in it produces income, and by dealers in securities with an established business as such. That is all.

Since the complaint does not state what the firm's business was, we have no right to assume that it was a dealer in securities. Again, if it produced or trafficked in merchandise, certainly the loan to Johann Haviland was not

merchandise, which alone is to be included in the inventory. This is apparent from the balance of article 1581, which provides only for raw materials and supplies, and finished or partly finished goods, and which makes the passage of title the test. The complaint is therefore wholly destitute of any allegations which would bring this case within the statute or the regulations. The loan, so far as appears, remained a mere chose in action on the firm's books, for aught we can tell, an accommodation to a relative, or an isolated transaction in the business. Variations in its value did not affect the firm income till it was closed out.

Judgment affirmed.

ARTICLE 155: Reserve for bad debts.

REVENUE ACT OF 1921.

Addition to a reserve for bad debts in the case of debts represented by bonds. (See G. C. M. 1887, page 61.)

ARTICLE 155: Reserve for bad debts. VI–42–3471
G. C. M. 938A

REVENUE ACT OF 1921.

Treatment of bad debts by reserve method under Revenue Act of 1921.

There are submitted for opinion various questions relative to determining deductions for bad debts.

Article 155 of Regulations 62, as amended by Treasury Decision 3997 [C. B. VI–1, 222], provides 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.

The questions submitted and the answers thereto follow:

I. Taxpayer filed, on September 15, 1921, a return for a fiscal year ended June 30, 1921, showing a net income of $30,000. A deduction of $10,000 was taken on such return for bad debts actually ascertained to be worthless. No new or supplemental return was filed after the enactment of the 1921 Act, but an additional tax of $100 for 1921 was assessed in 1924. On its fiscal 1922 return the taxpayer set up a reserve for bad debts and claimed the amount added to the reserve as a deduction against gross income. Has the taxpayer the right to elect the reserve method of treating bad debts in 1922 without obtaining permission from the Commissioner?

Answer. Taxpayers (with the exception hereinafter stated) may, regardless of their previous practice, elect either of the two methods recognized for determining bad-debt deductions for any fiscal year ending in 1922 without obtaining the permission of the Commis-

sioner. This opinion is based upon the fact that, unless extensions of time were obtained, returns for any fiscal year ending in 1921 were due in every case on or before the date (February 15, 1922) upon which Regulations 62 were promulgated.

The exception refers to cases where extensions of time for filing 1921 fiscal-year returns after February 15, 1922, were granted.

If there was no additional tax due under the 1921 Act which would require the filing of a supplemental return by the taxpayer, would the failure to file a supplemental return bar the free election to the reserve method in 1922?

Answer. There is no basis for denying a free election for 1922 under these circumstances.

If a supplemental return was filed prior to February 15, 1922, and no change was made from the specific ascertainment method in such supplemental return, would the taxpayer still have the right to elect the reserve method in 1922 without the Commissioner's permission?

Answer. The taxpayer may elect the reserve method for 1922. The determining factor is the notice given February 15, 1922, as to election. Returns, either regular or supplemental, filed prior to that date, necessarily were filed without the notice.

II. Taxpayer filed, on September 15, 1921, a return for a fiscal year ended June 30, 1921, showing net loss of $10,000. Bad debts were deducted on the specific ascertainment method. Supplemental return under the 1921 Act was filed March 15, 1922, showing the same net loss of $10,000 and no change in the method of treating bad debts. May the taxpayer change to reserve method in 1922 without obtaining Commissioner's permission?

Answer. No.

III. Taxpayer was incorporated in 1921 and filed its return for 1921 on calendar-year basis. No deduction was made for bad debts either on its books or on its return. May taxpayer elect the reserve method for the calendar year 1922 without obtaining the Commissioner's permission?

Answer. Yes. The 1922 return was the first one upon which the taxpayer could indicate a choice of methods.

IV. May a taxpayer change the method of determining its bad-debt deduction for prior years by filing amended returns therefor?

Answer. No. An amended return can be made to correct an error or to reflect a situation as it actually existed, but can not be used to change a method or basis previously adopted.

V. Taxpayer in 1921 set up on its books a reserve for bad debts but deducted on its return the debts actually ascertained to be worthless and charged off. In determining taxpayer's election, should the action taken on the return or that on the books govern?

Answer. The action taken on the return must govern.

VI. Taxpayer, in filing its 1921 calendar-year return, deducted $12,000, representing the amount of bad debts actually ascertained to be worthless. On its 1922 return the deduction of $15,000 for bad debts was made, on the basis of a reserve set up on the 1922 balance sheet. No permission for the change in method was given by the Commissioner, therefore the Unit disallowed the $15,000 reserve. Taxpayer protested, on the ground that $7,500 of the amount included in the reserve for 1922 represented debts actually ascertained to be

worthless. May the amount of $7,500 be allowed as a deduction for the year 1922?

Answer. The taxpayer has elected to use the specific ascertainment method and can not change therefrom except on permission and consent of the Commissioner. No amount should be allowed as a bad-debt deduction for the year 1922 unless it represents debts actually ascertained to be worthless and charged off during that year.

VII. Taxpayer organized in 1921, but did not take any deduction for bad debts on the 1921 return. In 1922 it set up a reserve, this being the first time any action was taken in respect to bad debts. On what method should the bad-debt deduction be computed?

Answer. As the taxpayer did not take any bad-debt deduction in its 1921 return, it could determine a bad-debt deduction in its 1922 return on either method at its election.

VIII. Taxpayer charged off in 1921 bad debts, which were disallowed as a deduction for that year for the reason they were not ascertained to be worthless until 1922. Taxpayer has received permission to set up a reserve in 1922. May the bad debts disallowed for 1921 be considered in computing a reasonable addition to reserve for 1922?

Answer. The bad debts disallowed for 1921 may be considered in estimating the reasonableness of the addition to a bad-debt reserve for 1922.

IX. In 1921 taxpayer took as a deduction an amount representing the sum of the actual bad debts and an increase in the reserve. The same procedure is followed in 1922. What method should be used to compute the bad-debt deduction?

Answer. Generally, the specific ascertainment method, as Commissioner in his discretion may deny the right to use the reserve method.

X. Taxpayer for 1920 had a reserve for bad debts on the books but deducted only the actual charge-off to such reserve on its return. In 1921 no deduction was claimed on the return for bad debts, and no debits or credits were made to the reserve. In 1922 taxpayer computed its bad-debt deduction on the reserve method. What method should be allowed to determine the deduction for the year 1922?

Answer. The reserve method.

XI. When permission has been received to change to the reserve method, should a reasonable increase in the reserve for the year in which the change is made provide for the bad debts which may result from prior year accounts and sales as well as the bad debts which may result from the accounts and sales of the current year?

Answer. Yes. See computation by Board of Tax Appeals in its opinion in the appeal of the Transatlantic Clock & Watch Co. (3 B. T. A., 1064, acquiescence published in C. B. V–2, 3).

XII. Taxpayer has been computing its bad-debt deduction on the reserve method. During the year 1923 an extraordinary loss on accounts is sustained. What provision should be made for such loss?

Answer. If the extraordinary loss on accounts is sustained during the year, such fact may be taken into consideration in computing what is a reasonable addition to a reserve for bad debts for that year. The regulations provide that what constitutes a reasonable addition to a reserve for bad debts must be determined in the light of "the facts," and the amount of debts ascertained to be worthless during

the taxable year is one of those facts, and often an important one. See answer to Question XVIII.

XIII. Should a bank keeping its books on the cash basis be permitted to take a bad-debt deduction on the reserve method?

Answer. No. Where accounts are kept on the cash receipts and disbursements basis the reserve method should not be permitted, as accounts receivable have no bearing on income returned on the cash basis.

XIV. Should a reserve for bad debts be applied only to trade accounts, or can it be applied to losses on loans and notes?

Answer. Loans and notes, as they represent debts, should be included under the reserve method. There is no basis for excluding them under one method and allowing them under another.

XV. In computing a reasonable addition to reserve for bad debts, the taxpayer set up an amount equal to the specific debts ascertained to be worthless. Is an increase determined on such basis acceptable, or should the increase be determined according to the percentage basis suggested in I. T. 1743 (C. B. II–2, 143)?

Answer. The answer must depend upon the particular case. The percentage system is not indicated as exclusive or compulsory. The Commissioner's discretion governs, and the particular facts will dictate his decision. The only test is whether such addition is reasonable.

XVI. In the event the Income Tax Unit discovers a taxpayer has taken a reasonable addition to reserve based on its past experience, but it later finds the reserve is excessive, in what manner should the correction be made? The example given is that of a taxpayer who elected the reserve method in 1921 and set up a reserve of $20,000 on its books to take care of the accounts outstanding at December 31, 1921. In 1923 it was ascertained all but $3,000 of the 1921 accounts had been collected. What adjustment should be made of the excess of $17,000 taken as a deduction against 1921 income?

Answer. If $20,000 was a reasonable addition to a reserve for bad debts for 1921 under the facts existing at the close of 1921, the original deduction should stand, and any adjustment necessary in view of the excess of $17,000 in the reserve should be made in computing the addition to the reserve for subsequent years. Otherwise, the addition to the reserve for 1921 and the deduction based thereon should be adjusted to a reasonable amount.

XVII. Article 151 of Regulations 62 provides that a change from the specific ascertainment method to the reserve method, or vice versa, may be made only by securing permission from the Commissioner. Numerous cases have been noted where permission was requested from a collector. Would permission secured from a collector validate a change in the method of determining the bad-debt deduction?

Answer. Wherever the term "Commissioner" is used in the internal revenue laws or regulations, it means the Commissioner of Internal Revenue. Permission from any other officer, unless he is acting as Commissioner of Internal Revenue, or unless the Commissioner has delegated power or has given authorization to such officer to act in his behalf, would be invalid.

XVIII. In I. T. 1743 the percentage to be applied to accounts receivable at December 31, 1922, in arriving at a reasonable addition

to a reserve for bad debts, was determined on the basis of the data pertaining to bad debts and accounts receivable for the five-year period ended December 31, 1921. A reasonable addition to a reserve must be determined in the light of facts and will vary as between classes of business and with conditions of business prosperity. A taxpayer in computing a reasonable addition for a taxable year has taken into consideration the data pertaining to the bad debts and accounts receivable of the taxable year along with the data of prior years and determined the percentage on the basis of the combined data. Is such procedure permissible?

Answer. Yes; if on its basis the addition is determined by the Commissioner to be reasonable. Such procedure is general in railroad accounting. See also opinion of Board of Tax Appeals in the appeal of the Transatlantic Clock & Watch Co.

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

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

ARTICLE 161: Depreciation. VI–34–3379
G. C. M. 1905

REVENUE ACT OF 1921.

When the point of time is reached at which it is definitely known that the facilities are becoming obsolete due to the adoption of more economic methods of production by competitors, a deduction for obsolescence may be claimed in amounts prorated over the years intervening between that point and the ultimate abandonment of the facility.

The question under consideration is one involving the obsolescence of plants and machinery used by the M Company in the manufacture of ice. The M Company was formed by a consolidation of the N Company and the O Company and began operations ——, 1916. The machinery was of the type that used distilled water in the manufacture of ice and was quite cumbersome. It became apparent in the latter part of 1921 that this machinery was becoming obsolete. The company then decided to install new machinery which used raw water in the manufacture of ice. Operations in the plant were discontinued in November, 1922, and the work of replacing the machinery was begun.

Section 214(a) of the Revenue Act of 1921 provides that in computing net income there should be allowed as deductions:

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of such property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;

Inasmuch as the property was acquired by the taxpayer on ——, 1916, the question of the March 1, 1913, value does not arise.

In order that the taxpayer may be entitled to the allowance of an obsolescence deduction in any year there must have been substantial reasons for believing in that year that the assets involved would become obsolete prior to the end of their ordinary useful life, and it must have been known to a reasonable degree of certainty, under all the facts and circumstances, when that event would likely occur.

(Appeal of Columbia Malting Co., 1 B. T. A., 999.) With respect to that portion of the physical property which is clearly shown by the taxpayer to be affected by economic conditions which will require its abandonment at a future date prior to the end of its normal useful life, and with respect to which depreciation deductions alone are insufficient to return to the taxpayer the cost (or other basis) at the end of its term of economic usefulness, a reasonable deduction for obsolescence in addition to depreciation may be allowed. Evidently it was the intention of Congress to permit a return of the cost (or other basis) of the physical asset by means of depreciation deductions, including obsolescence, prorated over its useful life. In other words, the cost (or other basis) of the capital asset should be returned to the taxpayer without a tax thereon being imposed by the Government. When the point of time is reached at which it is definitely known that the facilities are becoming obsolete due to the adoption of more economic methods of production by competitors, a deduction for obsolescence may be claimed in amounts prorated over the following years and prior to the abandonment of the facility. This period in the instant case appears to have begun in December, 1921, and to have ended in November, 1922.

A further question arises as to the basis to be used in the computation of the obsolescence allowable in this case. It should be noted that the transaction whereby the assets of the N Company and the O Company were transferred to the M Company resulted in a gain taxable to the transferors under the Revenue Act of 1916. The records of this office show that this gain was recognized and that the tax was assessed against the two old companies. The gain to the transferors so recognized was undoubtedly measured by the fair market value of the stock of the M Company issued to the old companies in payment for the assets received by the M Company in the consolidation. That fair market value is likewise the measure of the cost of those assets to the M Company. (O. D. 955, C. B. 4, 44.) The cost so established should be allocated to the various facilities acquired in proportion to their respective values as of the date of acquisition. The obsolescence allowable to the M Company with respect to any facility so acquired should be computed upon the basis of the cost of that facility to the M Company thus determined.

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

ARTICLE 163: Depreciation of intangible property.

VI-29-3317
T. D. 4034

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. DEDUCTIONS—OBSOLESCENCE—GOOD WILL.

No deduction can be taken for obsolescence of good will under section 214(a), subsection (8), of the Revenue Act of 1918 which limits the allowance for obsolescence to such property as is susceptible to exhaustion, wear and tear.

2. DECISION FOLLOWED.

The decision of the Circuit Court of Appeals for the Eighth Circuit in the case of *Red Wing Malting Co.* v. *Willcuts* (15 Fed. (2nd), 626; T. D. 3980 [C. B. VI-1, 225]) 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 District Court for the Northern District of California in the case of *Henry M. Landsberger* v. *McLaughlin, Collector*, is published for the information of internal revenue officers and others concerned.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

Approved July 6, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

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UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA, SOUTHERN DIVISION.

Henry M. Landsberger, plaintiff, v. *John P. McLaughlin, defendant.*

[April 26, 1927.]

KERRIGAN, District Judge: This is an action to recover $13,426 paid under protest to cover a deficiency in income tax assessed against plaintiff for 1919, and $1,154.31 similarly paid for 1920.

Plaintiff was, and had been for many years, a wine and brandy broker, doing business under the name of "Landsberger & Son." His dealings were with wholesalers only, with whom he negotiated for the purchase of whole cellars. This business was in flourishing condition prior to the time when it became certain that prohibition would go into effect. Since the National Prohibition Act went into effect plaintiff has ceased to do business with his old clients, and has endeavored to build up a new clientele to which he sells nonbeverage wines on a commission basis. The returns from the new form of his business are negligible.

In his income tax returns for 1919 and 1920 plaintiff claimed that the good will of his business was worth at least $90,113.90 on March 1, 1913, and that such good will became obsolete because of the national prohibition legislation which went into effect January 16, 1920. The Treasury Department having ruled that the date when it became reasonably certain, for the purposes of tax deduction, that prohibition was inevitable was January 31, 1918, plaintiff prorated his asserted loss of $90,113.90, the alleged value of the good will, over the period between January 31, 1918, and January 16, 1920. His figures follow:

Year.	Period.	Amount.
1918	11 months	$42,134.17
1919	12 months	45,964.54
1920	16 days	2,015.19
		90,113.90

The present case concerns only the amounts allocated to the years 1919 and 1920 on account of obsolescence of good will, and deducted from plaintiff's income as returned for those years. The Treasury Department disallowed the deductions and plaintiff paid the additional tax under protest.

The statute governing this controversy is section 214(a)8 of the "Revenue Act of 1918" (40 Stats., 1057–1152), which reads 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 trade or business, including a reasonable allowance for obsolescence."

The question in the case is as to whether loss of good will due to prohibition legislation may be deducted under this provision. It is strenuously urged that such loss is a permissible "allowance for obsolescence."

This problem has recently been considered by the Circuit Court of Appeals for the Eighth Circuit in *Red Wing Malting Co.* v. *Willcuts* (15 Fed. (2d), 626). In an exhaustive opinion the court reviews the history of section 234(a)7, Revenue Act of 1918 (40 Stats., 1057, 1077), which is identical in language with the statute now before me. It also considers such departmental constructions as have been given to the section, and discusses the nature of "good will." The court holds that there may be no deduction for loss of good will under this section. The reasoning upon which this conclusion is based appears from the following language:

"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. (P. 632.) * * * 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." (P. 633.)

This interpretation of the statute appears to be the correct one. Under it, plaintiff in this case is not entitled to recover. It is therefore unnecessary to consider the other questions raised at the trial and in the briefs.

In view of the conclusions expressed herein, no other or special findings will be made.

Let judgment be entered for defendant.

ARTICLE 163: Depreciation of intangible property.

REVENUE ACTS OF 1918 AND 1921.

Amendment. (See T. D. 4055, page 63.)

ARTICLE 163: Depreciation of intangible property.

VI-35-3399
T. D. 4067

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. DEDUCTIONS—OBSOLESCENCE—GOOD WILL.

No allowance for obsolescence of good will is deductible from gross income under section 234(a)7 of the Revenue Act of 1918 which allows a deduction for obsolescence in respect of such property only as is subject to exhaustion, wear and tear.

2. DECISIONS FOLLOWED.

The decisions in *Red Wing Malting Co.* v. *Willcuts* (15 Fed. (2nd), 626, T. D. 3980 [C. B. VI-1, 225]) and *Landsberger* v. *McLaughlin* (T. D. 4034 [page 211]), decided April 26, 1927, by the United States District Court for the Northern District of California, 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 District Court, Northern District of New York, in the case of *Haberle Crystal Spring Brewing Co.* v. *Jesse W. Clark, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 19, 1927.

S. LOWMAN,
Acting Secretary of the Treasury.

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UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF NEW YORK.

Haberle Crystal Spring Brewing Co. v. *Jesse W. Clark, Collector of Internal Revenue.*

[June 30, 1927.]

OPINION.

COOPER, J.: This is a motion for confirmation of the report of the special master to whom the trial of the issues involved was referred by consent of the parties to take the proof and report his findings of fact and conclusions of law, subject to the approval of the court.

The plaintiff brought this action against the collector to recover income and profits taxes in the sum of $15,530.92, paid for the fiscal year ending May 31, 1919, together with $1,087.16 interest, all of which plaintiff claims was illegally exacted from it because of the failure of the collector to allow a deduction from the plaintiff's income for that year for obsolescence of the good will of the plaintiff's business during that year.

Prior to prohibition plaintiff was conducting a brewing business in central New York, with two brewing plants located in the city of Syracuse, in which business it made substantial profits by the sale of its products under certain trade names filed in the office of the secretary of state of New York. The plaintiff corporation was dissolved in December, 1920, with the coming in of prohibition, and another corporation known as the Haberle Beverage & Products Co. was organized in 1920, which took over one of the two brewing plants, called the Haberle plant, and engaged in the business of manufacturing and selling soft drinks and cereal beverages, and is still carrying on the same business at the Haberle plant. With one exception, the stockholders of the new corporation are identical with the stockholders of the plaintiff corporation.

On the trial before the special master, the defendant contended (1) that the plaintiff was without legal capacity to sue, having been dissolved pursuant to the statutes of the State of New York, (2) that good will is not property that is taxable separate and apart from the business to which it is an appurtenance, (3) that even if good will is property, it is not the kind of property meant by section 234–A, subdivision 7, of the Revised Statutes, as the same was amended in 1918, which statute is conceded to govern the case at bar. The special master found in favor of the plaintiff on all these grounds and found a judgment in favor of the plaintiff for the full amount of the claim.

Inasmuch as this court refuses to confirm the report of the special master and finds that the plaintiff's complaint should be dismissed, because the court disagrees with the special master and upholds the defendant's third contention above stated, this memorandum will not discuss the defendant's contentions 1 and 2 above set forth. Section 234–A of the Revised Statutes reads in part 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—

* * * * * * *

"(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence."

The special master construed this section to cover obsolescence of good will and held that the collector of internal revenue should have allowed the plaintiff a deduction from its income for the year in question for obsolescence of good will in an amount which would entitle the plaintiff to the return of taxes illegally paid to the full amount claimed by the plaintiff with interest.

The case was carefully tried by the special master and his opinion and findings indicate careful study of the facts and the law. His decision is based upon the construction of the statute, which includes obsolescence of good will as covered by the words "including a reasonable allowance for obsolescence." He construes these words of subdivision 7 as covering an allowance in addition to and of another kind than "a reasonable allowance for exhaustion, wear and tear on property used in the trade or business." In this respect he seems to be in error and to have extended the meaning of the words "including a reasonable allowance for obsolescence" beyond the scope of meaning which Congress intended.

This very question and the construction of subdivision 7 in respect to these same words have been very carefully considered by the Circuit Court in the Eighth Circuit in the case of the *Red Wing Malting Co.* v. *Willcuts*, cited at the September term, 1926, and reported in 15 Fed. (2nd), 626. The United States Supreme Court denied certiorari in this case on March 21, 1927 (272 U. S.).

The circuit court there held in substance that the obsolescence intended to be designated by subdivision 7 could only mean obsolescence of property used in the trade or business which was subject to exhaustion, wear and tear, and could not include any property not subject to exhaustion, wear and tear, and therefore could not include good will or obsolescence of the good will.

Though not bound thereby, this court fully agrees with the decision in the Red Wing case and therefore must refuse to confirm the report of the special master and must dismiss the complaint, as the special master's decision is based entirely on the contrary construction of this statute.

Judge Kerrigan, of the Northern District of California, Southern Division, in the case of *Landsberger* v. *McLaughlin*, not yet reported, has also construed this statute as in the Red Wing case, supra, and there seem to be no contrary decisions.

The plaintiff excepted to the special master's findings of fact 42 to 47, inclusive, and to the conclusions of law 5 to 7, inclusive. These findings of fact and conclusions of law were that the National plant (one of the plaintiff's two brewery plants), including its machinery and fixtures, decreased a large sum in value due to obsolescence, and that certain liquor tax certificates with powers of attorney and notices to issuing officers also decreased a large sum in value due to obsolescence, but that that evidence relating to such things was offered by plaintiff and received in evidence only upon the question of obsolescence of good will or intangible assets and that the plaintiff was not entitled to any allowance or independent deductions on account thereof.

The record clearly shows that this evidence was offered and received only for its alleged probative force upon the plaintiff's claim that it was entitled to allowance for obsolescence of good will.

On pages 219 and 220 of the record plaintiff's attorney said, referring to this evidence, "it is offered upon the question of obsolescence of good will and intangible assets."

The special master's rulings in such mentioned findings of fact and conclusions of law were clearly right and plaintiff's exceptions are not well taken.

This case having been brought because of disallowance by the Government of plaintiff's claim for obsolescence of good will, which the Department had apparently formerly allowed, the question of an independent allowance or deduction because of obsolescence of the brewery plant or other real estate or liquor tax certificates is not in the case and not decided.

The defendant prevailing on the law in this case, it is not necessary to examine the defendant's exceptions to the specific findings of fact and conclusions of law.

Judgment may be entered in accordance with this decision.

SECTION 214(a)10.—DEDUCTIONS ALLOWED: DEPLETION.

ARTICLE 201: Depletion of mines, oil and gas wells; depreciation of improvements.

REVENUE ACT OF 1921.

Basis for depletion deductions in case of allottees of Quapaw Indian lands. (See G. C. M. 2056, page 65.)

ARTICLE 203: Amount returnable through depletion and depreciation deductions in the case of lessee. VI–37–3425 G. C. M. 2270

REVENUE ACT OF 1921.

A contract for sale and purchase between the owners of an oil and gas mining lease and the vendees provided that the consideration was to be paid out of oil by division orders; and that the assignment of the lease was to be delivered in escrow until all terms, conditions, and covenants were complied with, in which event the escrow holder was authorized to deliver the assignment to the vendees.

Held: (1) That at the time of the delivery in escrow by the vendors of the executed assignment all the beneficial incidents of ownership in the lease passed to the vendees and as of that time the vendees became possessed of such a property in the lease as to entitle them to a deduction for depletion.

(2) That the vendees are entitled to all the profits, and the income is taxable to the vendees.

(3) That the probable recoverable content of the oil and gas is to be computed in the same way as if the vendees held both the legal and equitable title to the lease, unencumbered by any interest by way of security held by the vendors.

(4) That the obligation of the vendees to pay the purchase price is to be treated as an unconditional obligation and the amount thereof is to be included in the "cost" of the lease to the vendees as of the date of acquisition.

An opinion is requested with respect to the effect for income tax purposes of a contract, dated August —, 1922, executed by certain persons (herein called the vendors) owning as tenants in common an oil and gas mining lease and the M Company and A (herein called the vendees).

The contract recites the desire of the vendors to sell and the vendees to buy a specified oil and gas mining lease; the payment by the vendees of the sum of $1; the covenant of the vendors "to sell, transfer, and convey the entire working interest in said oil and gas mining lease * * * for a total consideration of x dollars to be paid out of oil"; the covenant that the "entire proceeds of the oil, casinghead gas, or gas sold, saved, or marketed from said land under said lease shall belong, run, and be paid to" the vendors "free of any and all expense of any kind or character until the * * * sum of x dollars shall have been fully paid to them" (such proceeds being paid by division orders payable to the vendors forwarded to the holder of the escrow mentioned infra, and the vendees having otherwise full powers of disposition of the oil and gas run, qualified in certain specified particulars for the better security of the vendors); and the

agreement that a "proper and valid assignment of said working interest in said lease" will be attached to a copy of the contract and will be delivered in escrow to a named bank "as escrow holder, with instructions to such escrow to hold the same and not deliver said assignment * * * (to the vendees) * * * until all the terms, conditions, and covenants * * * have been fully complied with, and in event the same are fully and faithfully complied with, then such escrow holder shall be authorized and directed to deliver said assignment to" the vendees.

The contract further provides for the spudding by the vendees at their expense of certain wells at specified times and places, for stipulated developments of various kinds by the vendees at their own expense, for the maintenance of the properties unencumbered with liens, for a right in the vendors to enter upon the lease for the purpose of watching the operations and development, and for the option in the vendors in the event of the default by the vendees either (1) to terminate the contract, to take possession of all properties upon the lands leased, and to retain all moneys theretofore received and all developments and properties upon the lands as liquidated damages; or (2) to take possession of the premises, complete the drilling of the wells, charge the cost thereof to the vendees, and upon full repayment of such costs and of the consideration of x dollars to deliver possession to the vendees and cause the holder of the escrow to deliver the executed assignment.

No circumstances are disclosed from which it may be inferred that the transactions between the vendors and the vendees constituted other than a bona fide purchase and sale within the meaning of article 205, Regulations 62.

The issues presented by the contract and upon which the advice of this office is requested may be formulated as follows:

I. When do the vendees acquire such property in the lease as to entitle them to depletion under section 214(a)10 or section 234(a)9, Revenue Act of 1921?

II. What portion of the proceeds received from the sale of oil and gas produced under the lease constitutes income to the vendees?

III. Under the provisions of articles 209 and 214, Regulations 62, upon what basis shall an estimate be made of the "number of units of recoverable oil and/or gas" upon the vendees' property?

IV. What is the "cost," as of the date of acquisition, of the vendees' "equity" in the oil and gas property, for the purpose of computing the amount returnable through depletion and depreciation deductions under article 203 and related articles of Regulations 62?

These questions will be discussed seriatim.

I. When do the vendees acquire such property in the lease as to entitle them to depletion under section 214(a)10 or section 234(a)9, Revenue Act of 1921?

The contract speaks both of the sale of the "lease" and of the "working interest in the lease." The two terms are used interchangeably, both with respect to the rights of the vendees upon the delivery in escrow of the assignment of the lease and with respect to the rights of the vendees after the delivery from escrow of the legal assignment of the lease. Since no differentiation is there made, the intention of the contract is clear that after the delivery from

escrow of the assignment the vendees shall have all the rights of ownership possessed by the assignee of a lease, and "the working interest in the lease" is not a term of definite legal meaning, it is concluded that the latter term is to be interpreted in the same sense as the term "lease."

The contract clearly contemplates the ultimate transfer of all property in the lease to the vendees. The delivery from escrow of the executed assignment of the lease is conditioned upon the performance by the vendees of their obligations under the contract. While the delivery in escrow puts the assignment effectively beyond the control of the vendors, it is well settled that at least until the performance of the condition a binding and effective assignment to the vendees does not occur. (*Wood* v. *French*, 39 Okla., 685, 136, Pac., 734.)

But the contract also clearly contemplates that from the date of delivery in escrow of the executed assignment the vendees are entitled to possession under the lease. The contract is unmistakably clear that the possession to which the vendees are thus entitled upon the delivery in escrow is possession as lessees, and that the vendees have the right to use the properties as their own to the same extent as is customary with a mortgagor. From that time the vendees are entitled to the profits of the lease. (*Tucker* v. *McLaughlin-Farrar Co.*, 36 *Okla.*, 321, 129 Pac., 5.) From that time the vendees have every right of ownership not inconsistent with the security of the vendors, including the risk of loss and the opportunity for profit. (*Miller* v. *Waddingham*, 91 Cal., 377, 27 Pac., 750, 13 L. R. A., 680; *Baker* v. *Bishop Hill Colony*, 48 Ill., 264; *Baldwin* v. *Pool*, 74 Ill., 97.) It is, therefore, evident that under the contract as of the time of delivery in escrow by the vendors of the executed assignment all the beneficial incidents of ownership in the lease passed to the vendees and as of that time the vendees became possessed of such a property in the oil and gas lease as to entitle them to an allowance of a deduction for depletion under section 214(a)10 or section 234(a)9, Revenue Act of 1921, and the regulations prescribed thereunder. I. T. 2275 (C. B. V–1, 62) and ruling therein cited.

The delivery in escrow of the assignment of the lease deliverable from escrow to the vendees only upon the happening of the condition stipulated in the escrow agreement results in the retention of the title to the lease by the vendors, but this retention of title is merely as security for payment of the purchase price. The escrow was but a short way of accomplishing the same thing as would be achieved by assigning to the purchaser and taking a mortgage back. After the time when the assignment is delivered in escrow the vendors' rights are merely for the purpose of security and all the beneficial incidents of ownership are in the vendees. Such rights of ownership as the vendors possess are rights of security subordinate and incident to the debt or obligation of the vendees for the purchase price. One possessing only a security or a mortgage interest in oil and gas property can derive no income from the property as such; the income, if any, which results is derived from the debt or obligation for the payment or performance of which the property stands as security. After the time when the vendees became entitled to the beneficial incidents of ownership, the vendors had no such property in the oil and gas lease as to entitle them to the allowance of a

deduction for depletion under section 214(a)10 or section 234(a)9 of the Revenue Act of 1921 and the regulations prescribed thereunder.

II. What portion of the proceeds received from the sale of oil and gas produced under the lease constitutes income to the vendees?

Since the vendees, being entitled to all of the beneficial incidents of ownership, are entitled to the entire profits of the lease, the entire proceeds of all the oil and gas extracted under the lease constitute income to the vendees. It is quite immaterial that prior to their receipt the vendees have contracted to pay them over to the vendors, or that the instant such proceeds arise they may become under the contract the property of the vendors. The entire proceeds are constructively received by the vendees, being paid over at the time of their receipt to the vendors not as the profits of the lease but as installments on the unpaid portions of the purchase price owed by the vendees to the vendors.

III. Under the provisions of articles 209 and 214, Regulations 62, upon what basis shall an estimate be made of the "number of units of recoverable oil and/or gas" upon the vendees' property?

Article 209, Regulations 62, requires "In the case of either an owner or lessee * * * an estimate * * * of the probable recoverable oil contained in the territory with respect to which the investment is made as of the time of purchase * * *," while article 214, Regulations 62, prescribes "The recoverable oil belonging to the taxpayer shall be estimated for each property separately. * * * The unit value of the recoverable oil and/or gas for each property is the quotient obtained by dividing the amount returnable through depletion for each property by the estimated number of units of recoverable oil and/or gas on that property."

It is quite immaterial in the application of these provisions that the vendees' interests in the oil and gas deposits under the leases are held subject to the security rights of the vendors, since the security rights of the vendors are not different in kind from those of any other mortgagee or security holder, and for depletion purposes are disregarded.

While it is true that the entire property of the vendees in the lease is defeasible, in the event that proceeds aggregating the sum of x dollars do not arise from the sale (whether the event is caused by the exhaustion of the oil and gas deposits, or from the default of the vendees in not extracting and selling the oil and gas and thus failing to produce proceeds from which the payments are to be made), the defeasible character of the vendees' property is not different in substance from that of any other pledgor or mortgagor. Here the obligation secured is a conditional or contingent obligation and differs from an unconditional obligation, but the rights and liabilities incident to the security itself are in no way peculiar, except as they inhere in the character of the obligation itself.

It results that the probable recoverable content of the oil and gas upon the vendees' properties is to be computed in precisely the same way it would be computed if the vendees held both the legal and equitable title to the lease, unencumbered by any interest by way of security held by the vendors.

IV. What is the "cost" as of the date of acquisition of the vendees' "equity" in the oil and gas property, for the purpose of computing

the amount returnable through depletion and depreciation deductions under article 203 and related articles of Regulations 62?

The word "equity" as used in article 203, Regulations 62—"The value of a lessee's equity in a proven mineral property acquired on or after March 1, 1913, is its cost"—does not mean the equity of redemption of a lease subject to a mortgage or security charge but the whole beneficial interest or property of the lessee in the premises (the outstanding security interests being disregarded).

Under the contract here presented, the consideration for the assignment of the lease is fixed at x dollars. The contract recites the payment of $1 only. Whether this sum of $1 was actually paid or whether it represents merely the formal recital of a contract with respect to an interest in land it is unnecessary to determine, since even though it be considered as the initial installment of the purchase price actually paid upon or prior to the date the vendees acquire a property in the lease, the application of the law and regulations is not varied thereby.

A sum certain which the lessee has unconditionally promised to pay, as the purchase price of his lease, at a future time certain to come is properly to be included in "cost" as of the basic date (as defined by article 201, Regulations 62) in computing in the case of such lessee the amount returnable through depletion and depreciation deductions. The obligation in such a case differs in but one particular from the obligation incurred by the vendees in the instant case. Here the obligation is not to pay the sum of x dollars at all events, but to pay when and as there are proceeds from the sale of oil and gas run under the lease. At least until the sum of x dollars has been paid, the undertaking of the vendees is an absolute and unconditional undertaking to remove and sell all oil and gas from the leased premises. Since the vendees are thus unconditionally obligated, it results that their obligation to pay x dollars is unconditional and absolute except in the event that before the completion of the payment of x dollars the exhaustion of the oil and gas deposit occurs.

In the computation of the depletion allowance of the vendees, an estimate of the recoverable oil and gas was required, and the number of units of recoverable oil and gas so estimated becomes, under article 214, Regulations 62, an indispensable basis for the computation.

When, therefore, as the evidence indicates the fact to be in the instant case, the number of units of recoverable oil and gas as estimated for the purpose of computing the depletion allowance is so large that upon a conservative estimate of future market prices it must be assumed that the gross proceeds thereof when and as extracted will in the aggregate amount to more than the sum promised to be paid as the purchase price, it must be assumed that the only event upon which the vendees can cease to be absolutely bound to pay the purchase price can never happen. The fund out of which payment is unconditionally promised is in substance the total recoverable oil and gas content of the property. The extent of that fund and its sufficiency is necessarily determined and, as the measure of the reserves over which the total amount returnable through depletion is spread, is necessarily used in the computation of the

depletion deduction. In determining the amount to be spread over such reserves, an amount which that fund is unconditionally obligated and pledged to produce, and which, by a prior determination, the fund is clearly capable of producing, must be allowed as a part of the "cost" of the lease to the lessee as of the date of acquisition. If, in one part of the computation of the depletion deduction, the sufficiency of the fund is necessarily assumed, the contrary can not be asserted in another part of the same computation. The obligation of the vendees to pay the purchase price in the instant case should therefore be treated as an unconditional obligation and, as such, the amount thereof is to be included in the "cost" to the vendees as of the date of acquisition.

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

ARTICLE 215: Depletion—Adjustments of accounts based on bonus or advanced royalty. VI–52–3551 G. C. M. 2824

REVENUE ACTS OF 1918 AND 1921.

The taxpayers are entitled to depletion for the years 1918 to 1922, inclusive, on account of a bonus received upon the basis of discovery value, the payment of such bonus having been received, not at the time the unproven land was leased, but after the land was proved by a discovery well.

An opinion is requested upon the question of whether A and wife, lessors of oil land, are entitled to depletion upon the basis of discovery value, on account of a bonus received during the years 1918 to 1922, inclusive. The payment of such bonus, which was contingent upon oil production, was received not at the time the unproven land was leased but after the land was proved by a discovery well.

Treasury Decision 3938 (C. B. V–2, 117), amending article 215 of Regulations 45 (1920 edition), article 215 of Regulations 62, and article 216 of Regulations 65, is applicable to the case of these taxpayers. One of the basic purposes underlying the promulgation of that decision was the allowance of depletion against bonuses, and such purpose is expressed in subdivision (a) of those articles, as amended, which subdivision reads as follows:

ART. 216 (215). *Depletion—Adjustments of accounts based on bonus or advanced royalty.*—(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 foregoing provision contains no limitation upon the time when a specific bonus must be received. The fundamental question in such connection is whether the taxpayer, at the time the bonus was received, had such a cost or value of property as of the basic date as to invoke the application of the formula contained in the above subdivision. Stated otherwise, if, in a given case, at the time of the receipt of a bonus, the recipient thereof has no cost or other basis upon which depletion may be computed, subdivision (a), supra, is not applicable.

The taxpayers in the instant case have a basic date of valuation for their property—the date of discovery or within 30 days thereafter. (See article 201(a), Regulations 45 (1920 edition) and 62.) It follows, therefore, on the principles above set forth, that subdivision (a) of article 215 of Regulations 45 (1920 edition) and of article 215 of Regulations 62, as amended by Treasury Decision 3938, supra, is applicable to the case of the taxpayers, in that, at the time of the receipt of the bonus in question, they had such a basic date of valuation of their property as would entitle them to take depletion deductions on account of the bonus received upon the basis of discovery value.

It is, therefore, the opinion of this office that the inquiry should be answered in the affirmative.

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

ARTICLE 215: Depletion—Adjustments of accounts based on bonus or advanced royalty.

REVENUE ACT OF 1918.

Depletion on account of bonus received upon basis of discovery value after land was proved by a discovery well. (See G. C. M. 2824, page 221.)

ARTICLE 220: Oil and gas wells.

REVENUE ACT OF 1921.

Depletion allowable to an intercompany transferee on the basis of discoveries previously made by the intercompany transferor. (See G. C. M. 1345A, page 154.)

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells.

REVENUE ACT OF 1921.

Development expenditures in computation of net income from a discovery property. (See G. C. M. 2315, page 21.)

SECTION 214(a)11.—DEDUCTIONS ALLOWED: CHARITABLE CONTRIBUTIONS.

ARTICLE 251: Charitable contributions. VI-35-3400
T. D. 4069

INCOME TAX—REVENUE ACT OF 1917—DECISION OF COURT.

DEDUCTIONS—BUSINESS EXPENSE—CHARITABLE CONTRIBUTION.

A contribution to the American Institute of Accountants by a person engaged in the business of accounting is not deductible from gross income as a necessary expense in carrying on business or as a gift to an organization operated exclusively for scientific or educational purposes.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the Court of Claims of the United States in the case of *Robert H. Montgomery* v. *The United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 19, 1927.

S. LOWMAN,
Acting Secretary of the Treasury.

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COURT OF CLAIMS OF THE UNITED STATES.

Robert H. Montgomery v. *The United States.*

[June 6, 1927.]

OPINION.

Moss, Judge, delivered the opinion of the court.

The plaintiff, Robert H. Montgomery, was in 1917 and prior thereto a member of a partnership engaged in the business of accounting and auditing in the city of New York and elsewhere throughout the United States. During that year the partnership paid $5,000 into an endowment fund of the American Institute of Accountants. In its income-tax return the partnership claimed as a proper deduction from gross income the amount so paid, which claim was disallowed by the Commissioner of Internal Revenue. Plaintiff likewise claimed in his individual return as a proper deduction from gross income his share in the $5,000, the tax on which amounted, with interest, to $199.73, which was also disallowed by the Commissioner, and this action is for the recovery of that amount.

The question involved herein is governed by the Revenue Act of 1916 (39 Stat., 756), the applicable provisions of which are as follows:

"SEC. 5. That in computing net income in the case of a citizen or resident of the United States—

"(a) For the purpose of the tax there shall be allowed as deductions—

"First. The necessary expenses actually paid in carrying on any business or trade, * * *;

* * * * * * *

"Ninth (as added by sec. 1201(2) of the Revenue Act of 1917). Contributions or gifts actually made within the year to corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, * * * no part of the net income of which inures to the benefit of any private stockholder or individual, to an amount not in excess of 15 per centum of the taxpayer's taxable net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury."

Considering first the question as to whether or not the contribution to the endowment fund was a *necessary* expense, it should be noted that there were approximately 1,200 members of the institute, only 200 of whom subscribed to the fund, and that the benefits and advantages derived from said endowment accrued to all members, contributors and noncontributors, alike, as well as to the general public. The library, which was purchased with the income from said fund, was open to the public free of charge, and the books which were published for research work were sold to the public as well as to the members of

the institute. As a matter of right, plaintiff's firm could have availed itself of all the services of the institute without subscribing to the fund. It can not, therefore, be held that plaintiff's subscription was a *necessary* expense in carrying on the business of plaintiff's firm.

On the second point, the question for determination is whether or not the American Institute of Accountants was a corporation or association organized and operated *exclusively* for scientific and educational purposes. One of the purposes set forth in its article of incorporation was "* * * to safeguard the interest of public accountants * * *." In furtherance of this purpose Article IV of the constitution provided for the appointment of certain committees, one of which was for Federal legislation, and another was for State legislation. The evidence shows that whenever and wherever efforts were made to enact legislation which, in the belief of the American Institute of Accountants, would result in lowering the standard of qualification for admittance to membership in the institute every reasonable effort was made by these committees to defeat such legislation. It was also a part of the duty of said committees to procure legislation believed to be suitable for the purposes of the institute where no such legislation already existed. Conceding that this service might be regarded as entirely meritorious, it is, nevertheless, a scope of activity which is clearly incompatible with the spirit and purpose of the exempting statute.

It is the opinion of the court that plaintiff is not entitled to recover.

It is therefore adjudged that the petition herein be, and the same is, dismissed.

ARTICLE 251: Charitable contributions. VI-37-3426
T. D. 4086

INCOME TAX—REVENUE ACTS OF 1918 AND 1921—DECISION OF COURT.

DEDUCTIONS—CHARITABLE CONTRIBUTION—CEMETERY CORPORATION.

A contribution to a cemetery corporation is not deductible from gross income under section 214(a)11 of the Revenue Acts of 1918 and 1921 as a gift to a corporation organized and operated exclusively for charitable purposes.

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, District of Massachusetts, in the case of *Schuster* v. *Nichols, Collector*, is published for the information of internal revenue officers and others concerned.

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

Approved August 31, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

UNITED STATES DISTRICT COURT, DISTRICT OF MASSACHUSETTS.

Schuster v. *Nichols, Collector.*

[June 3, 1927.]

OPINION.

BREWSTER, J.: This is an action brought to recover income taxes amounting in the aggregate to $14,085.14, assessed upon the plaintiff's income, which taxes

were paid under protest. Claims for refund were duly filed and denied. The facts are not in dispute. Briefly stated, they are as follows:

The plaintiff filed his returns of net income for the calendar years 1918, 1919, 1920, and 1921. In his return for each of said years he deducted from his gross income certain amounts which he had contributed during the years in question to the East Douglas Evergreen Cemetery Co., of East Douglas, Mass., claiming these deductions as contributions to a charitable corporation. The amounts deducted from his income for each of the years in question on account of such contribution were as follows: For the year 1918, $5,000; for the year 1919, $13,494.87; for the year 1920, $12,276.44; for the year 1921, $977.24.

On review of the plaintiff's return for each of the said years, the Commissioner of Internal Revenue disallowed these deductions, as a result of which an additional tax was assessed against the plaintiff for each year as follows: 1918, $3,190.32; [1919] $6,546.30; 1920, $3,737.51; 1921, $371.74.

The East Douglas Evergreen Cemetery Co. is a corporation created by special act of the Legislature of the Commonwealth of Massachusetts, enacted March 27, 1858 (ch. 128, Special Laws 1858). The corporate purposes were set forth in section 3 of the act, which reads as follows:

"SEC. 3. The said corporation shall take and hold the real estate aforesaid for a rural cemetery or burial ground, and for the erection of tombs, cenotaphs or other monuments for, or in the memory of, the dead; and for this purpose shall have power to lay out the same in suitable lots or subdivisions for family or other burying places; to plant and embellish the same with trees, shrubbery and other rural ornaments; to inclose and divide the same with suitable walls and fences; and to construct and annex thereto such suitable buildings, appendages and other conveniences, as said corporation shall from time to time deem expedient."

The act further empowered the corporation to acquire and hold real estate in the town of Douglas for the purposes of the corporation and to grant and convey "to any person or persons the sole and exclusive right of burial" in any of the lots or subdivisions and to erect tombs and cenotaphs "upon such terms and conditions, and subject to such regulations, as said corporation shall prescribe; which right, so granted and conveyed, shall be held for the purposes aforesaid, and for no other." Under the statute the real estate was to be exempt from public taxes so long as it remained dedicated to cemetery purposes.

The by-laws of the corporation vested in a board of trustees authority to lay out, appraise, and sell at not less than the appraisal value burial lots and to improve the grounds inclosed for the purpose of a cemetery as the proceeds of sales would permit. All lot owners were members of the corporation and there was no limitation in the charter or by-laws as to the persons who might purchase lots. No capital stock was ever issued and no dividends ever paid to members. Nothing appears in the special act, or in the by-laws, to indicate that the corporation had any purpose to provide, gratuitously, suitable burial ground for the poor or indigent who could not afford to pay. It was suggested at the hearing that lots had been conveyed for which the purchase price had not been paid, but the evidence to support this claim was not definite or convincing and it amounted to no more than that perhaps in a few instances lots had been bought for which the purchase price had not been fully paid. I am unable to find any justification for the conclusion that the corporation had, in fact or in law, a purpose to assist the poor and needy.

The corporation acquired land in the town of Douglas which was divided into burial lots and has ever since been dedicated to cemetery purposes. Lots were conveyed subject to the condition that they were to be used for no purpose other than for burial of the dead. The cemetery has been improved and beautified out of proceeds derived from the sale of lots and gifts made by benefactors, among which latter were the contributions of the plaintiff. It is respecting these contributions made in the years 1918 to 1921, both inclusive, that plaintiff now asserts a right to a deduction from his gross income for the corresponding taxable years.

The statutes upon which plaintiff's claim is based are the Revenue Act of 1918 (sec. 214(a)11, Act of February 24, 1919, ch. 18, 40 Stat., 1068) and the Revenue Act of 1921 (sec. 214(a)11 B), Act of November 23, 1921, ch. 136, 42 Stat., 227).

The pertinent provisions common to both Acts may be summarized as follows:

In computing net income there shall be allowed as deductions contributions or gifts made within the taxable year to any corporation organized and operated exclusively for "charitable" purposes up to a maximum amount.

The controversy between the parties to this action arises over the scope and meaning of the word "charitable" as used in the Revenue Acts.

The plaintiff argues that the word "charitable," as used in the statute, is not to be confined to mere relief of poverty, or distress, or almsgiving, but that it carried a wider signification which embraced any purpose which had for its end the improvement and promotion of the general welfare. (*Jackson* v. *Phillips*, 14 Allen, 539; *New England Sanitarium* v. *Stoneham*, 205 Mass., 335; *Molly Varnum Chapter, D. A. R.*, v. *Lowell*, 204 Mass., 487.)

This broader definition would undoubtedly obtain in an equity court dealing with a charitable trust within the intent and purview of 43 Eliz. (ch. 4), which for the purposes of defining charitable uses is, in some jurisdictions at least, accepted as a part of the common law. (*Jackson* v. *Phillips*, supra; *In re Landis*, 66 N. J. Eq., 291.)

If we concede for the sake of argument that the word as used in the Federal statute is to be given this comprehensive meaning, the adjudications in this Commonwealth, which this court may with propriety follow, leave serious doubts whether the East Douglas Evergreen Cemetery Co. comes within that definition. (*Donnelly* v. *Boston Catholic Cemetery Asso.*, 146 Mass., 163; *Milford* v. *County Commissioners of Worcester*, 213 Mass., 162; *Alex. H. Bullock, Tr.*, v. *Commissioner of Corporations and Taxation* (Mass. Sup. Ct. decision May 24, 1927).)

In *Milford* v. *County Commissioners of Worcester*, supra, the question was whether the Pine Grove Cemetery was exempt under a Massachusetts statute which relieved from taxation the personal property of "benevolent" and "charitable" institutions. The facts in that case, so far as they relate to the corporate purposes, the manner of conducting the corporate activities and the membership, were in all essential details similar to those presented in the case at bar. Chief Justice Rugg, in disposing of this issue, doubted whether the corporation was a charitable corporation but based his decision upon the ground that the tax-exemption laws manifested a legislative purpose not to include cemetery corporations under the designation of charitable or benevolent institutions.

I am of the opinion that the decision in the case now before me can well be disposed of upon the same ground. The language employed in framing section 214 of the Revenue Laws of 1918 and 1921 reflects an intent not to include cemetery corporations under the designation of charitable corporations. This intention appears clearly when we consider the context of the eleventh subdivision of section 214(a) of the Revenue Act of 1918 and of clause B of subdivision 11 of section 214(a) of the Revenue Act of 1921. In the earlier statute the allowable deductions are "contributions or gifts made within the taxable year to corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals." In the latter statute the allowable deductions are to "any corporation, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, including posts of the American Legion or the Women's Auxiliary units thereof, or for the prevention of cruelty to children or animals."

The position of the word "charitable" in a sentence including religious, scientific, and educational purposes, all of which would be regarded as charitable purposes under the statute of 43 Eliz., points irresistibly to the conclusion that Congress was here using the word "charitable" in its more narrow and restricted sense as signifying those corporations which were organized and maintained exclusively for eleemosynary purposes. On any question of interpretation it is permissible to resort to the provisions of the whole Act in order to ascertain therefrom what meaning dubious language is intended to convey. (*Milford* v. *County Commissioners of Worcester*, supra.)

The provisions of section 231 of the Revenue Acts also furnish unmistakable indication that it was not the intention of those who enacted the laws to bring cemetery corporations within the class of corporations devoted to charitable purposes. This section deals with the exemption of certain corporations from the corporation income tax. Clause 6 of the section exempts corporations "organized for religious, charitable, scientific, literary or educational purposes," but notwithstanding that charitable corporations were included among the corporations exempt under clause 6, it was deemed necessary to incorporate another clause (clause 5) expressly relieving cemetery corporations from the burden of the tax.

As is suggested in the brief for the Government, the statute was drafted to apply to every State in the Union. In some of these the statute of Eliz. is incorporated in the common law, and in others it is not. In some States charities have been particularly defined by statute. It was necessary to give the word "charitable" a meaning which would have universal application. This meaning is most naturally found in the restricted sense of the word as referring to the relief of the poor. If we were defining the scope of a gift to charitable purposes, undoubtedly it would be incumbent upon the court to adopt the more comprehensive meaning of the word "charitable," but a different rule of construction applies to a statute by the terms of which one claims exemption from taxation. Any doubt as to the extent of the exemption must be resolved in favor of the sovereignty. (*Bank of Commerce* v. *Tenn.*, 161 U. S., 134; *Swan & Finch Co.* v. *United States*, 190 U. S., 143.)

"An exemption from taxation is an extraordinary grace of the sovereign power, and is to be strictly construed." (Rugg, C. J., in *Milford* v. *County Commissioners of Worcester*, supra, at page 165.)

My conclusion is, therefore, that the East Douglas Evergreen Cemetery Co., to which the plaintiff made his contributions, was not a corporation organized and operated exclusively for charitable purposes within the meaning of the applicable Revenue Acts, and that the action of the Commissioner of Internal Revenue in disallowing the deductions was correct.

Judgment for the defendant.

SECTION 215.—ITEMS NOT DEDUCTIBLE.

ARTICLE 294: Premiums on business insurance.

REVENUE ACTS OF 1918 AND 1921.

Premiums on life insurance policy assigned as collateral security for loan. (See T. D. 4087, page 161.)

SECTION 218.—PARTNERSHIPS AND PERSONAL SERVICE CORPORATIONS.

ARTICLE 332: Distributive shares of partners. VI-30-3337
T. D. 4042

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. INCOME—PARTNERSHIP—DISTRIBUTIVE SHARE—PROOF.

In determining the distributive share of partnership income to which one of the partners was entitled, the partnership return, made in conformity with section 224 of the Revenue Act of 1918 and showing such share to be the same in amount as that entered in the partnership books of account, is conclusive evidence as to such partner's distributive share, in the absence of satisfactory proof of fraud, accident, or mistake.

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 *Isidor Heilman* v. *United States* is published for the information of internal revenue officers and others concerned.

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

Approved July 18, 1927.

CARL T. SCHUNEMAN,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

Isidor Hellman v. *The United States.*

[May 2, 1927.]

OPINION.

GRAHAM, Judge, delivered the opinion of the court.

The plaintiff is seeking to recover an amount levied upon and collected from him as a tax on his distributive share of the net income for the taxable year 1919 of an incorporated partnership of which he was a member. The applicable provision of the Revenue Act of 1918 (40 Stat., 1070) is as follows:

"SEC. 218. (a) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. 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 for the taxable year."

Let us take up the question of plaintiff's distributive share of the net income of the partnership for the taxable year 1919. What was his distributive share? The defendant relies for establishing the amount of his share upon the books of the partnership, which when closed on December 31, 1919, preparatory to its transformation into a corporation, showed the plaintiff's distributive share for the year 1919 to be $121,701.25. It relies further upon the return made under oath by the president of the partnership to the Commissioner of Internal Revenue as required by section 224 of the said Revenue Act of 1918. This return showed, as the Act required, the distributive share of the net income of the partnership for the taxable year 1919, of each partner, and that the plaintiff's distributive share was the sum above mentioned.

The Act of 1918 did not tax partnerships as such, but each partner's distributive share of the net income. It seems plain that the purpose in requiring such a return from the partnership was to put the Bureau in possession of the information necessary to check up the income tax return of the partners. As it was made in conformity to the requirements of the statute and under the solemnity of an oath, and in this case by an official, the president of the partnership, it must be taken as conclusive of the fact unless it is overthrown by satisfactory proof of fraud, accident, or mistake.

In transforming this partnership into a corporation the plaintiff received as his share of the latter, representing his interest in the partnership, $450,000 of the preferred stock of the corporation, which amount is made up in part of the said $121,701.25, which, as stated, the books showed to be his distributive share of the net income of the partnership. In other words, as a part of his interest in the partnership he received this sum in par value of the preferred stock of the corporation.

There is no suggestion of fraud or accident in the said statement of the books and the return of the corporation as to the amount of the plaintiff's distributive interest for the year 1919. There has been some suggestion of a mistake, but this suggestion, when analyzed, is found to be based only upon a conjecture and not a fact.

There is proof that the net income of the partnership for the year 1919 was $531,141.26, and from this fact, on the basis of the plaintiff's 20 per cent interest as fixed by the partnership agreement of July, 1918, it is argued that the plaintiff's distributive share could not have been more than one-fifth of the last-mentioned sum, or $106,228.25. This conclusion proceeds from the premise that the distribution could only have been made on the basis of the agreement of July, 1918, whereas it could have been made on the basis of some later agreement, which fixed the plaintiff's distributive share at a higher sum, viz, the sum fixed by the books of the partnership. It is true that no later express agreement has been proved, but this does not controvert the fact established by the partnership books and the return, under oath, of the partnership, as required by law, that the plaintiff's distributive share was the sum there shown. The sum shown by the books of the partnership was apparently accepted by the plaintiff's copartners, and for it he received stock in the corporation afterwards formed, and it must be taken as the amount of the net income of the partnership to which he was entitled and which was in fact distributed to him by the said delivery of the shares of stock. It is not for the court to devise some explanation of how the amount was arrived at. It is enough that the

fact appears from the best evidence that this sum was his distributive share. How it happened that he was credited on the books of the partnership and in the report to the Government with more of the net income than his interest in the partnership agreement would have entitled him to is not explained by the evidence, and is not to be considered as in any way controverting the fact shown by the books and the return of the partnership and can not affect the issue as to that fact.

We are of opinion that the plaintiff's contract with some of his partners selling and assigning 199/800 of his 20 per cent interest in the net profits of the partnership does not affect the question at issue here. This was merely a side agreement which did not alter the responsibilities or the obligations of the plaintiff or the character of his interest under the partnership agreement. It was a matter between him and his partners and can not be injected into the case as affecting the issue here between him and the Government. We are of opinion that the action of the Commissioner of Internal Revenue in making the assessment of the plaintiff for taxation was right and that the petition should be dismissed, and it is so ordered.

ARTICLE 332: Distributive shares of partners. VI-38-3438
(Also Section 219, Article 343.) G. C. M. 2308

REVENUE ACTS OF 1917 AND 1918.

The taxpayer was a member of a partnership which reported income on the basis of a fiscal year ending January 31, while he reported on the cash receipts and disbursements basis for the calendar year. Taxpayer died on July —, 1917, and the surviving partner continued the business until the end of the partnership fiscal year.

Held, that the taxpayer's distributive share of the partnership profits for the fiscal year ended January 31, 1918, was improperly transferred to the 1917 return filed on his behalf.

An opinion is requested relative to certain adjustments made by the Income Tax Unit in the returns filed on behalf of A and his estate for the years 1917 and 1918.

A was a member of a partnership having a fiscal year ending January 31, on the basis of which the partnership's income was computed and its returns filed. A had always kept his books on the cash receipts and disbursements basis of accounting, and had filed his returns on that basis for the calendar year. He died July —, 1917. In 1918, his wife, as executrix, filed two returns; one covering the period January 1 to July —, inclusive, for A, and the other for his estate covering the balance of the year. In 1919, on behalf of the estate, she filed a return for the calendar year 1918, but excluded from such return all of the income paid to her by the partnership on account of the deceased's share of the partnership profits for the fiscal year ended January 31, 1918. This was done on the advice of counsel, who held that A's share of the partnership's profit for the fiscal year ended January 31, 1918, $46x$ dollars, came to her as part of the corpus of A's estate and not as income. The revenue agent who made the field examination included this in income for 1918. The Unit on audit of the case transferred the whole amount to the return for the decedent covering the period January 1, 1917, to July —, 1917, the date of the decedent's death.

There is in the file an affidavit executed by B, the other partner of the partnership, in which he states:

The partners agreed, also, that upon the death of A, his interest in the partnership business, and in the good will thereof, should cease abruptly, and

that his estate should be paid his proportion of the net partnership earnings, if any, for the partnership's fiscal year ending January 31 next after such death should occur, as apportioned to that part of the fiscal year during which A had lived, which amount, so determined, should be taken to include the guaranteed salary of $5x$ dollars per annum.

The Income Tax Unit treated the death of a partner as constituting an immediate dissolution of the partnership, and, upon the theory that the earnings of the partnership were the property of the individual partners as soon as they were earned, it concluded that the distributive share of partnership income, earned prior to the death of a partner, should be included in the decedent's individual return covering the period prior to death.

An opinion in the matter is now requested in view of the decision of the Board of Tax Appeals in the appeal of R. W. Archbald (4 B. T. A., 483). (Acquiescence notice published in C. B. VI–1, 1.)

The facts as they appear in the Archbald case, supra, are as follows:

Franz Ehrlich, jr., a resident of Pennsylvania, died August 15, 1920. The petitioners herein are the executors of his estate. Prior to his death the deceased was a member of the partnership of Ehrlich & Archbald. This partnership's accounts were kept on the basis of a fiscal year ending January 31. The partnership return for the fiscal year ending January 31, 1920, reported $15,164.84 as the deceased's distributive share of the partnership income for that period. The deceased had made his return upon a calendar year and cash receipts and disbursements basis. His return for 1920 was prepared by his executors, and therein they included as income from the partnership his distributive share of the partnership income for the fiscal year ending January 31, 1920.

The surviving partner, for the purposes of liquidation, continued the business until January 31, 1921, at which time he credited the decedent's estate with $11,266.32. This amount was returned by the executors as income for 1921.

The Board of Tax Appeals, in holding that the decedent's distributive share of the partnership net income for the period from February 1, 1920, to August 15, 1920, could not be included in his individual return for the year 1920, used the following language:

It is true, of course, that earnings of a partnership are the property of the individual partners as soon as earned. This legal theory has not, however, been applied in the computation of net income for the purpose of taxation. The statute expressly recognizes definite accounting periods for the partnership, for the partner, or for both, and has used the calendar or fiscal year as the measure. Calendar and fiscal years are but 12-month accounting periods. During the existence of the partnership a partner's taxable income therefrom is not measured by his share of the partnership earnings as they are earned but, on the contrary, the statute requires that it be measured by his share of its *net income* during its accounting period, *computed at the close of such period*, and this entirely without regard to distribution or ownership. The principle of requiring and permitting the computation of income on the basis of a 12-month accounting period was strictly adhered to. * * *

It seems clear to us that the death of a partner does not shorten the partnership's fiscal or calendar year to an accounting period terminating at the death of the partner and that only a complete liquidation during the calendar or fiscal year terminates the accounting period. This partnership has but one accounting period ending in 1920. The statutory net income of the partnership could not in this instance be computed before the close of its fiscal year. This being our view, we must hold that there should be included in the deceased's return of income for 1920 only his distributive share of the partnership net income for its fiscal year ending January 31, 1920.

The facts in the Archbald case, supra, and the instant case can not be distinguished. In both cases the partnership returns were filed on a fiscal-year basis and the individual partners' returns on a calendar-

year basis. In both cases the individual partners kept their books and reported their income on the cash receipts and disbursements basis. In both cases the surviving partner continued the business until the end of the partnership fiscal year. Upon these statements of facts the conflicting conclusions can not be reconciled. It follows from the Archbald case, supra, that A's distributive share of the partnership net income in the sum of 46x dollars for the period from February 1, 1917, to July —, 1917, the date of death, was not properly included in his individual return for the year 1917.

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

SECTION 219.—ESTATES AND TRUSTS.

ARTICLE 341: Estates and trusts. VI–44–3490
G. C. M. 2519

REVENUE ACT OF 1921.

The testator in his will provided for the setting aside of the corpus of his estate and part of the income therefrom in order to establish a fund for a State institution, with the proviso that the State legislature accept the bequest within two years after tender thereof should be made by the trustees for the estate.

Held, that the part of gross income set aside by the trustees as directed by the will is a proper deduction under section 219(b) of the Revenue Act of 1921.

An opinion is requested relative to the rejection of two claims for refund filed for the years 1922 and 1923, respectively, on behalf of the estate of A. The claims were based on the ground that the will of A provided for permanently setting aside a part of the gross income of the estate for a State institution, and that such amount should have been allowed as a deduction pursuant to the provisions of section 219(b) of the Revenue Act of 1921.

Under the date of May —, 1927, the attorney general of the State of R transmitted to the Secretary of the Treasury and to the Commissioner of Internal Revenue copies of a joint resolution of the State of R Legislature accepting the benefits provided under the will of A in aid of the State institution, and requesting the attorney general to cooperate in obtaining exemption of accumulating income from Federal income taxes.

The pertinent provisions of the will of A are quite extensive, but the situation may be briefly epitomized as follows: The testator in his will, after making certain reservations concerning income, provided for the setting aside of the corpus of his estate and part of the income therefrom in order to establish a fund for a State institution. The will provided that the legislature accept the bequest within two years after the tender of the bequest was made by the trustees for the estate, and that tender should not be made by the trustees of the estate until the death of the testator's daughter. In case the legislature of the State of R did not accept the bequest, the estate was to be divided into three parts, one going to the city of S and the other two parts to surviving relatives.

The reservations as to income provided that a certain amount of income was to go to the decedent's daughter during her lifetime.

The balance of the income was to be held by the trustees of the estate, who were to act with the officers of the State institution in administering the estate for the best interests of the State institution. The trustees of the estate submitted annual reports to the officers of the State institution and consulted with them in order to carry out this provision of the will.

Section 219(b) of the Revenue Act of 1921 provides in part that in computing the net income of a trust estate—

> * * * there shall also be allowed as a deduction, without limitation, any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214.

Section 214(a)11 provides, inter alia, that in computing net income there may be claimed as a deduction "contributions or gifts made within the taxable year to or for the use of: (A) The United States, any State, Territory, etc."

It is conceded that the State institution comes within the purview of the foregoing provisions. Apparently the deduction was originally disallowed, however, on the ground that "it is possible, although improbable, that the State of R may not pass the special act of acceptance within the two years specified," and the income previously set aside "would then be distributed to others, as provided by the —— paragraph of the will."

The policy of the State relative to the acceptance of gifts such as this was expressed in an act wherein it was declared that "all gifts, grants, bequests and devises for the benefit or advantage of the university * * * shall be legal and valid * * * but no such accumulation shall be allowed to produce a fund more than twenty times as great as that originally given." The ultimate amount of the fund that could accumulate under the will was $50x$ dollars and the estate at the time of decedent's death amounted to some $3x$ dollars, thus bringing the gift well within the limitation. In this connection the affidavit of B, one of the trustees, expresses the opinion that the State of R statutes "anticipated the requirements of such special act of acceptance" by the act of 1883 referred to. B takes the view that the intent of the testator in providing for the special act of acceptance was solely to provide against the possibility that the accumulation of $50x$ dollars might exceed the twentyfold limitation of the State of R statute, because in provision — of the will the testator expresses the belief that the terms of the gift were "all within the law as it now exists if my estate shall amount to the sum I suppose."

While there is, no doubt, considerable force to this theory, this office believes that the deduction must be allowed upon other grounds. The contingency that a testamentary gift may not be accepted is always present, for a beneficiary may always disclaim or renounce his right under the will. (40 Cyc., 1898.) And, of course, in such cases the gifts must go to others, or possibly to the State. No possible question can now arise as to the testator's intention that the amounts in question should be permanently set aside. The validity of the will has been sustained by the State of R courts, and since 1910 the trustees have been setting aside the amounts directed. The governor and all proper officers of the State have exercised the right

of visitation granted by the will. The policy of the State, as evidenced by statute and by a resolution of the legislature passed in 1927, is to accept such gifts, and the event (i. e., the daughter's death) requiring a proffer of the gift will certainly happen. The only possible uncertainty was that the gift might not be accepted in the manner prescribed by the will. But this is a very common type of uncertainty, and one which has apparently never been taken as decisive against a deduction under the later Acts. Thus, in Solicitor's Memorandum 4613 (C. B. V-1, 71), a bequest was made to trustees to hold for a certain period, at the end of which it was to be given to a corporation to be created for educational purposes. There was there the possible uncertainty that the corporation might never be organized. Indeed, the policy of the State might change, and the organization of such corporations be prevented by statute. Yet in that case, as in this, there appeared to be no reason for supposing that the formalities required by the will would not be gone through with, and the conclusion was reached that the amounts of income in question were permanently set aside.

It is, therefore, the opinion of this office that the part of gross income set aside by the trustees, as directed by the testator in his will, is a proper deduction under section 219(b) of the Revenue Act of 1921.

ARTICLE 343: Decedent's estate during administration.

REVENUE ACTS OF 1917 AND 1918.

Partnership income received by decedent's estate. (See G. C. M. 2308, page 229.)

ARTICLE 345: Estates and trusts taxed to beneficiaries. VI-36-3413 T. D. 4076

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. INCOME—TRUST—INCOME TAXABLE TO BENEFICIARY.

Where under the terms of a trust instrument the trustee is required to pay to a beneficiary the entire amount of the net income of the trust at such times as he might request, the entire amount is income which is to be distributed to the beneficiary periodically, and it is therefore taxable directly to the beneficiary under section 219(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 Court of Claims in the case of *Edward T. Esty, as Executor of the Will of George I. Alden, deceased*, v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 26, 1927.

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

COURT OF CLAIMS OF THE UNITED STATES.

Edward T. Esty, as Executor of the Will of George I. Alden, deceased, v. *The United States.*

[May 2, 1927.]

OPINION.

Moss, Judge, delivered the opinion of the court.

On August 24, 1912, plaintiff's decedent, George I. Alden, executed and delivered to Albert H. Stone, Edward T. Estey, and to himself a certain trust instrument by the terms of which he conveyed certain properties to said trustees, with direction and authority to collect the income and make disposition thereof during the lifetime of plaintiff's decedent. After the death of the beneficiaries under the trust the entire income was to be used for certain charitable and educational purposes. The instrument was several times modified, but the particular provision involved in this controversy was never altered. It is contained in clause 2 of the original conveyance, and is as follows: "The trustees shall pay as often as requested to me during my lifetime the net cash income of the said trust fund; and they may further pay to me from time to time, as much of the principal as they may in their judgment deem advisable."

During the years 1918, 1919, and 1920 plaintiff's decedent requested the payment of only a part of net income, and the trustees paid to him only the amount so requested. However, he included in his tax return for each of said years the entire net income, as if the whole amount had been actually received, and paid the tax for each year computed on the income shown by his returns. Later, plaintiff's decedent filed a claim for refund, based on the contention that he should have included in his tax returns only that amount of the income which had actually been received by him. This claim was rejected by the Commissioner of Internal Revenue and this action is for the recovery of same. The amount involved is $70,894.39.

The tax in this case was collected under the Revenue Act of 1918 (40 Stat., 1057), the applicable provisions of which are as follows:

"SEC. 210. That, in lieu of the taxes imposed by subdivision (a) of section 1 of the Revenue Act of 1916 and by section 1 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax at the following rates: * * *."

[Here follow the rates.]

"SEC. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

* * * * * * *

"(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

* * * * * * *

"(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary his distributive share, whether distributed or not, of the net income of the estate or trust for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the estate or trust is computed, then his distributive share of the net income of the estate or trust for any accounting period of such estate or trust ending within the fiscal or calendar year upon the basis of which such beneficiary's net income is computed. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust."

It is the contention of plaintiff that the provision of the trust deed that "The trustees shall pay as often as requested to me during my lifetime the net cash income from said trust fund * * *," created and vested in plain-

tiff's decedent a general power of appointment and that he acquired no property in said income, and did not under the language of the Act of 1918 above set forth become a beneficiary of the net cash income of the trust fund until he had exercised his power of appointment by requesting its payment and collecting same. The court is unable to agree with this theory.

Under the terms of the trust instrument the trustees were required to pay to plaintiff's decedent not merely such part of the net income as he might request but to pay the entire amount *at such times* as he might request. No right whatever was reserved to the trustees as to any part of the net income which he might not request. Plaintiff's decedent was the unqualified owner of the net income. It was held by the trustees subject to payment to the founder of the trust "as often as requested." The trustees were not authorized to invest any uncollected portion, nor to add same to the principal, nor to make any other disposition of it. They did have authority under clause 10 of the trust instrument "to use as much of the income during my lifetime as I may request in writing * * * for the promotion of the objects set forth in clause 11, and may add to the principal so much of the income, from time to time, as I may request in writing." It does not appear that this authority was ever exercised. Plaintiff's decedent alone had the disposition of the net income, and it is taxable under section 219(d), which provides that "there shall be included in computing the net income of each beneficiary his distributive share, whether distributed or not, of the net income of the * * * trust."

It is the judgment of the court that plaintiff's petition be, and the same is hereby, dismissed.

ARTICLE 347: Estates and trusts with income which is distributed periodically and other income. VI-46-3502 G. C. M. 2509

REVENUE ACT OF 1921.

A husband residing in Georgia died intestate on June 12, 1922, leaving a widow but no lineal descendants.

Held, that the wife, as administratrix, in determining the net income of the estate, is entitled to deduct the amount of income received by the estate which was properly paid or credited to her, in her individual capacity, for the period from June 13, 1922, to December 31, 1922, and that no 1922 return need be filed by her for the estate, the net income thereof for 1922 being less than $1,000.

An opinion is requested relative to the necessity of filing a 1922 income tax return in the case of B, as administratrix of her husband's estate.

A, who was engaged in the timber business in Georgia and owned several sawmills and leases on timber tracts, died intestate on June 12, 1922; he left surviving him a widow, B, but no children or lineal descendants; he left both real and personal property; B carried on the timber business after her husband's death, and on March 15, 1923, filed a personal return for 1922, in which she included as her income, and paid an income tax thereon, the gains and profits of her husband prior to his death in 1922 as well as the gains and profits from the timber business from June 13, 1922, to December 31, 1922. As a result of investigations by revenue agents a return was prepared on behalf of the decedent for the period from January 1, 1922, to June 12, 1922, and a return was prepared on behalf of the estate for the period from June 13, 1922, to December 31, 1922. All the income reported by B in her return for 1922 was allocated to these two returns.

It is the contention of B that under paragraph 3931(1) of Park's Annotated Code of Georgia for 1914 (hereinafter quoted) she is the

sole heir of her deceased husband, and, therefore, the income derived in the period from June 13, 1922, to December 31, 1922, was properly reported in her personal return.

That B is the sole heir of her deceased husband is conceded. Paragraph 3931 of Park's Annotated Code of Georgia, 1914, states in part:

> Rules of inheritance. The following rules shall determine who are the heirs at law of a deceased person:
> 1. Upon the death of the husband without lineal descendants, the wife is the sole heir, and upon the payment of his debts, if any, may take possession of his estate, without administration.

Paragraph 4040 of the same code provides:

> Rules of distribution. After the payment of expenses of administration and the debts of the deceased, the balance of the estate, both real and personal, stands subject to distribution among the heirs at law of the deceased, according to the relationship hereinbefore prescribed.

Hence, after payment of administration expenses and debts, the personal estate, as well as the real estate, stood subject to distribution to B, as the sole heir.

B petitioned for and was granted the administration of the estate of her deceased husband, by order of the Court of Ordinary of —— County, Ga., dated August —, 1922. In such case, paragraph 3929 of Park's Annotated Code of 1914 applies:

> Descent to heirs. Upon the death of the owner of any estate in realty, which estate survives him, the title vests immediately in his heirs at law. The title to all other property owned by him vests in the administrator of his estate for the benefit of the heirs and creditors.

Under the laws of Georgia, therefore, the contention of B may be sustained in so far as the income from the real estate is concerned, for by operation of the statutes quoted the title to A's real estate vested in B at the time of his death, subject only to a qualified liability for the debts of the estate. (Paragraph 3934, Park's Annotated Code.) As the title to the personal property vested in the administratrix, B, acting in that capacity, should have filed a 1922 return on behalf of the estate in case the net income of the estate exceeded $1,000, and should have reported as gross income therein the gains and profits from the decedent's personal property for the period from June 13, 1922, to December 31, 1922.

It is the opinion of this office, however, that the net income of the estate did not exceed $1,000, for the reason that the administratrix is entitled to the deduction provided for in section 219(c) of the Revenue Act of 1921, which section reads in part as follows:

> In cases under paragraphs (1), (2), or (3) of subdivision (a) or in any other case within subdivision (a) of this section except paragraph (4) thereof the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, *except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary.* * * *. [Italics supplied.]

B, as administratrix, in determining the net income of the estate, is therefore entitled to deduct the amount of the income received by the estate and paid or credited to herself in her individual capacity for the period from June 13, 1922, to December 31, 1922. Under the facts and circumstances shown it is believed that the estate's entire income in 1922 may be said to have been properly paid or credited to B in her individual capacity. Accordingly, the allowable deduc-

tion entirely offsets the income, and no 1922 return need be filed for the estate under the provisions of section 225, Revenue Act of 1921, the net income for 1922 being less than $1,000.

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

ARTICLE 361: Withholding tax at source. VI-30-3338
T. D. 4044

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. WITHHOLDING TAX—TAX-FREE COVENANT BONDS.

A provision in a bond that "The principal and interest * * * are payable * * * without deductions for taxes which the company may be required to pay or retain therefrom by any governmental authority of the United States * * *," held to be an agreement by the obligor "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" within the meaning of section 221(b) of the Revenue Act of 1918, under which the obligor is required to deduct and withhold a tax equal to 2 per centum of the interest paid upon such bonds.

2. CASES DIFFERENTIATED.

Haight v. *Railroad Co.* (6 Wall., 15) and *Urquhart* v. *Marion Hotel Co.* (128 Ark., 283) differentiated.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the District Court of the United States for the Southern District of New York, in the case of *Roanoke Water Works Co.* v. *Anderson, Collector*, is published for the information of internal revenue officers and others concerned.

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

Approved July 18, 1927.

CARL T. SCHUNEMAN,
Acting Secretary of the Treasury.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

Roanoke Water Works Co., plaintiff, v. *Anderson, Collector, defendant.*

[February 24, 1927.]

AUGUSTUS N. HAND, District Judge: This is an action for the return of taxes alleged to have been improperly exacted from the plaintiff.

On January 1, 1916, the plaintiff executed a mortgage securing a bond issue. The bonds each contained the following clause:

"The principal and interest on this bond are payable whenever lawful without deductions for taxes which the company may be required to pay or to retain therefrom by any governmental authority of the United States, or any State, county, or municipality therein in the United States gold coin at the office of the Commercial Trust Co. in the city of Philadelphia, Pa."

During the year 1919, the plaintiff paid to holders of the bonds interest in the sum of $26,105. May 22, 1925, the defendant-collector assessed against the plaintiff 2 per cent of this, amounting to $522.10, and $130.53 penalties, which the plaintiff paid under protest and seeks to recover in this action.

The assessment of 2 per cent upon the interest was based upon section 221(b) of the Revenue Act of 1918, which is 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 individually or to an individual citizen or resident of the United States or to a partnership: *Provided*, That the Commissioner may authorize such tax to be deducted and withheld in the case of interest upon any such bonds, mortgages, deeds of trust or other obligations, the owners of which are now known to the withholding agent. 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; nor in the case of a nonresident alien individual if so provided for in regulations prescribed by the Commissioner under section 217."

The question is whether the 2 per centum is a tax which the company is "required to pay or to retain" from the interest "by any governmental authority of the United States." The corporation executing the trust deed is only required to pay the 2 per centum interest where the bonds contain a contract whereby the obligor agrees "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."

I do not understand how payment of the tax in question can be avoided. The very language of section 221(b) is used in the bond. The statute says:

"In any case where bonds, * * * of a corporation contain a contract or provision by which the obligor agrees * * * 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 * * *."

The bonds say:

"The principal and interest * * * are payable * * * without deductions for taxes which the company may be required to pay or retain therefrom by any governmental authority of the United States * * *."

It is true that the plaintiff did not in express terms agree to pay the bondholders' income tax, but how the clause of the bonds can fail to imply such an obligation, where these securities were issued at a time when income taxes were so much in the public mind and a withholding tax under prior income tax provisions had been generally applicable, I can not imagine. It is contended that the income tax was the tax of the bondholder, not of the plaintiff, and that neither the bond nor any law of the United States required the plaintiff to pay this tax, but the provisions of section 221(b) do require the obligor to deduct 2 per centum from the interest where it agrees "to pay the interest without any deduction for any tax which the obligor may be required or permitted to pay thereon or withhold therefrom under any law of the United States." Such agreement is in the very language of the bond and neither that bond nor section 221(b) can, to my mind, have any sense if not taken to cover the item herein said.

The case of *Haight* v. *Railroad Co.* (6 Wall., 15) is not in point, for there the covenant did not necessarily cover income taxes and was made before the passage of the Civil War income tax legislation. In *Urquhart* v. *Marion Hotel Co.* (128 Ark., 283), where there was a clause similar to the one in this case, I can only say that I can not reconcile that decision with the language of the bonds there under consideration. Moreover, the bond issue in that case was

put out in 1906, prior to the passage of the present income tax Act, and two out of the five judges of the court dissented from the prevailing opinion which held that the language only required the obligor to pay taxes imposed upon the property mortgaged and upon the bonds and coupons as such and not upon the income of the bondholder.

Under the rulings of the Commissioner of Internal Revenue, with which I agree, we have a tax-free covenant which entitled the collector to require payment of the tax in question.

The motion to dismiss the complainant is granted and final judgment should go to the collector unless the plaintiff can show a different state of facts upon an amendment of the complaint.

SECTION 223.—INDIVIDUAL RETURNS.

ARTICLE 401: Individual returns.

REVENUE ACT OF 1921.

Constitutionality of statutory requirement for a return of income from crime. (See T. D. 4028, page 177.)

SECTION 225.—FIDUCIARY RETURNS.

ARTICLE 421: Fiduciary returns. VI-33-3369
(Also Section 214(a)3, Article 134.) T. D. 4056

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. INCOME OF DECEDENT—TAXABILITY—RETURN.

The income of a decedent from the beginning of the taxable year to the date of his death is subject to tax. A return of such income is required to be made by the executor or administrator as provided in section 225 of the Revenue Act of 1918.

2. INCOME OF DECEDENT—DEDUCTION—INHERITANCE TAX.

No part of the State inheritance tax is deductible from the gross income of the decedent.

3. DECISIONS FOLLOWED.

The decisions in *Keith* v. *Johnson* (271 U. S., 1 (T. D. 3864 [C. B. V-1, 236])) and *Catherwood* v. *U. S.* (291 Fed., 560 (T. D. 3516 [C. B. II-2, 114])) 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 Court of Claims of the United States in the case of *Central Union Trust Co. of New York, Guaranty Trust Co. of New York, Frederic A. Juilliard, Chester A. Braman, and Robert Westaway, as Executors of the Last Will and Testament of Augustus D. Juilliard, deceased,* v. *The United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 4, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

Central Union Trust Co. of New York, Guaranty Trust Co. of New York, Frederic A. Juilliard, Chester A. Braman, and Robert Westaway, as Executors of the Last Will and Testament of Augustus D. Juilliard, deceased, v. *The United States.*

[June 6, 1927.]

OPINION.

Moss, Judge, delivered the opinion of the court.

Augustus D. Juilliard died on April 25, 1919, leaving a last will and testament, which was duly probated, and on September 25, 1919, letters testamentary were duly issued to plaintiffs herein as executors, who thereafter and during the period involved in this action were duly qualified and acting executors of decedent's estate.

Between the 1st day of January, 1919, and the date of decedent's death, April 25, 1919, decedent received a net income of $336,710.96 subject to normal tax, and a net income of $934,010.96 subject to surtax.

On March 15, 1920, plaintiffs, as executors, filed a return showing the income above stated disclosing an income tax amounting to $567,973.89, which tax was paid in four equal installments. Thereafter plaintiffs filed with the Commissioner of Internal Revenue a claim for the refund of the entire tax. The Commissioner failing to take any action on said claim within six months from the filing of same, plaintiffs instituted this action for the recovery of said amount. Plaintiffs also filed on the same date a tax return showing the net income of the estate of Juilliard from the date of his death, April 25, 1919, to December 31, 1919, amounting to $69,095.81 subject to normal tax and $376,438.32 subject to surtax, the tax on which, $190,930.80, was paid by plaintiffs. In reference to this item it appears from an agreed statement of facts herein that there is now pending in this court on action, D–1112, by which plaintiffs assert a claim against the Government for the deduction of $400,000 from the gross income of decedent's estate for the period beginning April 25, 1919, and ending December 31, 1919, on account of the New York inheritance taxes paid by plaintiffs. It further appears that at the time of the filing of the agreed statement of facts there was also pending another action by plaintiffs against the Government, E–161, involving a claim for refund growing out of the payment of a certain item of Federal estate tax. This action has since been disposed of by judgment of this court. At any rate, the present action relates only to the claim for refund of the amount paid as income tax on the income accruing during the life of plaintiffs' decedent, $567,973.89.

The question involved in this case is controlled by the Revenue Act of 1918 (40 Stat., 1057), the applicable portions of which are as follows:

"SEC. 210. That, in lieu of the taxes imposed by subdivision (a) of section 1 of the Revenue Act of 1916 and by section 1 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax at the following rates: (Here follow the rates.)

"SEC. 211. (a) That, in lieu of the taxes imposed by subdivision (b) of section 1 of the Revenue Act of 1916, and by section 2 of the Revenue Act of 1917, but in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual, a surtax equal to the sum of the following: (Here follow the rates.)

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

"(3) Taxes paid or accrued within the taxable year imposed (a) by the authority of the United States, except income, war-profits, and excess-profits taxes; or (b) by the authority of any of its possessions, except the amount of income, war-profits, and excess-pofits taxes allowed as a credit under section 222; or (c) by the authority of any State or Territory, or any county, school district, municipality, or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed; or (d) in the case of a citizen or resident of the United States, by the authority of any foreign country, except the amount of income, war-profits, and excess-profits taxes allowed as a credit under section 222; or (e) in the case of a nonresident alien individual, by the

authority of any foreign country (except income, war-profits, and excess-profits taxes, and taxes assessed against local benefits of a kind tending to increase the value of the property assessed), upon property or business."

Plaintiffs contend, first, that there was no provision in the Revenue Act of 1918 which authorized a tax upon the income received by plaintiffs' decedent from January 1, 1919, to the date of his death, April 25, 1919, and that said Act contained no provision which could be construed to require the filing of a return or the payment of a tax for any period less than a taxable year of 12 months. Plaintiffs' second point is that if plaintiffs were liable for the payment of income tax for the period from January 1, 1919, to the date of the death of plaintiffs' decedent, April 25, 1919, they were entitled to deduct from the gross income for that period, in determining the net income, the amount of inheritance taxes paid to the State of New York during the year 1919, and not theretofore deducted in computing the income tax of decedent's estate during the period of administration.

The court is unable to agree with plaintiffs' contention on either point. It is inconceivable that Congress intended, under the Revenue Act of 1918 or under any other Revenue Act, to relieve from taxation the income received by a taxpayer for the period between the first of the year and ending with the death of the taxpayer dying within the taxable year. The statute under consideration provides that "there shall be levied, collected, and paid *for each taxable year* upon the net income of *every individual*, a normal tax at the following rates * * *." The same language is used concerning the surtax. The fact that the income in this case was imposed for a period of less than a taxable year does not affect the statutory requirement that "there shall be levied, collected, and paid *for each taxable year* * * *." This income was received by plaintiffs' decedent from January 1 to April 25, 1919. It constituted the entire income received by Juilliard for the full *taxable year* and for the tax on that income he was liable. His death, however, prevented him from making a return and paying the tax at the time the tax became due. The Government was still entitled to the tax on that income. Although the return filed by the executor for the income of the decedent was for a period which was less than the taxable year, it was, nevertheless, on a yearly basis and constituted the entire income received by Juilliard for the *full taxable year*.

In order that the Government might receive the tax on all the income of a decedent for the entire taxable year within which the death occurs, that which was received during the life of the decedent as well as the income received by the estate after the death, the law requires a return to be made by the executor or representative under the provisions of section 225 of the 1918 Act, the pertinent portions of which are as follows: "Every fiduciary * * * shall make under oath a return for the *individual*, estate, or trust for which he acts * * * stating specifically the items of the gross income and the deductions and credits allowed by this title * * *," and, further, * * * "fiduciaries required to make returns under this Act shall be subject to all the provisions of this Act which apply to *individuals*." Section 200 of the Act provides "that when used in this title * * * the term 'fiduciary' means a guardian, trustee, *executor* * * * or any person acting in any fiduciary capacity for any person, trust, or estate."

For the reasons stated herein the court must hold that the return in this case, and the collection of the tax thereunder, was strictly in accord with the intention of Congress as expressed by the appropriate statutes on the subject.

On the second contention, that if plaintiffs were liable for the tax for the period from January 1, 1919, to April 25, 1919, they were entitled to deduct from the gross income the amount of inheritance State taxes paid to the State of New York during the year 1919.

This question is governed by section 214(a)(3) of the Act of 1918, which provides that in computing net income for the purpose of the tax there shall be allowed as deductions the taxes paid or accrued within the taxable year imposed by the authorities of the United States or of any State. In the case of *United States* v. *Mitchell* (271 U. S., 12) it is declared that "paid" means "paid or accrued," and that the phrase "paid or accrued" shall be construed, according to the method of accounting, upon the basis on which the net income is computed. The return in that case showed that the computation was made on the basis of income actually received in 1919, which indicated, said the court, that the accounts were kept on the basis of actual receipts and disbursements. The executors maintained that the estate tax in that case, accruing in 1919 and *paid in 1920*, was deductible from the gross income actually received in 1919 in

determining the net income of the estate. This contention was rejected by the court on the ground that the tax in question was not paid *within the taxable year*. The tax returns in the case under discussion were likewise made on a receipt and disbursement basis of income. It appears that $25,481.50 of the amount paid by plaintiffs on account of the New York inheritance tax was not paid until the year 1921. Under the authority of the principle above announced it is clear that this amount is not an allowable deduction. The balance of the State inheritance tax, $23,561.75, was paid in 1919. The court, however, has reached the conclusion that under the authority of the decisions in *Keith* v. *Johnson* (271 U. S., 1) and *Catherwood* v. *United States* (291 Fed., 560), no part of the State inheritance tax constitutes an allowable deduction from the income of decedent. Inasmuch as an action is now pending in this court by plaintiffs claiming a deduction of $400,000 from the gross income of the estate of decedent for the period from April 25, 1919, to December 31, 1919, on account of said State inheritance tax, and that the cases cited involve chiefly a consideration of the same questions presented in the pending suit just mentioned, it does not seem desirable at this time to discuss those decisions. It is deemed sufficient to state that the principles therein announced afford ample support for the theory that the State inheritance tax is not an allowable deduction from the income of the decedent.

It is therefore adjudged that the plaintiffs' petition herein be and the same is dismissed.

PART III.—CORPORATIONS.

SECTION 231.—CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

ARTICLE 518: Business leagues.

REVENUE ACTS OF 1918 AND 1921.

Amendment. (See T. D. 4089, page 74.)

ARTICLE 521: Local mutual insurance companies and like organizations. VI-31-3350 T. D. 4050

PREMIUM TAXES—INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

EXEMPTION—LOCAL MUTUAL LIFE INSURANCE COMPANY.

A local mutual life insurance company is not exempt from taxation under section 231(10) 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 District Court of the United States, Southern District of Illinois, Southern Division, in the case of *Shelby County Mutual Relief Association* v. *G. W. Schwaner, Collector, etc.*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved July 26, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES, SOUTHERN DISTRICT OF ILLINOIS, SOUTHERN DIVISION.

Shelby County Mutual Relief Association v. *G. W. Schwaner, Collector, etc.*

[June 7, 1927.]

MEMORANDUM.

The plaintiff sues to recover the sum of $600.56, premium taxes assessed and collected upon the insurance policies, under the provisions of section 503, Revenue Act of 1918 (40 Stat., 1057–1104).

It appears from the evidence in this case that plaintiff is organized, and its purpose is, to pay death benefits to its members; that it is being operated solely for the exclusive benefit of its members in the payment of death benefits to dependents of members of the association, upon proof. The revenues of the company are derived from assessments made on its members, from time to time, as deaths occur, to pay benefits and expenses. The membership is limited to persons living in Shelby County. The taxes were paid under protest.

It is contended by the plaintiff that it comes within the exemption granted in paragraph 10 of section 231 of the Revenue Act of 1918, which is as follows:

"SEC. 231. That the following organizations shall be exempt from taxation under this title— * * *

"(10) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses;"

There can be no doubt from the evidence in this case that the plaintiff is a local, mutual life insurance company within the meaning of the statute and it is liable for the taxes unless it comes within the exemption of paragraph 10 of the Revenue Act of 1918.

Plaintiff contends that the words in paragraph 10, above quoted, "or like organizations of a purely local character," should be so construed as to include the plaintiff. If it can be said that there is any doubt as to whether plaintiff brings itself, by the evidence, within the purview of this exemption in the statute, that doubt must be resolved in favor of the Government. (*Bank of Commerce* v. *Tennessee*, 161 U. S., 134, 146; *Cornell* v. *Coyne*, 192 U. S., 418, 431 [T. D. 757]; *Swan & Finch* v. *United States*, 190 U. S., 143, 146.)

Where a similar statute was under consideration (*Bankers' & Planters' Mutual Ins. Ass'n.* v. *Walker, Collector*, 279 Fed., 53, T. D. 3318 [C. B. I–1, 259]), the Circuit Court of Appeals for the Eighth Circuit said:

"Life insurance is too well known and important for us to suppose that Congress would detail hail, cyclone, and fire insurance, and intend life insurance to be included in the general expression of 'like association.' The plaintiff is clearly liable to the tax."

The conclusion that there is a serious doubt as to whether the plaintiff was within the exemption claimed by it under the Revenue Act of 1918 is strengthened by the fact that not until the Sixty-eighth Congress was it deemed advisable to extend the exemption to benevolent life insurance associations of a purely local character. When Congress did conclude to extend the scope of the exemption it added the words "Benevolent life insurance associations of a purely local character" at the beginning of paragraph 10, section 231, of the Revenue Act of 1924. If the plaintiff's contention were correct, it would have been unnecessary for Congress to enact the amendment referred to.

The court therefore finds the issues for the defendant, and judgment may be entered accordingly.

SECTION 233.—GROSS INCOME OF CORPORATIONS DEFINED.

ARTICLE 541: Gross income.

REVENUE ACT OF 1921 AND PRIOR ACTS.

Income of trust formed for use of stockholders of corporation. (See G. C. M. 2185, page 75.)

ARTICLE 547: Income from leased property. VI-50-3535
G. C. M. 2536

REVENUE ACTS OF 1918 AND 1921.

The M Company leased the entire property of the O Company, each company continuing its separate corporate existence although being operated under one head. The M Company, in order to obtain control of the preferred stock of the O Company, made an offer to the holders of such stock in a separate transaction from the lease, under which they might deposit their stock certificates with a trustee and receive in exchange therefor the stock exchange certificates of the M Company. Such certificates provided that the M Company would pay to the former preferred stockholders of the O Company a certain sum per annum per share for each certificate deposited with the trustee, that the M Company would vote such stock, and that upon default of such annual payments the stock would revert to its former owner.

Held, that the annual payments made by the M Company to the holders of the stock exchange certificates represented income to them but did not represent constructive rental or income to the O Company.

An opinion is requested as to whether certain payments made by the M Company to a number of the former preferred stockholders of the O Company should be regarded as income to the O Company by reason of being amounts constructively received by it as rentals.

The instant case involves the question of tax under the Revenue Acts of 1918 and 1921. From a review of the facts in the case it appears that prior to 190– the M Company had no facilities in the city of —— and in order to secure them it decided to acquire the majority of the stock of the O Company, to lease its property and to merge the operation of the two companies under a single management and control. By the terms of an instrument dated April —, 190–, and styled a "lease," the O Company as lessor and the M Company as lessee agreed that it was deemed to be to the best interests of the parties thereto that the companies be operated together while preserving the separate corporate existence and status in law of each of the respective organizations. Under the provisions of the lease the lessor rented to the lessee for the period of 99 years all the property of the lessor described and set forth at length in the lease.

Articles — and — of the lease read as follows:

ARTICLE —.

The lessee shall be entitled upon the execution hereof to the sole control of all the funds and other assets of the lessor, whether current or accumulated, and also of all earnings of said leased properties during the term hereof (including any proceeds from the sale, rent or royalties of any and all lands now held and owned by the lessor or held in trust for its benefit, or which it shall acquire during the term of this lease over which the lessor has or may have control) to be used, however, wisely and prudently according to its best judgment for the sole purpose of operating, maintaining and improving the —— and other properties hereby leased, and for meeting and discharging the taxes, charges, liabilities and obligations of the lessor pertaining thereto and any interest payable on account of the same, and, so far as may be legally possible, for the payment of such dividends on the outstanding capital stock of the lessor as the board of directors of the lessor may from time to time declare, provided, however, that the lessee shall not in any event commingle said earnings, funds or assets with its own, and that it shall keep and maintain, with respect thereto, a separate and complete system of accounting and auditing during the full term

of this lease. But said earnings, funds and assets shall stand charged in favor of the lessors with the payments to be made for the said purposes or for other purposes in accordance with the provisions contained in this lease.

ARTICLE —.

Whenever in their judgment the earnings and the physical condition of the properties hereby demised shall warrant, the directors of the lessor company may, from time to time, declare dividends on the capital stock of the lessor company payable out of the net earnings of said properties for such amounts as may be warranted by such earnings and which may be considered in the best interests of the property hereby demised and the public service connected therewith, and the lessee company may pay such dividends out of such net earnings.

Contemporaneously with the signing of the lease described above, an instrument styled a "Preferred stock exchange agreement relating to the issue of 4 per cent —— stock certificates" was executed by the M Company, the O Company, a committee representing certain preferred stockholders of the O Company, and the Bank of ——, trustee. By the terms of this stock exchange agreement the holders of the preferred stock of the O Company might deposit their stock certificates with the trustee and receive in exchange therefor the stock exchange certificates of the M Company under the provisions of which the M Company obligated itself to pay to the preferred stockholders the sum of —— dollars per annum per share for each certificate of preferred stock deposited with the trustee. The stock exchange certificates read in part as follows:

* * * This certificate is issued in exchange for said stock and represents the rights and interest of the owner hereof in and to the same, and so long as said payments are made by said M Company, it shall have the sole right to vote said stock and shall enjoy all the rights and benefits and be subject to all the obligations of a holder thereof.

* * * Upon default in the annual payment of said —— dollars per share, or any installment thereof, and the continuance of such default for 60 days, the owner hereof, upon presentation of this certificate to said bank, shall have the right to an immediate transfer to him of the said shares and the delivery to him of a certificate for the same, free from all encumbrances or conditions. * * * In any event, at the expiration of said period ending April —, 200—, said stock so deposited shall be delivered to the owner hereof upon the surrender of this certificate properly indorsed.

The question is raised whether the payments made by the M Company to the former preferred stockholders who are in possession of the stock exchange certificates should be considered as rental constructively received by the O Company and accordingly as taxable income of the O Company.

It will be noted at the outset that there are two separate and distinct agreements in this case, although the provisions of each are incorporated by reference into the other. The first is an agreement between the M Company and the O Company as separate corporate entities whereby one agrees to lease and operate the facilities of the other, it being provided, however, that the separate corporate status of each should not be changed. The second agreement is in the nature of a contract between the M Company and such preferred stockholders of the O Company as care to take advantage of the proposition to the effect that if the preferred stockholders should divest themselves of their rights, interests, and ownership in favor of the M Company the said M Company would pay to such preferred stockholders of the O Company —— dollars per annum for each

share of stock conveyed to the trustee for the use and benefit of the M Company.

In considering the question whether the payments made to the holders of the stock exchange certificates constitute income constructively received by the O Company it is necessary to refer to the provisions of article 546 of Regulations 45 (article 547 of Regulations 62, 65, and 69), which deals with the question of income from leased property and reads in part as follows:

> Where a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the stockholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability to the tax. While the payments made by the lessee directly to the bondholders or stockholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the stockholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

The article of the regulations quoted above outlines a principle of law dealing with the constructive receipt of income by a corporation where such income is actually paid to the stockholders or bondholders of the lessor, or paid out for other purposes, on behalf of the lessor. It will be noted, however, that the principle is made applicable where a corporation has leased its property in consideration that the lessee shall pay certain amounts in lieu of other rental to parties other than the lessor.

There are a number of cases, many of which are reviewed in the opinion of the Board of Tax Appeals in the appeal of the American Telegraph & Cable Co. (2 B. T. A., 991), in which the principle set out in the article of the regulations quoted above has been reviewed and approved. In the appeal of the American Telegraph & Cable Co., supra, the taxpayer leased all its property for $700,000 annual rental, the lessee to pay the rental direct as dividends to the stockholders of the lessor. In the case of *Anderson* v. *Morris & Essex R. R. Co.* (216 Fed., 83) and in the case of *Rennsselaer & Saratoga R. R. Co.* v. *Irwin* (249 Fed., 726) there was involved a lease under the terms of which the lessee was required to make payments of interest on bonded indebtedness and as dividends upon capital stock direct to the bondholders and stockholders of the lessor as rental for the use of the property of the lessor. In these cases it was held that such payments constituted income to the lessor corporations. Likewise, in the cases of *Blalock* v. *Georgia Railway & Electric Co.* (246 Fed., 387) and *West End Railway Co.* v. *Malley* (246 Fed., 625), it was held that amounts paid direct to stockholders of a lessor as rent for the use of property by a lessee constituted income to the lessor. Other cases with respect to the same point herein involved are *Hamilton* v. *Kentucky & Indiana Terminal R. R. Co.* (289 Fed., 20), *Houston Belt & Terminal Railway Co.* v. *U. S.* (250 Fed., 1), and *Boston Terminal Co.* v. *Gill* (246 Fed., 664). The principle of law announced in these cases is succinctly stated in the opinion of the Circuit Court of Appeals for the Second Circuit in the case of

Bowers v. *New York Trust Co.* (9 Fed. (2d), 548). After making reference to a number of the cases cited above, the court stated that—

> Those cases regard a distribution to the constituent members (the shareholders) of the corporate entity as equivalent to a payment to the entity itself, and a distribution by it.

There are important distinctions to be drawn between the cases cited above and the instant case. In the cases cited above the amounts involved were paid to the actual stockholders of the lessor corporations or otherwise paid on behalf of the lessors, and were designated as rentals or service charges. Such payments were the moving consideration for the lease agreements and not merely the consideration for the collateral agreements. In the instant case there is no provision made in the lease for the payment of rent and the payment of rent is not a consideration for the lease. The amounts to be paid under the stock exchange agreement were subject to the condition precedent of a transfer of stock to the trustee which was an optional proceeding by the preferred stockholders, not availed of by all of them. If none of the preferred stockholders had transferred their stock in the instant case, the lease agreement would apparently have been just as effective. If the M Company fails to make the annual payments to the holders of the stock exchange certificates, the lease will not be voided. The stock exchange agreement creates a situation where the M Company does not make annual payments to a stockholder of the O Company but such payments are only made to the persons who divest themselves of all the incidents of ownership of the preferred stock of the O Company for 99 years. The subject matter of the cases cited above and the regulations which are based on the principle determined in those cases is so clearly different from that involved in the instant case that it is at once obvious that neither the regulations nor the decisions of the courts in the cases cited are applicable in determining the issue involved in the instant case.

At a hearing afforded the representatives of the M Company it was developed that the —— dollars annual payments made to the holders of the stock exchange certificates are not charged against any accumulated profits earned by the M Company. It was also developed that no profits have been made by the O Company nor any dividends paid to any of its preferred stockholders since 1921 and no dividends have been paid on the O Company's common stock since that company became associated with the M Company in 190—. If dividends are declared by the O Company, the holders of the stock exchange certificates do not benefit thereby. If it should be regarded that the payments made to the holders of the stock exchange certificates are income of the O Company, it is an income from which none of the present holders of the preferred stock may receive a benefit and it is not a benefit flowing to any of the holders of the common stock.

There are certain outstanding features in connection with the two agreements under consideration to which attention should be particularly directed. The former preferred stockholders of the O Company who receive —— dollars per annum per share from the M Company receive such payments by virtue of a contract made

with the M Company and not by virtue of the present ownership of preferred stock, since the present holders of the preferred stock receive no part of the —— dollars annual payments. In other words, the holders of the stock exchange certificates do not receive the annual payments by virtue of being stockholders of record of the O Company but receive such amount by reason of the fact that they have divested themselves of their interest in the stock for a period of 99 years. If dividends are paid by the O Company on its preferred stock the recipients of the dividends with respect to such stock would be the M Company and the preferred stockholders of the O Company who have not transferred their interest in their stock to the trustee.

For the reasons stated above, this office is of the opinion that the annual payments made by the M Company to the holders of the stock exchange certificates, who were former preferred stockholders of the O Company, constituted income to the stock exchange certificate holders but did not represent constructive rental or income to the O Company.

SECTION 234—DEDUCTIONS ALLOWED CORPORATIONS.

ARTICLE 561: Allowable deductions. VI–28–3303
G. C. M. 2000

REVENUE ACT OF 1921.

The interest paid by joint stock land banks, organized under the Federal Farm Loan Act of July 17, 1916, to the holders of farm loan bonds secured by farm mortgages is not deductible from gross income under section 234(a)2.

An opinion is requested in the case of the M Bank (the taxpayer) as to the deductibility, under section 234(a)2 of the Revenue Act of 1921, of interest paid by certain joint stock land banks on bonds secured by farm mortgages.

The taxpayer owns the capital stock of the N First Trust Joint Stock Land Bank of —— and the O First Trust Joint Stock Land Bank of ——, which were organized under the Federal Farm Loan Act of July 17, 1916. It appears that, pursuant to the provisions of the Farm Loan Act, these joint stock land banks issue farm loan bonds and invest the proceeds from the sale thereof in first mortgages on farm lands, the mortgage notes being deposited in trust with the farm loan registrar as collateral security for the farm loan bonds.

The taxpayer claims that the interest paid by the joint stock land banks to the holders of farm loan bonds is deductible from gross income under the provisions of section 234(a)2 of the Revenue Act of 1921, which states as follows:

(a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities * * * the interest upon which is wholly exempt from taxation under this title.

The claim advanced by the taxpayer is based upon the proposition that the interest paid to the bondholders does not come within the

exceptions specified in section 234(a)2, supra, and consequently is a deductible item.

This claim, as presented, raises two distinct issues: (1) Whether funds derived from the sale of farm loan bonds and loaned to farmers on their first mortgage notes are used to *purchase or carry* obligations or securities; (2) whether farmers' mortgage notes are "securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916," thus falling within the provisions of section 213(b)4 of the Revenue Act of 1921.

(1) As shown by the report of the House committee on the farm loan bill (Sixty-fourth Congress, first session, Report No. 630), the object of the Farm Loan Act was to give farmers long-time loans on farm mortgages at low interest rates. Section 16 of the Farm Loan Act provides:

> That corporations, to be known as joint stock land banks, *for carrying on the business of lending on farm mortgage security* and issuing farm loan bonds, may be formed by any number of natural persons not less than 10. [Italics supplied.]

In discussing the constitutionality of the Farm Loan Act the Attorney General stated in part as follows:

> I do not deem it necessary to analyze the Act in detail. It is sufficient to say that the mortgages and farm loan bonds are of the very essence of the system created by it. The original capital of the Federal land banks is to be loaned, through the agency of national farm loan associations, to bona fide cultivators of the soil on first mortgages on farm lands. When a sufficient amount in such mortgages has accumulated, they are to be turned over to a "registrar" appointed by the Farm Loan Board, and, with the approval of that board, farm loan bonds are issued by the land bank and sold. With the proceeds further loans are made on mortgages, which mortgages in their turn become the basis for an additional issue of bonds. This continuous flow and reflow of mortgages and bonds constitutes the prime function of the whole system. (31 Op. Atty. Gen., 105.)

Thus it appears that, for all practical purposes, the sole object of the joint stock land banks in raising money by the sale of bonds is *to carry* the mortgage notes of the farmers who apply for loans.

(2) The taxpayer contends that only the farm loan bonds of the joint stock land banks qualify as securities under the language of section 213(b)4 of the Revenue Act of 1921, and that the mortgage notes, payable to the joint stock land banks, are not securities within the contemplation of the language of that section.

Section 213(b)4 of the Revenue Act of 1921 provides in part as follows:

> SEC. 213. That for the purposes of this title * * * the term "gross income"—
>
> (b) Does not include the following items, which shall be exempt from taxation under this title:
>
> (4) Interest upon (*a*) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (*b*) *securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916;* or (*c*) the obligations of the United States or its possessions; or (*d*) bonds issued by the War Finance Corporation. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income, war-profits and excess-profits taxes. [Italics supplied.]

Bills of exchange, bonds for the payment of money, and promissory notes are in the popular acceptance of the term "securities" for money. (*Jennings* v. *Davis*, 31 Conn., 134; *Bank of Commerce* v. *Hart*, 37 Neb., 197, 55 N. W., 631.) In *Wagner* v. *Scherer* (85 N. Y. Supp., 894), the Supreme Court of New York (Appellate Division) had before it the question whether a promissory note was a security within the meaning of the New York statute involved, and in rendering its opinion the court stated in part as follows:

> In popular acceptation the term "securities" includes promissory notes. (Anderson's Dictionary of Law, page 931.) "Promissory notes, among our people, are regarded as securities for money, more or less valuable; indeed, in proportion as the pecuniary ability and credit of the makers of them, are more or less reliable." (*Jennings* v. *Davis*, 31 Conn., 134, 140.) Under the charter of a bank empowering it to "purchase securities of every kind" it has been held that the term "securities" as therein used meant notes, bills of exchange, and bonds; in other words, evidences of debt, promises to pay money. (*Bank of Commerce* v. *Hart*, 37 Neb., 197, 202, 55 N. W., 631, 20 L. R. A., 780, 40 Am. St. Rep., 479.) But the term "securities" embraces promissory notes not only in a popular sense, but in a legal sense as well. This was expressly held by Lord Chancellor Sugden in the case of *Barry* v. *Harding* (1 Jones & Latouche, 475, 483).

From the authorities reviewed above it is apparent that the term "securities" includes promissory notes.

In *Smith* v. *Kansas City Title Co.* (255 U. S., 180), the Supreme Court considered the constitutionality of section 26 of the Farm Loan Act. The appellant in that case alleged that the provisions exempting from taxation the mortgages executed to secure loans made by the joint stock land banks and the farm loan bonds issued by these banks were unconstitutional. In rendering its opinion the court referred to both the mortgage notes and the farm bonds as securities in the following language:

> Deciding, as we do, that these institutions have been created by Congress within the exercise of its legitimate authority, we think the power to make the *securities* here involved tax exempt necessarily follows. This principle was settled in *McCulloch* v. *Maryland* and *Osborn* v. *Bank*, supra.
>
> That the Federal Government can, if it sees fit to do so, exempt such *securities* from taxation, seems obvious upon the clearest principles. [Italics supplied.]

Section 2 of the Farm Loan Act defines "first mortgage" as follows:

> That wherever the term "first mortgage" is used in this Act it will be held to include such classes of first liens on farm lands as shall be approved by the Federal Farm Loan Board, and the credit instruments secured thereby.

Section 16 provides "that no loans shall be made which are not secured by first mortgages on farm lands," and section 19 declares that:

> No mortgage shall be accepted by a farm loan registrar from a land bank as part of an offering to secure an issue of farm loan bonds, either originally or by substitution, except first mortgages made subject to the conditions prescribed in said sections 12, 15, and 16.

Section 12 specifies that every farm mortgage shall contain an agreement providing for the repayment of the loan on the amortization plan; that interest on the notes shall not exceed 6 per cent; that no loan shall exceed 50 per cent of the value of the land mortgaged; and that certain express covenants undertaking to pay liens, judgments, etc., shall be included in the mortgage deed.

Attention is directed to the fact that the Farm Loan Act not only provides for the issuance of the mortgage notes in question, but specifies how the notes shall be drawn, and declares that they must meet certain prescribed conditions before they can be accepted as collateral security for the farm loan bonds.

It can not be said that Congress, by the use of the word "securities" in section 213(b)4, supra, meant only farm loan bonds, when the first mortgage notes are essential to the operation of the system created by the Farm Loan Act, are the final security upon which the holders of the bonds must depend for safety in their investment, and are in fact the very basis of the financial system created by the Farm Loan Act. In the light of the authorities reviewed and from an examination of the provisions of the statutes involved, it is the opinion of this office that the word "securities" as used in section 213(b)4 of the Revenue Act of 1921 includes not only the farm loan bonds issued by the joint stock land banks but also the first mortgage notes issued by the farmers and payable to these banks.

Moreover, even if the argument of the taxpayer were conceded to be sound—that is, that the farmers' notes are not securities issued under the provisions of the Federal Farm Loan Act—nevertheless it appears that the conclusion for which the taxpayer contends would not follow.

The farmers' mortgage notes are exempt from Federal income tax under section 26 of the Farm Loan Act and article 75 of Regulations 62, as amended by Treasury Decision 3515 (C. B. II–2, 91).

Section 26 of the Federal Farm Loan Act of July 17, 1916, provides as follows:

> * * * First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation.

Article 75 of Regulations 62, as amended by Treasury Decision 3515, states in part as follows:

> As section 26 of the Federal Farm Loan Act of July 17, 1916 (ch. 245, 39 Stat., 360), as amended by an Act approved March 4, 1923 (ch. 252, 42 Stat., 1454), provides * * * that first mortgages executed * * * to joint-stock land banks, * * * with the income therefrom, shall be exempt from taxation, the income derived from * * * interest on promissory notes secured by such first mortgages, * * * is not subject to the income tax.

This office is of the opinion that Congress sought to deny to the taxpayer the right of deduction with respect to interest paid on indebtedness incurred or continued for the purpose of enabling the taxpayer to purchase or carry tax-exempt obligations, regardless of the source or the reason for such tax exemption. The exception contained in section 234(a)2 contemplates obligations or securities wholly exempt from the tax burden imposed by Title II of the Revenue Act. It is a matter of no consequence whether this tax exemption arises by virtue of constitutional limitations, provisions contained in other Acts of Congress, or exclusions embodied in the Revenue Act itself. The taxpayer would interpret that exception as referring only to those obligations or securities the interest from which is relieved by Title II of the Revenue Act from taxation. Such a construction is not possible without recognizing the exception as creating an arbitrary

classification which could not be justified in reason. Moreover, that construction would necessitate a readjustment of the phraseology employed in the statute and a disregard of what this office believes to have been the plain intention of Congress in its enactment. *Taxation under the Act*, or freedom therefrom, was the item of concern to Congress and not simply *exemptions created by the Act.*

In conclusion, this office is of the opinion that the indebtedness represented by the farm loan bonds to joint stock land banks is indebtedness incurred or continued to purchase or carry obligations or securities, the interest upon which is wholly exempt from Federal income tax. Accordingly, the interest on the farm loan bonds is not deductible from gross income under section 234(a)2 of the Revenue Act of 1921. The claim of the taxpayer that such interest is a deductible item should be denied.

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

ARTICLE 566: Tax on bank or other stock.

REVENUE ACT OF 1918.

Idaho State and county taxes imposed upon holders of bank stock and payable by bank. (See T. D. 4078, page 201.)

SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 631: Affiliated corporations. VI–36–3414
(Also Section 1312, Article 1141.) G. C. M. 2189

REVENUE ACTS OF 1917, 1918, AND 1921.

The fact that the taxes of one member of a consolidated group have been settled upon an erroneous separate basis under a "determination and assessment," as provided in section 1312 of the Revenue Act of 1921, can not mean that the "proportion" to be assessed upon the other respective affiliated corporations must be likewise erroneously determined and assessed. If the status of affiliation exists, the mandatory provision that the tax be computed on the basis of a consolidated return becomes operative.

The question has arisen as to the effect of an agreement of "final determination and assessment" under section 1312 of the Revenue Act of 1921 in the case of the M Company and the O Company. The returns of these two corporations were previously audited upon a separate basis, but it was later ruled that the corporations were affiliated. The opinion of this office is requested as to whether, in view of the fact that the case of the O Company has been closed under section 1312 of the Revenue Act of 1921 for the years 1917 to 1920 upon a separate basis, the ruling that these two corporations were affiliated should be followed in considering the claims of the M Company for the years 1917, 1918, and 1919, and in the audit of 1920.

The taxpayer's representative has challenged the affiliation ruling upon the grounds of divergencies and minorities in stock holdings of

the two corporations. It is also stated in the protest that the corporations were operated separately and that there were no intercompany transactions whereby any artificial distribution of profits or income could or did arise. This, however, is not consistent with statements made in the affiliated corporation questionnaire, nor was any serious attempt made to explain these inconsistencies. It appears, therefore, that the affiliation ruling was correct and in accord with the decisions of the Board of Tax Appeals in such cases as Wright Cake Co. (2 B. T. A., 58), The Barnes Coal & Mining Co. (3 B. T. A., 891), and American Box Co. (3 B. T. A., 824).

It was argued before this office that even if the affiliation ruling were correct, the Commissioner was nevertheless barred from asserting taxes against the M Company upon the basis of a consolidated return because the taxes of the O Company had been settled under the provisions of section 1312 of the Revenue Act of 1921 upon a separate basis. Section 1312 of the 1921 Act reads as follows:

> That if after a determination and assessment in any case the taxpayer has without protest 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.

An agreement under this provision of the law, or similar provisions in other Revenue Acts, operates as a bar to the reopening of a case or modification of the determination and assessment. (G. C. M. 74, C. B. V–2, 102.) The purpose of the provision was to permit the taxpayer and the Commissioner to reach an agreement as to the amount of tax due which, except upon a showing of fraud or malfeasance, would be conclusive and binding on the parties, and not so much that the tax liability in each case in which such an agreement is made will be correct in every respect.

Section 240 of the Revenue Act of 1918 requires that the taxes of "corporations which are affiliated * * * shall be computed and determined upon the basis" of a consolidated return. It further provides that the—

> * * * total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each.

Notwithstanding the theory adopted by the Board of Tax Appeals that the separate existences of affiliated corporations cease for tax purposes (American La Dentelle, Inc., 1 B. T. A., 575) or that the separate entities of the corporations included in the group are "fused" (G. M. Standifer Construction Co., 4 B. T. A., 525), the statute requires the assessment to be made "upon the *respective affiliated corporations*" in the proportions designated. If the status of affiliation exists the mandatory provisions that the tax be computed on the basis of a consolidated return become operative. (American La Dentelle, Inc., supra.) Hence, the fact that the taxes

of one member of the group have been settled under a "determination and assessment" upon an erroneous separate basis can not mean that the "proportion" to be assessed upon the other "respective affiliated corporations" must be likewise erroneously determined and assessed. The agreement is not that the tax agreed upon was in all respects correct but that the amount agreed upon could never thereafter be challenged either by the Commissioner or the taxpayer. In cases such as this there are, of course, no agreements among the corporations as to the proportions assessable against the respective corporations, so the assessment to be made against those corporations in whose case no settlement was made should be computed on the basis of the net income properly assignable to each.

It is, therefore, the opinion of this office that the decision holding that the O Company and the M Company are affiliated should be followed in considering the claims of the latter company for the years 1917, 1918, and 1919, and in the audit of 1920.

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

ARTICLE 633: When corporations are affiliated. VI–47–3515
T. D. 4100

INCOME TAX.

Consolidated returns of corporations.—Article 633 of Regulations 45 (1920 edition), article 633 of Regulations 62, * * * amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 633 of Regulations 45 (1920 edition), article 633 of Regulations 62, * * * are hereby amended by omitting from each of said articles the last sentence thereof, having to do with the definition of the words "the same interests."

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved November 12, 1927.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 634: Change in ownership during taxable year.

REVENUE ACT OF 1918.

Return by a corporation acquiring substantially all the stock of another corporation for that period in 1920 prior to affiliation. (See G. C. M. 786A, page 276.)

SECTION 245.

ARTICLE 681: Reserve funds. VI-29-3318
T. D. 4035

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. LIFE INSURANCE COMPANIES—GROSS INCOME—DEDUCTIONS.

Under the provisions of the Revenue Act of 1921 a life insurance company is not taxed on its interest realized from tax-exempt securities when such interest is included in gross income under the provisions of section 244 but is deducted therefrom in computing net income under the provisions of section 245(a)1.

2. DEDUCTIONS—PERCENTAGE OF RESERVE.

Under the provisions of section 245(a)2 of the Revenue Act of 1921 a life insurance company is entitled to deduct only an amount equal to the excess, if any, of 4 per cent of the mean of its reserves over the interest received from tax-exempt securities (sec. 245(a)1); and the use of said interest as a measure of the deduction allowed does not impair the exemption from taxation of such interest.

3. CONSTITUTIONALITY—DISCRIMINATION.

The constitutional requirement of uniformity in the application of Federal statutes refers only to geographical uniformity and in construing the provisions of section 245(a)(1) and (2) of the Revenue Act of 1921 the circumstance that one company may have more tax-exempt securities than another, or none at all, does not result in discrimination nor destroy geographical uniformity of operation.

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 *National Life Insurance Co.* v. *The United States* is published for the information of internal revenue officers and others concerned.

H. F. MILES,
Acting Commissioner of Internal Revenue.

Approved July 6, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

National Life Insurance Co. v. *The United States.*

[March 7, 1927.]

OPINION.

CAMPBELL, Chief Justice, delivered the opinion of the court.

This is an action to recover an amount the plaintiff was required to pay as taxes which it is alleged were illegally exacted. The facts are stipulated. The plaintiff is a corporation engaged in business as a life insurance company. It filed a tentative return of its income for the year 1921, and in March, 1922, paid a tax under protest. Thereafter, in June, 1922, it filed an amended

return, but the collector of internal revenue required it to file a second amended return. Item 6 in the two amended returns is here set forth and shows the difference between the claims of the parties:

(1) 4 per cent of the mean of the reserve funds	$2,695,279.12
(2) Excess of 4 per cent of the mean of the reserve funds over item 5	1,569,490.86

The question is whether plaintiff can recover the tax of $92,490.20, with the addition of a small item of $5.09 stated in the second amended return, being the amount it was required to pay.

The tax in question is controlled by the Revenue Act of 1921 (42 Stat., 261), which provides a special method for ascertaining the "taxes on insurance companies." Section 242 defines the term "life insurance company," and section 243 imposes a tax in lieu of taxes imposed by section 230 (the corporation tax), and section 1000 (capital stock tax), and Title III (war-profits and excess-profits tax). It imposes on a domestic life insurance company "the same percentage of its net income as is imposed upon other corporations by section 230," that is, 10 per cent. Section 244 provides that in the case of a life insurance company the term gross income means the gross amount of income received during the taxable year "from interest, dividends, and rents." Plainly these specific items are not inclusive of all the sources of income to a life insurance company nor are they broad enough to cover "gains or profits and income derived from any source whatever" used in section 213 when referring to gross income of individuals—a section that is made applicable to "gross incomes" of corporations by section 233. The gross income of the life insurance company is thus limited to three sources, and the net income, which alone is taxed, is this income from three sources less certain authorized deductions stated in section 245(a) under nine separate paragraphs. The deductions authorized by paragraphs (1) and (2) are the material ones in this case, and are as follows:

"(1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title.

"(2) An amount equal to *the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of* 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year."

We italicize certain words in the paragraph for convenience of reference. There is no question as to the mean of the reserve. The amount is stipulated to be $67,381,977.92, 4 per centum of which is $2,695,279.12. The interest exempt from taxation under paragraph (1) is interest on State or municipal bonds and certain Federal securities. It amounted to $1,125,788.26, and in accordance with paragraph (1) was deducted from the gross income as item 5 in both of the amended returns. Including this amount the gross income was $3,824,592.78.

As shown by the two amended returns (item 6), the controversy turns upon the effect to be given paragraph (2) of section 245(a) above quoted. In this paragraph the plaintiff is allowed a deduction which it contends should be 4 per centum of the mean of its reverse funds, while the Government contends that the deduction is not 4 per centum of these funds but "an amount equal to the excess" of 4 per centum of them over the amount of the interest from the tax-free securities. Paragraph (2) certainly uses the word "excess," which, according Webster's dictionary, means "the amount by which one thing or number exceeds another." The amount of one of these things is ascertained by taking 4 per centum of the mean of the reserve funds (stipulated to be $2,695,279.12) and the other of these things is ascertained by taking the amount of the interest on certain securities (stipulated to be $1,125,788.26). The difference between these amounts shows what excess is authorized to be deducted, and unless the 4 per centum of the reserve is in excess of the other factor, there is no deduction to be made under this paragraph. It is apparent that if the deduction is to be ascertained by recourse to the language used the position of the plaintiff is not tenable. The words used are plain and unambiguous. It further states, however, its fundamental contention to be that in so far as the Act purports to authorize the exaction of the sum in question "it is repugnant to the Constitution, in that it attempts to tax the income of tax-free securities, and is not referable to any power granted to Congress." We do not understand the contention to go to the extent, in one phase of the case, of urging as unconstitutional all of paragraph (2). Because if this end be attained and the whole paragraph be stricken down without affecting the others the result would be

that plaintiff would not be entitled to the deduction of item 6 in either of the returns. The argument proceeds upon the theory that the part of the paragraph (that part we have italicized) is void, though effect may be given to the balance of it. This will be adverted to later. It is sufficient here to say that it is urged by plaintiff that interest on tax-free securities being nontaxable, "it is a breach of the taxpayer's rights to include in the gross income upon which the tax is based interest on State and municipal bonds." It is to be conceded that interest on State and certain other bonds is not taxable, but that such interest does actually constitute a part of the gross income of its recipient is a truism. It is not a part of taxable income and the Act does not attempt to tax this interest or "gross income." It defines "gross income" as something less than the life insurance company's actual income, but the tax is imposed upon "the net income of every life insurance company" (sec. 243).

This term "net income" is defined to mean the gross income, as defined by the statute, less certain authorized deductions, the first of which is the amount of interest received during the taxable year from tax-free securities. So that if this interest is first treated as part of the gross income it is immediately deducted, and if there were no other authorized deductions it is manifest that there could be no basis for a claim that the interest on tax-free securities is taxed. To include this interest in the gross income and then to deduct the amount of it to ascertain the taxable net income produces the same result that would be reached if this interest had not been included in the gross income in the first instance. In neither event is it taxed. But since there are a number of other deductions authorized to be made from the aggregate of "the interest, dividends and rents" constituting the gross income, the amount remaining after the tax-free interest is deducted must be kept in view. No objection is taken to the deductions except paragraph (2), the others, which may be designated as miscellaneous deductions, being taken from the "gross income" to reach the net. As to the deduction authorized by paragraph (2), it is said by plaintiff that "it virtually destroys the exemption" of tax-free securities when held by insurance companies, that it produces a "glaring discrimination" between life insurance companies and individuals and between various life insurance companies themselves.

The contention, it seems to us, confounds what is taxed with what is deducted. As already stated, the tax-free interest being authorized to be and actually deducted from the gross income, there can be no pretense that this element is subjected to a tax imposed on what remains. The principle securing this right of exemption from taxation does not extend to conferring a right to have the exemption counted twice. The paragraph provides a deduction defined to be the amount of the excess of one ascertainable amount over another, and the plaintiff contends that this virtually destroys the value of the deduction of tax-free interests already made because it argues the provision is that the deduction of 4 per centum of the reserves "to which all life insurance companies are entitled" is to be diminished by the amount of this tax-free interest. What basis there is for this statement that all life insurance companies are entitled to a deduction of 4 per centum of the reserves does not appear. It is not stipulated and we do not find it in the Act. Paragraph (2) makes it an element in ascertaining the "excess" that may be deducted from the "gross," and if a company has no tax-free interest to deduct from the 4 per centum it of course secures a larger deduction under this item than a company having such interest can secure under the same item. But how can that affect the deduction which the owner of the tax-free interest has already taken? The question resolves itself into whether the Act is void because of discrimination. Before considering this let us advert to a contention above suggested that the constitutionality of paragraph (2) could be upheld by striking therefrom the words we have italicized, and thus leave the right to a deduction of 4 per centum of the reserves instead of the "excess" mentioned. It is recognized that effect should be given to the legislative intent, and it is not questioned that the intent is primarily to be found in the language of the enactment.

The rule has been thus stated: "As one section of a statute may be repugnant to the Constitution without rendering the whole Act void, so, one provision of a section may be invalid by reason of its not conforming to the Constitution, while all the other provisions may be subject to no constitutional infirmity. One part may stand, while another will fall, unless the two are so connected, or dependent on each other in subject matter, meaning or purpose, that the good can not remain without the bad. The point is * * * whether the provisions are so interdependent that one can not operate without the other."

Loeb v. *Columbia Township Trustees* (179 U. S., 472, 490). "But * * * if they are so mutually connected with and dependent on each other, as conditions, considerations, or compensations for each other as to warrant a belief that the legislature intended them as a whole, and that, if all could not be carried into effect, the legislature would not pass the residue independently, and some parts are unconstitutional, all the provisions which are thus dependent, conditional, or connected must fall with them." *Allen* v. *Louisiana* (103 U. S., 80, 84). "The point to be determined," it is further said (p. 84), "in all such cases is whether the unconstitutional provisions are so connected with the general scope of the law as to make it impossible, if they are stricken out, to give effect to what appears to have been the intent of the legislature." See *Butts* v. *Merchants Transportation Co.* (230 U. S., 126, 138); *Supervisors* v. *Stanley* (105 U. S., 305, 312); *Reagan* v. *Farmers Loan & Trust Co.* (154 U. S., 362, 395). Tested by these rules there can be no doubt that the provisions of paragraph (2) are inseparable. Neither can be eliminated and leave a basis for ascertaining the deduction. It can not be said that Congress would have enacted the paragraph with the italicized words deleted. They had the right to authorize a deduction and the courts are without power to make a different one. This brings us to the question of the constitutionality of the entire paragraph (2). As already stated, it is not subject to the objection that it taxes the income from tax-exempt securities. Nor is it subject to the objections that it is void because of supposed discriminations. The class of life insurance companies coming within the provisions of section 242, to which plaintiff belongs, are all treated alike, so far as they are similarly circumstanced, though an extreme case such as plaintiff uses to illustrate its contention may show that one company may have a deduction of 4 per centum of its mean reserves, while another company may get no deduction under paragraph (2). But if in application, the authorized deduction, in particular instances, may seem to bear upon one life insurance company more than upon another, this is due to differences in their circumstances and not to any uncertainty or want of generality in the tests applied. See *LaBelle Iron Works case* (256 U. S., 377, 393, T. D. 3181 [C. B. 4, 373]). The established doctrine is that the requirement of uniformity prescribed by the Constitution refers only to geographical uniformity. See *Knowlton* v. *Moore* (178 U. S., 41, 98, 106); *Billings case* (232 U. S., 261, 282); *Barclay & Co.* v. *Edwards* (267 U. S., 442, 450).

The Revenue Act of 1918 was attacked in *Barclay & Co.* v. *Edwards* (267 U. S., 442 [T. D. 3691, C. B. IV–1, 207]), and the Revenue Act of 1921 in *National Paper & Type Co.* v. *Bowers* (266 U. S., 373 [T. D. 3677, C. B. IV–1, 203]), the two cases being heard at the same time because the same question was presented in both. In *Barclay & Co.* v. *Edwards* it is said: "The power of Congress in levying taxes is very wide, and where a classification is made of taxpayers that is reasonable, and not merely arbitrary and capricious, the fifth amendment can not apply. As this court said, speaking of the taxing power of Congress, in *Evans* v. *Gore* (253 U. S., 245, 256), 'It may be applied to every object within its range "in such measure as Congress may determine"; enables that body "to select one calling and omit another, to tax one class of property and to forbear to tax another"; and may be applied in different ways to different objects so long as there is "geographical uniformity" in the duties, imposts and excises imposed.'"

The classification of life insurance companies by the Revenue Act of 1921 does not furnish a basis for plaintiff's objection, and the injustice thought to be worked by the Act by reason of its operation as between the insurance companies affected "is an argument, not for the constitutional invalidity of the law before a court, but for its repeal before Congress." *Barclay & Co.* v. *Edwards*, supra (p. 451).

That the Act in referring to life insurance companies makes a distinction between them and other corporations and individuals is not to be questioned when their gross income is by section 244 limited to "interest, dividends, and rents." The income of individuals is from "whatever source derived." Is this a discrimination that strikes down the entire scheme for taxing life insurance companies? They are not taxed as other corporations are taxed, but that does not impair the validity of the sections imposing the tax. As already suggested, it would seem that the definition given in section 242 itself limits the number of the companies that are affected by the following sections. The circumstances that one company may have more tax-exempt securities than another company has, or that one company may have none, is not something a court may seize

upon to strike down a plan devised for the taxation of the class of life insurance companies. *LaBelle Iron Works case*, supra. The deduction of a percentage of mean reserves must rest in congressional action. It is not a constitutional right or one existing outside of the statute.

An exemption from taxation of the interest arising from State and municipal bonds and tax-exempt Federal bonds is a right which may not be impaired, but when this right is recognized and applied as it is in paragraph (1) the court is powerless to prevent the use of the amount of this interest as an element in measuring the extent of the additional deduction allowed by paragraph (2). We find nothing in the case of *Miller* v. *Milwaukee*, decided January 3, 1927, by the Supreme Court, that militates against our conclusion. In that case, involving the construction of a State statute, plaintiff's testator was a stockholder in a Wisconsin corporation that owned tax-exempt bonds of the United States. The interest on these bonds was collected by the corporations and was credited to their surplus. It was subsequently distributed as dividends to the stockholders. The corporations were not taxed for the amount of this interest, it being treated as exempt in the hands of the corporation. The law of Wisconsin provided, however, that, while the stockholders were not taxed upon dividends received from corporations, the income of which was assessed, yet where only part of the income was assessed by the corporation then only a corresponding part of the dividend received therefrom should be deducted from the income taxed to the stockholder. The law was condemned as an attempt to tax the interest received from Government bonds. But we have no such case. There is not the slightest basis for the claim that the interest on the bonds, State and Federal, is not exempt under the Act in question, nor, as has been shown, is it taxed because of paragraph (2). It is urged for the Government that in any event the tax in question is an excise tax. We do not pass upon that question, because, treating it as an income tax, we think the plaintiff must fail.

The court has not made a finding requested by plaintiff to be added to the stipulation of facts. This relates to a statement by the "tax adviser of the Treasury Department" before the Committee on Finance of the Senate when it was considering the tax bill which eventuated in the Act of 1921. The full statement of this witness covers several printed pages of the "Hearings before the Committee on Finance" on H. R. 8245 in September, 1921. We think this document is not material or competent in this case, but it is as available as a public document to another court as it is to this court, and in any event has no place in the court's findings of ultimate facts.

Our conclusion is that the petition must be dismissed. And it is so ordered.

SECTIONS 246 AND 247.—INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL COMPANIES.

ARTICLE 691: Tax on insurance companies. VI–47–3509
G. C. M. 2640

REVENUE ACT OF 1921.

A corporation, a substantial portion of whose income is neither investment income nor underwriting income, is not taxable as an insurance company under section 246 of the Revenue Act of 1921, but is taxable under section 230 of that Act.

In 1893 the M Company was incorporated to engage in the business of issuing certificates of title on lands. Its articles of incorporation provided that it might carry on such business and, in addition, carry on a trust business, although this power was not then exercised. In 189– a trust department was organized and operated as a part of the business of the taxpayer.

On August 10, 1913, section 453X of the Civil Code of California became effective, causing material changes in taxpayer's mode of doing business. It provided, in substance, that a title insurance

company might maintain a trust department, but that, in case it did so, it must segregate and allocate its capital and surplus between the two departments. The section further provided that the title insurance department should be subject to the jurisdiction of the insurance commissioner of the State of California and all laws governing insurance companies and that the trust department should be subject to the control of the State superintendent of banks and all laws governing banking institutions. After the allocation of capital and surplus, "the respective portions * * * shall be considered and treated as the separate capital and surplus of each department, respectively, as if each such department was a separate business." (Deering's Civil Code of California, sec. 453X.)

In compliance with this new statute, the taxpayer amended its articles of incorporation to read in part as follows:

> Second: That the *purposes* for which it is formed are:
> (1) To carry on the business of a title insurance company.
> (2) To carry on the business of a trust company.
> (3) *To carry on the business of a combined departmental title insurance and trust company under the provisions of section 453X of the civil code.*
> The respective portions of such capital and surplus * * * shall be considered and treated as the separate capital and surplus of each such department, respectively, as if each such department was a separate business. [Italics supplied.]

On November —, 1913, in further compliance with the controlling statute, the taxpayer allocated 1,000x dollars of its capital and surplus to its title insurance department and 500x dollars to its trust department. By means of subsequent allocations, made necessary by the continued growth of the corporation, it has maintained approximately the same proportion between its two departments.

The returns of the taxpayer for 1922 and 1923 disclose that income was derived from the following major sources, and in these amounts, for those years:

	1922.	1923.
	Dollars.	*Dollars.*
From title department	1,636x	2,706x
From trust department	374x	566x
From investments	277x	355x

The taxpayer's return for 1922 was filed and tax paid on March 15, 1923. On March —, 1927, a claim for refund was filed by the taxpayer, asking a return of 46x dollars of the tax paid for 1922, on the ground that there was erroneously included as income in its return for that year the sum of 374x dollars, which was the income of its trust department. The position taken is that the taxpayer is an insurance company under section 246 of the Revenue Act of 1921, that that section provides that gross income shall include only "investment income" and "underwriting income," and that, as the income from the trust department is neither investment nor underwriting income, it may remain untaxed.

The taxpayer has assumed and based its argument upon the proposition that it is an insurance company within the meaning of section 246 of the Revenue Act of 1921. In that it appears to be in error.

The portions of the charter of the taxpayer quoted above clearly indicate that it engages in a line of business separate and distinct from that pursued by insurance companies. It has, since 1913, allocated one-third of its large capital and surplus to the trust department enterprise. Its income has in a very substantial amount been derived from that enterprise. The statute which permits the taxpayer to follow two vocations commands a segregation of capital and provides that each department shall be considered and treated as if each such department were a separate business. The only possible conclusion is that the taxpayer is not simply an insurance company but that it is a corporation engaged in two distinct commercial activities.

In section 246 of the Revenue Act of 1921 Congress defined the gross income of insurance companies (other than life or mutual insurance companies) to mean investment income (the gross amount of income earned from interest, dividends, and rents) and underwriting income (the premiums earned on insurance contracts less losses and expenses). It has apparently recognized that the gross income from such *insurance companies* could only arise from these two sources, as, indeed, the National Convention of Insurance Commissioners has indicated. A corporation which receives a substantial portion of its income from sources other than the two sources contemplated in section 246 is engaged in "a distinctive line of business" other than insurance, and can not be regarded as an insurance company within the meaning of that section, but simply as a corporation pursuing commercial enterprises for profit.

Classification as an insurance company under section 246 of the Revenue Act of 1921 carries with it exemption from the capital stock tax imposed by section 1000 of that Act. Section 230 of that Act imposes a tax upon "the net income of every corporation," and section 1000 levies an excise tax upon "every domestic corporation" except that such taxes shall not apply "to any insurance company." It is a well-settled rule of construction that where a taxpayer seeks to invoke the benefit of an exception or proviso the application of which would relieve it from taxation, it must bring itself within the letter of the exception or proviso, and, further, that any doubts as to the right of a taxpayer to be placed in the favored class must be resolved in favor of the Government.

In *Swan & Finch* v. *United States* (190 U. S., 143) the court said:

> Where a burden is placed upon a citizen, if there be a doubt as to the extent of the burden, it is resolved in favor of the citizen, but where a privilege is granted, any doubt is resolved in favor of the Government.

In *Bank of Commerce* v. *Tennessee* (161 U. S., 134) the court stated:

> These cases show the principle upon which is founded the rule that *a claim for exemption from taxation must be clearly made out.* Taxes being the sole means by which sovereignties can maintain their existence, any claim on the part of anyone to be exempt from the full payment of his share of taxes on any portion of his property must on that account be clearly defined and founded upon plain language. There must be no doubt or ambiguity in the language used upon which the claim to the exemption is founded. It has been said that *a well-founded doubt is fatal to the claim;* no implication will be indulged in for the purpose of construing the language used as giving the claim for exemption, where such claim is not founded upon the plain and clearly expressed intention of the taxing power. [Italics supplied.]

To the same effect are *United States* v. *Dickson* (15 Peters (U. S.), 141); *Cornell* v. *Coyne* (192 U. S., 418); and *Hannibal, etc., Ry. Co.* v. *Packet Co.* (125 U. S., 260).

This office is therefore of the opinion that the taxpayer is not an insurance company within the meaning of section 246 of the Revenue Act of 1921, but is taxable under section 230 with respect to income derived from all sources. The claim for refund should be rejected.

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

ARTICLE 692: Gross income of insurance companies. VI–39–3446 G. C. M. 2332

REVENUE ACT OF 1921.

The additions to the "title insurance surplus fund" maintained by title insurance companies of California, may not be excluded from gross income or allowed as deductions in determining the net income of such insurance companies subject to tax under section 246 of the Revenue Act of 1921.

An opinion is requested relative to the tax liability of the O Company for the years 1922 and 1923. The specific question involved is whether in the case of title insurance companies of California the additions to the "title insurance surplus fund" maintained by such companies, which additions are required to be made by the State insurance department, may be excluded in computing gross income under section 246, or deducted in determining net income under section 247 of the Revenue Act of 1921.

In a memorandum of this office in the case of the M Company (S. M. 5501, C. B. V–1, 102) it was concluded that a title insurance company was an insurance company within the meaning of section 246 of the Revenue Act of 1924. In the course of the opinion, however, it was said:

The fact that a particular company makes reports to the State insurance department, or is under the jurisdiction and control of such department, is not conclusive as to its status as an insurance company. In the determination of this question the entire business conducted by the company must be considered and the nature of the contracts it issues must be examined with regard to the purpose or object for which they are made. If the contracts issued are contracts of insurance, it follows that any corporation issuing such contracts and not engaging in any other distinctive line of business is an insurance company within the meaning of section 246 of the Revenue Act of 1924.

Assuming, therefore, that the O Company meets these tests, it would be an insurance company within the meaning of section 246 of the Revenue Act of 1921, the provisions of which are substantially similar to the provisions of section 246 of the Revenue Act of 1924.

By section 246(a) of the Revenue Act of 1921 it is provided:

That, in lieu of the taxes imposed by sections 230 and 1000, there shall be levied, collected, and paid for the calendar year 1922, and for each taxable year thereafter, upon the net income of every insurance company (other than a life or mutual insurance company), a tax as follows:

* * * * * * *

Section 246(b), paragraphs 1 and 2, respectively, defines "gross income" and "net income" of insurance companies subject to tax under that section. The succeeding paragraphs of section 246(b) are devoted to the definition of the various items to be included or

excluded in determining gross income which is defined generally as follows:

The term "gross income" means the combined gross amount, earned during the taxable year, from investment income and from underwriting income as provided in this subdivision, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners.

The contention is advanced that additions to the fund in question are not to be included in computing the "underwriting income" of the O Company, for they are not "premiums earned on insurance contracts during the taxable year" under section 246(b)5. This contention is apparently based on the assumption that the "title insurance surplus fund" is an "unearned premium reserve," and for that reason the amount added to this fund is to be excluded in determining "premiums earned" under section 246(b)5. However, in the opinion of this office the amount required to be added to this fund annually is not "unearned" in a real sense of the term.

Under section 246(b)2 the "net income" of insurance companies taxed under section 246 is defined as follows:

The term "net income" means the gross income as defined in paragraph (1) of this subdivision less the deductions allowed by section 247.

A reference to section 247 will disclose that Congress has incorporated in that section, expressly or by reference, numerous deductions authorized by the various provisions of section 234 of the Revenue Act of 1921, but has failed, either expressly or by reference to section 234(a)10 of that Act, to provide for the deduction of additions to reserve funds.

It is accordingly the opinion of this office that the additions to the "title insurance surplus fund" maintained by title insurance companies of California may not be excluded from gross income or allowed as deductions in determining the net income of such insurance companies subject to tax under section 246 of the Revenue Act of 1921.

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

ARTICLE 693: Deductions allowed insurance companies.

REVENUE ACT OF 1921.

"Losses incurred but not reported" and "resisted losses." (See G. C. M. 2318, page 80.)

PART IV.—ADMINISTRATIVE PROVISIONS.

SECTION 250.—PAYMENT OF TAXES.

ARTICLE 1002: Payment of tax when no proper return.

REVENUE ACTS OF 1916, 1918, AND 1921.

Assessment of additional taxes found to be due more than five years after the filing of false and fraudulent returns. (See G. C. M. 2256, page 90.)

ARTICLE 1008: Collection of tax by suit. VI-29-3324
T. D. 4039

INCOME AND PROFITS TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. ASSESSMENT AND COLLECTION—IRREGULAR ADMINISTRATIVE METHODS—SUIT—TRANSFERRED ASSETS.

Where a corporation dissolves and its assets are taken over and its business is continued by a partnership composed of the former stockholders, additional income and profits taxes, admittedly due from the corporation for the last year of its existence but assessed against and paid under protest by the partnership, can not be recovered in a suit brought by the partners where such irregularity resulted from the conduct of the partners in returning the income of the corporation in the name of the partnership, paying the tax shown on such return to be due and formally acknowledging themselves to be the direct successors to the business and assets of the corporation.

2. CLAIM FOR REFUND—STATUTE OF LIMITATIONS.

The bar of the statute of limitations, not having been presented to the Commissioner of Internal Revenue in the claim for refund, can not be made the basis for recovery of taxes by 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 District Court for the Eastern District of Louisiana, in the case of *Dreyfuss Dry Goods Co.* v. *Lines, Former Collector*, is published for the information of internal revenue officers and others concerned.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

Approved July 12, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF LOUISIANA.

Dreyfuss Dry Goods Co. v. *D. Arthur Lines, Collector of Internal Revenue.*

[April 1, 1927.]

OPINION

Petitioner, Dreyfuss Dry Goods Co., is a commercial partnership of Shreveport, La., composed of Samuel Dreyfuss and Jacob G. Levy. These partners had theretofore been the principal stockholders of Dreyfuss Dry Goods Co., Ltd., a corporation which had been chartered in 1901, and dissolved by the surrender of the charter on February 28, 1919, when the partnership was formed and took over all of the business and assets of the corporation, with which they continued the business as a going concern.

The petition alleges that the defendant collector of internal revenue is indebted to them in the sum of $19,321.84, because of his collection of certain profit and income taxes, made illegally under an assessment for the year 1918; that the said assessment was illegal because the partnership was not in existence during that year, and therefore the assessment in the name of the partnership instead of in the name of the corporation was void.

The collector answers that the copartnership, by taking over all of the assets of the dissolved corporation, thereby constituted same a trust fund and became liable for the taxes assessed against the corporation for the year 1918; that the plaintiff partners had filed a tentative return in the name of the corporation for the year 1918 on March 18, 1919, though it was then dissolved, and thereafter, on May 23, 1919, filed a complete return in the partnership name, covering the income and profit taxes of the dissolved corporation for the year 1918, and paid the amount shown to be due thereby; that thereafter the Commissioner of Internal Revenue found this return to be misleading, incorrect, and false in certain particulars, and thereupon made the additional assessment for the additional taxes due for the year 1918.

By supplemental petition the plaintiff also pleads the limitation of five years under section 250(d) of the Revenue Act of 1921, which provides that assessment should be made and determined within five years after the return was filed and that no suit or proceedings should be begun after the expiration of five years after the date when such return was filed.

From the claim for refund, which was dated May 29, 1925, it appears that this issue was not presented to the Commissioner of Internal Revenue. In substance that document recited that the corporation was originally chartered in 1901; that it filed a corporation income and profit tax return for the year 1918; that on February 28, 1919, it surrendered its charter, all of its assets having been turned over to its stockholders, who, in turn, formed a partnership; that in 1923 the defunct corporation's records for the year 1918 were examined by revenue agents, as a result of which the assessment was made against the partnership and not against the corporation; that a protest was filed and a claim for abatement made which, on appeal, was denied by the Commissioner; that the partnership was thereby compelled to pay the tax to avoid distraint of its assets; that the partnership, which was not in existence during the year 1918, could not be taxed for that year, particularly since the Revenue Act of 1917 did not put a tax upon partnerships as such; that the assessment was made in the name of Dreyfuss Dry Goods Co., instead of Dreyfuss Dry Goods Co., Ltd.

There was no objection or plea submitted to the Commissioner that the statutory limitation had run.

In *Red Wing Malting Co.* v. *Willcuts* (15 Fed (2nd), 626 (8th C. C. A.) [T. D. 3980, C. B. VI-1, 225]), Circuit Judge Kenyon said, inter alia, that the application for refund must state the precise ground upon which the refund is demanded, and "if that is not done, a party can not base a recovery in the courts upon an entirely distinct ground from that presented to the Commissioner." The same doctrine was applied by the Supreme Court in *Rock Island R. R. Co.* v. *U. S.* (254 U. S., 141 [Ct. D. 2; C. B. 4, 342]): "Men must turn square corners when they deal with the Government. If it attaches purely formal conditions to its consent to be sued, those conditions must be complied with * * *."

Accordingly, in view of sections 3221, 3226, 3228, reenacting sections 1011, 1012, and 1014 of the Revised Statutes, which prescribe the formal conditions upon which suits for a refund may be maintained in the courts, it must follow that the issue raised by the supplemental petition can not be considered here.

The main issue turns upon the validity of the assessment. The plaintiff admits that the tax was due; that if the defendant had reduced the same to a judgment by a suit at law against the corporation, then the copartnership would have been answerable to a decree in a suit in equity to enforce the collection, under the trust fund doctrine, out of the assets in the hands of that transferee and amply sufficient to pay the tax, which was admittedly due upon the income and profits of the corporation; that the Internal Revenue Service, being unwilling to pursue the remedy prescribed by law, usurped an authority not sanctioned by law when it made the assessment against the partnership instead of against the corporation; that prior to the Revenue Act of 1926, section 280 of which for the first time authorizes the Commissioner to make assessments directly against the transferees, the Commissioner had no authority to enforce the trust fund doctrine except after judgment liquidating the claim, and by a suit in equity, citing *U. S.* v. *Merriam* (263 U. S., 179, 187, 68 L. ed., 240, 244 [T. D. 3535; C. B. II-2, 87]), to the effect that in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication. If the words are doubtful, the doubt must be resolved in favor of the taxpayer. The same rule of construction was applied in *Gould* v. *Gould* (245 U. S., 153). Both of these cases involved

the interpretation or definition of mere words; the word "bequest" in the one and the word "alimony" in the other.

In this case there is called in question the authority or power of the Commissioner of Internal Revenue, as a tax collecting agent of the Government, to proceed otherwise than by the precise method prescribed by the statute, and therefore the same principle undoubtedly applies. The Commissioner, as an administrative officer, must turn square corners in the exercise of his authority no less than the citizen must, in availing himself of the sovereign's consent to be sued. He can not deviate from the method of assessment and collections prescribed by the statutes. It appears from the record, however, that the Commissioner's action was compelled by circumstances wholly within the control of the taxpayer, and by its acts. The assessment was not made by mistake or error, though such error might have resulted from the mere omission of the abbreviation "Ltd.," which is all that distinguishes the name of the partnership from that of its predecessor corporation. The plain fact was that the corporation was no longer in existence after February 28, 1919. Among the documents filed, there was a tentative return and estimate of corporation income and profits taxes, dated March 13, 1919, for the year 1918. It was filed in the name "Dreyfuss Dry Goods Co., Ltd." We should bear in mind that when the charter had been theretofore surrendered, on February 28, 1919, the business was taken over as a going concern by the stockholders, who formed the new partnership. On May 23, 1919, the "Corporation income and profit tax return" for that year was filed in the name "Dreyfuss Dry Goods Co.," omitting the affixed abbreviation "Ltd." which was the distinguishing mark of the corporate name. On March 8, 1920, a "Corporation income and profit tax return" for the period January 1, 1919, to February 28, 1919 (the date of dissolution), was filed likewise in the name "Dreyfuss Dry Goods Co.," omitting the abbreviation "Ltd." from the name. The contemporary correspondence which followed shows that all letters were addressed by the Commissioner to "Dreyfuss Dry Goods Co.," and those sent the Commissioner were so signed.

On May 8, 1924, Samuel Dreyfuss and J. G. Levy filed a power of attorney naming one J. B. McGuire, of "Winston & McGuire, Inc., Federal Tax Advisors," as their attorney in fact to appear before the Internal Revenue Bureau, Washington, D. C., in their behalf as the principal stockholders of the defunct corporation "since liquidating" and as the copartners in "Dreyfuss Dry Goods Co." on income tax matters for the years 1918 and 1919. From this it appears clearly that both the plaintiff and the Commissioner were treating the subject matter throughout as a transaction between the Government and the partnership as successor to the corporation.

It was not until May 28, 1925, when the "claim for refund" was filed, that the partnership questioned the validity of the assessment on the ground that the tax bill was rendered against "Dreyfuss Dry Goods Co." (the partnership), and not against "Dreyfuss Dry Goods Co., Ltd." Throughout their correspondence the two copartners freely admitted to the Commissioner that the business being conducted by them "is the same business they took over from the Dreyfuss Dry Goods Co., Ltd., a corporation * * * of which they were the principal stockholders when it was dissolved." They had paid the 1918 tax shown to be due by the defunct corporation under their voluntary final return, in the name of the partnership, for the [year] 1918, and admitted thereby their liability for the payment of the tax then appearing to be due. Their obligation to pay the tax was complete.

Among the documents in the record there is the balance sheet of December 31, 1918, showing the corporation's net worth at the close of 1918 as being $199,748.74. The final *corporation* income and profits tax return filed by the Dreyfuss Dry Goods Co. (partnership) on March 17, 1920, for the period January 1 to February 28, 1919, the time of dissolution, included that balance sheet as of December 31, 1918, and a letter explaining that no closing balance sheet could be furnished as of February 29, 1919, because: "Our books were not closed on February 28, 1919, when the corporate charter was surrendered * * * we do not have on file a trial balance as of that date * * *. Our return for the period ended that date is based on average profits for the taxable period, applied to sales for the period under question, against which profit we applied the actual expenses as reflected by the books." In Schedule B of the same return it appeared that the partnership's invested capital corresponded exactly with the net worth of the assets transferred from the corporation at its dissolution, and voluntarily received by these partners as transferees.

Under the trust fund doctrine, both the individual partners and the partnership became liable, as a matter of law, for the payment of taxes due by the defunct corporation to the extent of the assets transferred to themselves. When this dissolution and transfer took place they received and took over approximately $160,000 without paying the approximate $19,000 due the Government, which they were bound in law, equity, and good conscience to pay.

The payment, however, was made under protest, upon the collector's demand, after a claim for abatement and appeal to the Commissioner had been denied. This, they say, was done in order to prevent the closing of the business under a warrant of distraint. It is curious that the record does not contain evidence of a seizure by distraint, and important to remember that if such distraint did issue, and the partnership did then believe that the assessment had been made against them illegally for the tax due by another or distinct entity, a "third person," such seizure and levy by distraint could readily have been interrupted by the judicial remedy of injunction.

Plaintiffs chose the more devious course leading to this suit upon the theory that the Commissioner of Internal Revenue was bound to reduce his claim to judgment, which, under the circumstances here presented, is tantamount to saying he was bound to assess and sue the defunct corporation, which suit was rendered impossible by their own acts. Why should the Commissioner have been required to make an assessment and file a suit against a corporation which he knew to be nonexistent, whose officers were functis juris, and who were advising him of their new status and acknowledging their liability in a series of documents and letters during the two or more years following the dissolution and preceding the assessment, in course of which the plaintiffs had themselves abandoned the use of the corporate name, and substituted the firm name and style of their copartnership? They formally acknowledged themselves to be direct successors and transferees of the defunct corporation, in possession of all its assets, which they continued in operation as a going concern. By so doing they acknowledged these assets to be a trust fund quoad the creditors of the corporation, for which the partnership and themselves, individually and directly, were liable. (*R. R. Co.* v. *Howard*, 7 Wall., 393, 409, 410; *U. S.* v. *Capps Mfg. Co.*, 9 Fed. (2nd), 79, affirmed 15 Fed. (2nd), 528.)

Upon a full consideration of the whole record, I am persuaded that the Commissioner's failure to assess and attempt collection of the tax in the manner contended for by the plaintiff was fully justified. The original taxpayer was no longer in existence. He could not have sued the defunct corporation had he so desired. (*Swan Land & Cattle Co.* v. *Frank*, 148 U. S., 603.) If he had actually issued a distraint, the plaintiff had available its judicial remedy by injunction proceedings in which the legality of the assessment could have been tested. An original suit in equity against the plaintiff, in the absence of a prior judgment at law, would have been a vain gesture. A court of equity is bound to consider the conduct of parties seeking equitable relief, even though estoppel be not specially pleaded. The Commissioner's proceeding can not be designated as such an irregularity as would affect the legality of the collection. It was irregular only to the extent made necessary by the conduct of the plaintiff, and not such as would strike the collection of the tax with nullity, because the tax was admitted to be due out of the trust funds actually in their hands. (Decision 2062, on the appeals of H. F. Kerr and A. E. Clegg, Docket Nos. 1973, 1975, of the U. S. Board of Tax Appeals, 5 U. S. B. T. A., 1073.)

Accordingly, a decree may be entered dismissing plaintiff's suit at its cost.

ARTICLE 1008: Collection of tax by suit. VI-33-3370
T. D. 4054

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. BANKRUPTCY—LIMITATIONS—CLAIM FOR TAXES.

The filing of a proof of claim for taxes in a bankruptcy proceeding is a "proceeding" within the meaning of section 250(d) of the Revenue Act of 1921, but payment of the claim is not barred because of its being filed more than five years after the taxpayer's return is filed, inasmuch as it is the duty of the trustee, under section 64(a) of the Bankruptcy Act, to pay all taxes legally due when they are called to his attention, and it is not necessary for the Government to file a proof of claim therefor.

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 *Chandler Motors of New England, Inc., Bankrupt*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 4, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MASSACHUSETTS.—BANKRUPTCY NO. 30839.

[December 28, 1926.]

MORTON, J.: This petition for review presents a question of law relating to the Federal income tax.

On 1 April, 1918, the present bankrupt filed its Federal income tax return for the calendar year 1917 under the laws then in force; and in due course a tax—and later an additional tax—were assessed against it. It was adjudicated bankrupt on 3 November, 1922, on a creditor's petition filed on October 19 preceding, the additional tax being still unpaid. Under date of 1 March, 1923, the collector notified the trustee of the existence and amount of this tax, and under date of 22 March, 1923, he again wrote to the trustee about it, saying that proof of claim had that day been forwarded to the United States attorney for filing. No proof of claim was in fact filed until August, 1923.

Under the Revenue Act of 1921 (sec. 250(d)) "No suit or proceeding for the collection of" this tax could be "begun after the expiration of five years after the date when such return was filed." This statute bars any proceeding in court for the collection of the tax after the specified period has run. The proof of claim would be such a proceeding. If it were necessary for the Government to file proof of claim, its right is barred, unless the statute was tolled by the bankruptcy of the taxpayer. It is, however, perfectly well settled that the Government is not obliged to file a proof of claim for taxes. (*U. S. v. Eyges*, 286 Fed., 683; *In re Ashland Emery & Corundum Co.*, 229 Fed., 829, and cases cited; Collier on Bankruptcy, 13th ed., p. 1446, note 41, collecting cases.) It is the duty of the trustee under Bankruptcy Act (sec. 64a) to pay all taxes legally due upon their being called to his attention.

The trustee contends that the running of the statute not merely prevented the Government from taking legal steps to collect the tax, but extinguished its right to the tax—an old question of theoretical law about which, in different forms, there has been much discussion, which I do not propose to extend. The trustee holds the estate in trust for various purposes, one of them being to pay lawful taxes. No proceedings by the Government with respect to this tax were required except such as might be necessary in order to fix the proper amount of it. Under such circumstances the Government's right to the tax was clearly not lost by the failure to file the proof of claim.

The order of the referee is vacated; and an order may be entered directing the payment of the tax with interest.

ARTICLE 1008: Collection of tax by suit. VI–35–3401
T. D. 4070

BANKRUPTCY—FEDERAL TAXES—DECISION OF COURT.

BANKRUPTCY—FEDERAL TAXES—PROOF OF CLAIM—LIMITATION.

Section 57n of the National Bankruptcy Act, providing that claims shall not be proved against a bankrupt estate subsequent to one year after the adjudication, is not a bar to the presentation and payment of a claim by the United States for taxes while the estate is open and there are undistributed assets.

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 *Villere* v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 19, 1927.

S. LOWMAN,
Acting Secretary of the Treasury.

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CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT.

Villere v. *United States.*

[April 8, 1927.]

OPINION.

FOSTER, Circuit Judge: This is an appeal from an order denying a motion to expunge a claim of the United States for certain income and internal revenue taxes, amounting to over $40,000, filed by the Commissioner of Internal Revenue against the bankrupt estate of John P. Rausch Co., Inc.

The undisputed facts are that said company was adjudicated bankrupt May 1, 1922, and the trustee, appellant herein, filed a provisional account on February 6, 1923, of which filing the collector was given notice by mail. No claim on behalf of the United States was filed at that time, and the money then in the hands of the trustee was distributed in accordance with his provisional account. Thereafter additional income and revenue taxes for the years 1918 and 1919 were assessed against the bankrupt, and on August 24, 1923, the claim in suit was filed with the referee. When the claim was filed there were still about $9,500 of assets undistributed. The trustee sought to have the claim expunged on the ground that it had been presented more than a year after the adjudication, and was therefore barred by the provisions of section 57n, Bankruptcy Act of 1898 (Comp. St., sec. 9641). The referee ruled against this contention, and on appeal to the district court the ruling was affirmed.

Unquestionably the rule is that the sovereign is not bound by any of the provisions of an insolvency law, unless especially mentioned therein; and in respect to taxes the United States is entitled to be paid by preference out of the assets of the bankrupt estate. As the United States is not mentioned therein, the provisions of section 57n of the National Bankruptcy Act do not operate as a bar to the presentation and payment of a claim on behalf of the Government while the estate is open and there are undistributed assets. There is nothing in the case before us to take it out of the general rule. (In re J. Menist Co. (C. C. A.), 294 F., 532; *U. S.* v. *Birmingham Trust & Savings Co.* (C. C. A.), 258 F., 562;

Guarantee Title & Trust Co. v. *Title Guaranty & Surety Co.*, 224 U. S., 152, 32 S. Ct., 457, 56 L. Ed., 706.)

The case of In re Anderson (C. C. A.) (279 F., 525), relied on by appellant, does not attempt to hold contrary to the general rule. It merely goes to the extent of holding that, as the bankruptcy court has jurisdiction to determine the amount and validity of the taxes claimed by the United States, the trustee may, by proper notice served on the collector, require him to file his claim within a time fixed, or otherwise be barred, to the end that settlement of the estate may not be unreasonably delayed. It is not applicable to the instant case, as the Government is not seeking to reopen the provisional account, and makes no claim to the assets previously distributed.

Affirmed.

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ARTICLE 1008: Collection of tax by suit. VI–51–3547
T. D. 4108

INTERNAL REVENUE LAWS—REVENUE ACT OF 1921—DECISION OF COURT.

SUIT—LIMITATIONS—BOND.

A suit, begun after the expiration of five years from the date when an income tax return was filed, to recover on a bond given in connection with a claim for abatement of the tax and conditioned for the payment of the tax found to be due, is not barred by section 250(d) of the Revenue Act of 1921, which limits the time within which suits for the collection of income tax may be begun.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the District Court of the United States for the District of Wyoming, in the case of *The United States of America, plaintiff*, v. *Onken Bros. Co., Inc., a Corporation, and Royal Indemnity Co., a Corporation, defendants*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 13, 1927.

A. W. MELLON,
Secretary of the Treasury.

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DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF WYOMING.

The United States of America, plaintiff, v. *Onken Bros. Co., Inc., a Corporation, and Royal Indemnity Co., a Corporation, defendants.*

[October 14, 1927.]

JUDGE'S MEMORANDUM.

KENNEDY, Judge: This is a suit against the defendants to recover upon a bond in which the petition has been challenged by a demurrer now before the court for determination. From the petition, as far as may be necessary for the consideration of the point involved, the facts appear to be as follows: That the defendant, Onken Bros. Co., was engaged in business in Sheridan, Wyo., during the years 1917 and 1918; that in April, 1921, defendant was assessed for additional corporation income and profits taxes for the years first mentioned; that

in May, 1921, a claim for abatement of the additional tax was filed; that in order to protect against the collection of the assessed taxes pending a hearing upon the claim for abatement the bond in controversy was filed with the defendant Royal Indemnity Co. as surety, by which it was provided that in the event the claim for abatement should be rejected the surety would insure the payment of the tax, with penalties and interest, and save the internal revenue collector harmless from liability under his bond by reason of any default in the payment of such assessed taxes; that subsequently and in June, 1923, the claim for abatement was passed upon by the Commissioner, who allowed it for the year 1917, but rejected it for the year 1918; that demand was made for the payment of the finally assessed tax and the defendant Surety Company notified of the default, and likewise a demand was made upon it but payment was refused; and that in consequence of such situation the suit is brought upon the bond to recover the penal sum thereof, it being less than the entire amount of the assessed tax, penalties, and interest.

Under their demurrer, which challenges the petition on the ground that the petition fails to state facts sufficient to constitute a cause of action, the point is raised that the cause of action is barred by the statute of limitations, as fixed by section 250(d), Revenue Act of 1921 (ch. 136, 42 Stats., 227–265), which provides that no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was filed.

Defendants chiefly rely upon the construction of that statute as laid down in the case of *Bowers* v. *New York & Albany Co.* (273 U. S., 346) [T. D. 4009, C. B. VI–1, 268], which holds that the statute applies alike to a suit in court or to a proceeding by distraint after the lapse of the five-year period. Were this a suit on the part of the Government to collect the tax, or were it a proceeding to enforce collection by distraint, that case would undoubtedly be controlling. This is a suit upon a bond given to the plaintiff for the purpose of suspending further action or proceeding for the collection of the tax until the claim for abatement could be passed upon.

In the opinion of this court the bond is a separate and distinct agreement representing voluntary action on the part of the Government and the defendant against whom the tax was sought to be collected, which superseded and took the place of their rights and privileges under the revenue law limitation. Under that law the Government after the first assessment of the tax could have sought collection by the court procedure or by distraint. If it did not do so for a period of five years after the return was filed, the defendant was entitled to assert his rights guaranteed him by the statute of limitations. Through the promise and agreement represented by the bond, the rights of the parties under the revenue law were postponed and incorporated in the bond, which straightforwardly on its face insures the payment of the tax which may be subsequently determined in a consideration of the claim for abatement, and without mention of the time when such determination should be made. Under such a situation the only limitation to apply would be the limitation governing suits upon bonds of this character, which is not the point involved here.

For the reasons stated, the demurrer will be overruled, and the defendants given 30 days within which to plead further, reserving to them their proper exceptions.

ARTICLE 1009: Collection of tax by distraint. VI–27–3297
G. C. M. 760A

REVENUE ACT OF 1921.

The issuance of notice and demand does not constitute the commencement of a proceeding by distraint under the provisions of section 250(d) of the Revenue Act of 1921.

The taxpayer, the M Company, filed its 1917 return on March 27, 1918, showing a tax liability of $3x$ dollars. Its 1918 return was filed April 15, 1919, and disclosed a tax liability of $8x$ dollars.

On November —, 1920, the October income tax assessment list was signed by the Commissioner. On that list there were assessed a deficiency in tax of $48x$ dollars for the year 1917, and a deficiency in

tax of 37x dollars for the year 1918. On November —, 1920, the collector mailed to the taxpayer notice and demand for the payment of the deficiencies in tax. The taxpayer, on November —, 1920, filed a claim for the abatement of these taxes totaling 85x dollars. On March —, 1923, by action of the Bureau, the tax liability for 1917 was reduced by 6x dollars. On April —, 1923, the taxpayer filed a second claim in abatement for 1917 in the amount of 42x dollars (the difference between the deficiency in tax assessed for that year on the October, 1920, assessment list, and the amount abated on March —, 1923).

After full consideration of the evidence on record, including that furnished by the taxpayer in support of its claims for abatement, the Bureau in May, 1926, further reduced the tax liability for the year 1917 by x dollars and that for 1918 by 9x dollars. These actions resulted in a tax liability for 1917 of 41x dollars and for 1918 of 28x dollars, which remains unsatisfied.

The taxpayer was advised by letter of April —, 1926, of the final adjustments made, which letter was accompanied by a statement and schedule showing in detail the bases of the adjustments. The letter, however, while fully informative, did not contain the usual paragraph advising the taxpayer of its right of appeal to the United States Board of Tax Appeals and of the procedure incident to acquiescence in the Bureau's determination of tax liability for the years involved.

No appeal was taken by the taxpayer, and in due course the collector, on June —, 1926, mailed to the taxpayer a Form 17 (Notice and demand for the payment of tax), the amounts therein being those resulting from the adjustments made necessary in the course of audit. On July —, 1926, a second notice and demand was mailed by the collector, but, as no payment was made, the collector, on July —, 1926, issued and served a distraint warrant on the taxpayer and on the bank where it maintained an account.

The taxpayer, under date of August —, 1926, complained that it had never received a 60-day letter informing the taxpayer "that the Commissioner had determined to reject the abatement claims in a stated amount, and further advising the taxpayer of its right to file an appeal to the United States Board of Tax Appeals in accordance with the provisions of section 283(e) of the Revenue Act of 1926," and requested that the collector be directed to withdraw his notice and demand, and that a 60-day letter be issued permitting the taxpayer to file an appeal.

After due consideration, a 60-day letter was mailed to the taxpayer on October —, 1926. The collector was advised of this fact, and also that the mailing of the final notice of deficiency suspended the running of the statute of limitations for collection during such period as proceedings for the enforced collection were prohibited. Later, on November —, 1926, the collector was advised that if he had reason to believe that the collection of the tax would be jeopardized he should require the taxpayer to file a bond to protect the Government. On December —, 1926, the collector was advised that the taxpayer had not filed an appeal within the 60-day period. The collector, following the receipt of the letter of December —, 1926, mailed another notice and demand and issued a new distraint warrant.

The taxpayer now contends that in view of the decision of the Supreme Court in *Bowers* v. *New York & Albany Lighterage Co., etc.* (47 Sup. Ct., 389) [T. D. 4009, C. B. VI–1, 268], handed down February 21, 1927, collection of the outstanding taxes can not lawfully be enforced for the reason that more than five years have elapsed since the respective dates of filing of the 1917 and 1918 returns. The five-year period from the filing of the 1917 return expired on March 27, 1923; and from the filing of the 1918 return, April 15, 1924.

The warrant, or warrants, of distraint were not issued until long after the expiration of both five-year periods.

There were three cases decided in the above-mentioned decision of the Supreme Court, the first of which, the New York & Albany Lighterage Co. case, more nearly resembles in its facts the case of the M Company. In the Lighterage company case the taxpayer filed its return for the year 1917 on March 26, 1918, and its disclosed tax liability was paid. Shortly before the end of the five-year period of limitation prescribed by section 250(d) of the Revenue Act of 1921 for the assessment, subsequent to the passage of such Act, of taxes under prior income, excess profits, or war profits tax Acts, a deficiency in tax for 1917 was assessed, and on March 18, 1923, which was also within the five-year period, the collector gave notice to the taxpayer of the assessment of the deficiency in tax and made demand for the payment thereof. In October and November, 1923, several months after the five-year period had expired, the collector filed notices of lien and collected the unpaid taxes through warrants of distraint. The taxpayer thereupon brought suit to recover and judgment in its favor was rendered by the United States District Court for the Southern District of New York. (*New York & Albany Lighterage Co.* v. *Bowers*, 4 Fed. (2), 604.)

The judgment of the district court was affirmed by the circuit court of appeals (10 Fed. (2), 1017), and finally the determinations of the lower courts were affirmed by the Supreme Court on February 21, 1927. (47 Sup. Ct., 389.)

Section 250(d) of the Revenue Act of 1921, provided, in respect to assessments of taxes imposed by prior Revenue Acts, made after its passage, that such assessments should be made within five years after the return was filed, unless both the Commissioner and the taxpayer consented in writing to "a later determination, assessment, and collection of the tax." With respect to the collection of a tax it was also provided that "no suit or proceeding" for the collection of any tax—that is, a tax assessed under the terms of section 250(d)—"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 question before the Supreme Court was, where income and profits taxes imposed by the tax laws enacted prior to the Revenue Act of 1921 were assessed within five years after filing return, does section 250(d) of that Act bar collection by distraint proceedings after the expiration of the five-year period?

In the Lighterage company case, as in the other two cases considered with it by the Supreme Court, the collector had begun dis-

traint proceedings after the expiration of the five-year period because of the construction placed on the words "no suit or proceeding" in the cited section of the Revenue Act of 1921. These words were considered by the Bureau as applying to proceedings in court only and not as relating to proceedings by distraint. The Supreme Court, however, negatived this construction and held:

> 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 is 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, secs. 3194, 3199, 3200, 3203; sidenotes to secs. 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.

In the case of the M Company, assessments of deficiencies for the years 1917 and 1918, made on November —, 1920, were well within the period of limitation prescribed by law, and notice and demand for each of the years involved was likewise within such period. In section 250(d) of the Revenue Act of 1918 it is provided that no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. Distraint proceedings, however, were not resorted to until long after this period had expired.

As to the year 1918, there can be no question as to the application of section 250(d) of the Revenue Act of 1918 to the assessment of the deficiency in tax for that year. Under the provisions of section 1400(b) of the Revenue Act of 1918, the Revenue Acts of 1916 and 1917 remained in force for the assessment and collection of taxes which had accrued thereunder. Under the provisions of section 14(a) of the Revenue Act of 1916, as amended by the Revenue Act of 1917, there was no limitation as to the assessment or collection of a deficiency in tax, provided discovery was made of an erroneous, false, or fraudulent return within three years after the return was due. However, as the five-year period, both as to assessment and collection, is made by section 250(d) of the Revenue Act of 1921 to apply to any return (excepting false or fraudulent returns with intent to evade the tax), it is patent that the earlier laws were superseded to this extent, even though their provisions were kept alive by section 1400(b) of the Revenue Act of 1918 for the assessment and collection of taxes imposed by such prior statutes.

Due to the mandatory provisions of section 1130 of the Revenue Act of 1926 that distraint shall be deemed to have been begun (a) in the case of personal property, on the date on which the levy upon such property is made; or (b) in the case of real property, on the date on which notice of the time and place of sale is given to the

person whose estate it is proposed to sell, it is impossible to consider a notice and demand served within the five-year period in an income tax case as a step in distraint proceedings to enforce the collection of the tax, even though the service of the notice and demand is an essential preliminary toward the collection of an assessed tax. Without notice and demand and the taxpayer's neglect or refusal to pay the tax, distraint would not lie; but clearly, in view of section 1130 of the Revenue Act of 1926, the notice and demand required in such cases by section 3184, Revised Statutes, is not a step "taken for the collection of taxes by distraint," to use the language of the Supreme Court in the Lighterage company case.

In that case the court says, as to the enforced collection of taxes:

> There are two methods to compel payment. One is suit, a judicial proceeding; the other is distraint, an executive proceeding.

While, therefore, there may be other proceedings incident to the assessment and collection of internal revenue taxes—as, for example, the assessment *per se*, the issuance of notices and demands, and the filing of notices of lien—proceedings for the enforced collection of an assessed tax are limited to a suit in court and to distraint. The beginning of either of these methods of collection, under existing law, must take place before the expiration of the statutory period of limitation.

It may be added that the five-year period of limitation for assessment and collection of deficiencies in tax for 1917 and 1918 expired prior to the passage of the Revenue Act of 1924; and as (if the cited decision of the Supreme Court is correctly interpreted) no proceedings were begun before the expiration of the five-year period, collection actually was barred before such Revenue Act was approved. (See section 278(e)1, Revenue Act of 1924.)

In the light of the facts of record and of the decision of the Supreme Court in *Bowers* v. *New York & Albany Lighterage Co., etc.*, this office is of the opinion that the collector is without authority of law to levy upon and sell, under warrant of distraint, the property of the M Company to satisfy the outstanding assessments, for the reason that proceedings in distraint were not begun within five years from the respective dates when the returns for the years 1917 and 1918 were filed.

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

ARTICLE 1009: Collection of tax by distraint.

REVENUE ACT OF 1921.

Partial payment of additional assessment, made as a result of warrant of distraint issued after running of statute as to collection, acting as collection waiver as to unpaid balance. (See G. C. M. 2581, page 95.)

TITLE III.—WAR-PROFITS AND EXCESS-PROFITS TAX FOR 1921.

PART II.—IMPOSITION OF TAX.

SECTION 301.—IMPOSITION OF TAX.

ARTICLE 711: Imposition of tax. VI-30-3330
(Also Section 240, Article 634.) G. C. M. 786A

REVENUE ACT OF 1918.

On March 1, 1920, prior to the passage of the Merchant Marine Act on June 5, 1920, the M Company acquired substantially all of the stock of the O Company and an affiliation was determined as of that date.

Held, that the M Company must report separately its income for the period prior to affiliation, January 1, 1920, to February 29, 1920, and it is not entitled to the benefits of section 23 of the aforesaid Act during that period.

On March 1, 1920, the M Company (the taxpayer) acquired substantially all of the stock of the O Company, and for purposes of taxation an affiliation of the two corporations was determined as of that date. The M Company kept its accounts and closed its books on a calendar-year basis for the year 1920. The taxpayer's liability for the period prior to March 1, 1920, the date of affiliation, was determined separately from its liability for the period subsequent to affiliation.

It has been determined that the total income from foreign trade for the calendar year 1920 amounted to $11x$ dollars, of which amount $2x$ dollars has been allocated to the two months' period January 1 to February 29, 1920, both dates inclusive, which was prior to the affiliation of the taxpayer with the O Company, and the balance of the amount is deemed to have been earned during the period of affiliation—that is, from March 1, 1920, to December 31, 1920, inclusive.

Section 23 of the Merchant Marine Act of 1920, approved June 5, 1920, provides in part as follows:

That the owner of a vessel documented under the laws of the United States and operated in foreign trade shall, for each of the 10 taxable years while so operated, beginning with the first taxable year ending after the enactment of this Act, be allowed as a deduction for the purpose of ascertaining his net income subject to the war-profits and excess-profits taxes imposed by Title III of the Revenue Act of 1918 an amount equivalent to the net earnings of such vessel during such taxable year, determined in accordance with rules and regulations to be made by the board: *Provided*, That such owner shall not be entitled to such deduction unless during such taxable year he invested, or set aside under rules and regulations to be made by the board in a trust fund for investment, in the building in shipyards in the United States of new vessels of a type and kind approved by the board, an amount, to be determined by the Secretary of the Treasury and certified by him to the board, equivalent to the war-profits and excess-profits taxes that would have been payable by such owner on account of the net earnings of such vessels but for the deduction allowed under the provisions of this section: *Provided further*, That at least two-thirds of the cost of any vessel constructed under this paragraph shall be paid for out of the ordinary funds or capital of the person having such vessel constructed. * * *

An opinion is requested as to whether or not, under the provisions of section 23 of the Merchant Marine Act, supra, the net earnings of the M Company derived from operations in foreign trade for that portion of its accounting period prior to the date of affiliation, i. e., January 1 to February 29, 1920, inclusive, can be excluded from income subject to excess-profits tax.

It is contended by the taxpayer that the net earnings for the entire calendar year 1920 should be deducted under the provisions of the Merchant Marine Act, supra.

In the appeal of American La Dentelle, Incorporated, and Manorial Development Corporation (1 B. T. A., 575), where an affiliation was effected on July 1, 1919, the Board held that a new tax status was created at that time, and that the consolidated invested capital and income must be computed from that date for the period ended at the close of the calendar year. In that case also the constituent corporations of the consolidation were required to file separate returns for that portion of their respective accounting periods prior to affiliation. The tax status of each company prior to July 1, 1919, was separate and distinct from their affiliated tax status subsequent to that date. The affiliation in that case resulted from the fact that all of the stock of both corporations was acquired by the same interests.

In the appeal of Bay State Securities Co. (3 B. T. A., 43), an affiliation was held to have taken place on December 4, 1919, the date when the taxpayer corporation acquired all of the stock of the American Insulator Co. The tax in that case was computed on the same basis set forth in the appeal of American La Dentelle, Incorporated, supra.

The principle of these cases has been incorporated in Regulations 45, applicable to the year 1920. Article 634 of Regulations 45, as amended by Treasury Decision 4022 [C. B. VI–1, 258], provides in part as follows:

* * * 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, * * * 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.

It is apparent that the appeal of American La Dentelle, Incorporated, supra, and appeal of Bay State Securities Co., supra, when considered together, announce a rule covering both classes of affiliation mentioned in section 240 of the Revenue Act of 1918 and subsequent Acts. The comprehensive language of article 634 of Regulations 45, as amended, coupled with the prior acquiescence by the Commissioner in the two cases cited, clearly indicates that the article 634 contemplates both classes of affiliations.

In General Counsel's Memorandum 786 (C. B. V–2, 195), this office expressed the opinion that the benefit of the deduction under the provisions of the Merchant Marine Act of 1920, supra, is limited to any taxable year ending after June 5, 1920, and not later than December 31, 1920. Under article 634 of Regulations 45, supra, the

taxpayer is required to report separately the income for the period prior to affiliation. The period prior to affiliation in the instant case having ended on February 29, 1920, which date was prior to June 5, 1920, it follows that under General Counsel's Memorandum 786, supra, the relief sought must be denied.

It is, therefore, the opinion of this office that the M Company is not entitled to the benefit of section 23 of the Merchant Marine Act of 1920 for that portion of its accounting period prior to the date of affiliation—i. e., January 1 to February 29, 1920, inclusive.

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

PART V.—INVESTED CAPITAL.

SECTION 326.—INVESTED CAPITAL.

ARTICLE 831: Meaning of invested capital. VI-37-3427
T. D. 4081

EXCESS PROFITS TAX—REVENUE ACTS OF 1917 AND 1918—DECISION OF COURT.

1. INVESTED CAPITAL—WITHDRAWALS—PROMISSORY NOTES.

Where two persons owning equally the capital stock of a corporation withdrew for their personal use, in addition to the sums to which each was entitled as salary, expenses and dividends, a portion of the surplus for which each gave the corporation his non-interest-bearing demand notes, no part of which has ever been paid, such notes can not be included in invested capital under the Revenue Acts of 1917 and 1918.

2. DECISION DISTINGUISHED.

The decision in *English & Mersick Co.* v. *Eaton* (7 Fed. (2d), 54) distinguished.

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, District of Connecticut, in the case of *P. Garvan, Inc.*, v. *Robert O. Eaton, Collector of Internal Revenue*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 30, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

UNITED STATES DISTRICT COURT, DISTRICT OF CONNECTICUT.

P. Garvan, Inc., v. *Robert O. Eaton, Collector of Internal Revenue.*

[June 2, 1927.]

OPINION.

THOMAS, District Judge: This is an action at law to recover income and excess-profits taxes in the amount of $68,634.16 for the fiscal years ending

November 30, 1917, 1918, 1919, and 1920, which are alleged to have been erroneously assessed and collected under the provisions of the Revenue Acts of 1917 and 1918. By stipulation on file, trial before a jury was waived.

The plaintiff is a Connecticut corporation, organized in 1905, and engaged in dealing in paper stock and as jobbers of paper.

During the years in question the authorized and issued capital stock of the corporation consisted of 1,500 shares of the total value of $150,000, of which all except 4 shares were equally divided between the two brothers, John S. and Thomas F. Garvan. Each of them received a substantial salary. During the years 1916 and 1917 their salaries were $20,000 each. In 1918 each received $30,000, and in 1919 and 1920, $50,000. In addition to their salaries each was allowed $10,000 a year for expenses. At the end of each year a 7 per cent dividend was declared.

In addition to their salaries, expenses, and dividends on their stock, each one withdrew various amounts from the corporation during the years in question. If the sums to which each of the Garvans was entitled as salary, expenses, and dividends happened to be less than the amount actually withdrawn by them, they would each execute, at the end of the year, a demand note, bearing no interest, which note represented the excess so withdrawn. The dates and amounts of the notes executed by each of the Garvans follow:

1916.	Thomas F. Garvan	None.
	John S. Garvan	$21,467.10
1917.	Thomas F. Garvan	106,531.58
	John S. Garvan	88,379.01
1918.	Thomas F. Garvan	70,424.05
	John S. Garvan	65,130.18
1919.	Thomas F. Garvan	31,049.08
	John S. Garvan	68,577.63
1920.	Thomas F. Garvan	103,376.28
	John S. Garvan	95,214.28

In the returns filed by the corporation for the above-enumerated years the notes were included as invested capital. At the close of the fiscal year of 1920 the notes aggregated the sum of $650,149.19. The Commissioner of Internal Revenue disallowed these notes as invested capital. No payments have ever been made on any of the notes by either one of the brothers. A tax having thereupon been assessed, and paid under protest, this suit is brought to recover the amount so paid.

The plaintiff invokes the provisions of the Revenue Acts of 1917 and 1918, which provide for a deduction from the income and excess-profits tax of a percentage of the invested capital. The germane text is as follows:

Section 207 of the Revenue Act of 1917 provides—

"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: * * *."

Section 325(a) of the Revenue Act of 1918 provides:

"The term 'tangible property' means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property; * * *."

Section 326(a) of the Revenue Act of 1918 reads as follows:

"(a) That as used in this title the term 'invested capital' for any year means (except as provided in subdivisions (b) and (c) of this section):

"(1) Actual cash bona fide paid in for stock or shares;

"(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus. * * *

"(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;"

The moneys which were so withdrawn by the Garvans and which were represented by the demand notes above enumerated were not moneys which were used by them in the prosecution of the corporate business. They were moneys which went into the pockets of the Garvans for their own personal use; uses which had no connection of any kind with the corporate affairs.

In spite of this, however, the secretary of the corporation testified that—

"Subsequent to 1916 was the war period, and the fluctuation in the market values of material in which P. Garvan dealt was so great that in order to conserve all the assets of the corporation it was deemed inadvisable to pay any dividends and to build up a surplus, due to the fact that the prices and commodities were changing so rapidly they didn't know just how much capital they would need to carry on the business.

"Q. And for that reason they didn't undertake to distribute all their assets as they had done in prior years?

"A. That was the reason."

I find that this testimony is disingenuous. The plain fact is that reserves of surplus are not built up by the process of extracting the funds from the corporation. To physically pay out corporate funds and to substitute therefor non-interest-bearing promissory notes, upon which, for a period of years, not a single payment has been made, is indeed a curious method of building up a reserve.

It will serve no useful purpose to discuss the question as to whether the amounts withdrawn by the Garvan brothers ever constituted cash paid in, or paid-in surplus. The gist of the problem consists in the determination of the status of these amounts after they were corporeally segregated from the rest of the corporate property. The contention of the plaintiff is that these notes are corporate assets and that because they are corporate assets they constitute "invested" capital within the meaning of the Revenue Acts. With this suggestion I find myself unable to agree.

The practicalities of the situation at bar indicate the existence of a copartnership in the guise of a corporation—a copartnership composed of two individuals having equal interests. That these gentlemen could in fact withdraw the corporate funds and still continue the status of these funds as invested capital seems to me to be clearly inconsistent.

The notes which were substituted for the funds which were withdrawn I find to be pro forma obligations only. The fact that 10 years have elapsed in the first instance and 6 years in the last instance, and that not a dollar has been paid to the corporation on account of the notes, when viewed in connection with the personnel and organization of the corporation, is quite conclusively indicative of their real nature. It serves not to say that they have been carried as assets on the corporate books of account, and that corporate credit statements have been rendered in which they are so declared. If corporate creditors have been led to believe that these notes are active assets, it does not follow that a court must trail along with them.

The spirit of the Revenue Act is replete with the idea that invested capital is capital employed in the corporate business. It is true that a promissory note may be regarded as invested capital, but it will be found that wherever it has been so regarded it constituted a current exigent obligation, and represented an actual undertaking to pay for corporate stock, or that it was discountable paper given in regular course in payment of corporate property. The notes in question belong to neither class. I find them to be nothing but a transparent device for distributing surplus funds without appearing to do so.

English & Mersick Co. v. *Eaton* (7 Fed. (2d), 54) is cited by the plaintiff in support of its case. A careful reading of that case will serve to enforce the lesson that the terminology of accounting practice will not be permitted to obfuscate the interpretation of the revenue statutes. That case presented

a situation practically the reverse of the one at bar. There, instead of pro forma obligations, there were pro forma divisions of surplus. The divisions never had an actual existence. They could not have had an actual existence without destruction of the corporate business. In that case, the surplus was represented by plant, fixtures, and stock in trade—all of which continued to be used in the corporate business, in spite of a verbal distribution thereof to stockholders. There having been no real distribution, there having been no real separation of this surplus from the corporate property, that surplus continued to remain invested capital.

In the case at bar, I find a real distribution of the surplus, without the formality of a declaration of dividends. Judgment may therefore be entered for the defendant, with costs to abide the event. Counsel may submit findings in accordance with this opinion.

ARTICLE 833: Tangible property paid in: evidences of indebtedness. VI-33-3371 T. D. 4052

INCOME TAX.

Article 833 of Regulations 45 and article 833 of Regulations 62 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 833 of Regulations 45 (1920 edition) and article 833 of Regulations 62 (1922 edition) are hereby amended to read as follows:

ART. 833. *Tangible property paid in: evidences of indebtedness.*—Enforcible notes or other evidences of indebtedness, either interest bearing or noninterest bearing, of the subscriber bona fide paid in to a corporation upon a subscription for stock may be considered as tangible property in computing its invested capital to the extent of the actual cash value of such notes or other evidences of indebtedness at the time when paid in.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 2, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

ARTICLE 833: Tangible property paid in: evidences of indebtedness. VI-33-3372 T. D. 4057

EXCESS PROFITS TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. INVESTED CAPITAL—TANGIBLE PROPERTY PAID IN—PROMISSORY NOTES.

Promissory notes bona fide paid in for stock of a New York corporation constitute tangible property under section 325 of the Revenue Act of 1918 and as such are property actually received for stock under section 69 of the New York stock corporation law and may be included in invested capital under section 326(a) of said Revenue Act to the extent of the actual cash value thereof at the time paid in.

2. INVESTED CAPITAL—DEDUCTION FOR ACCRUED TAXES.

Where accounts are kept on the accrual basis, the amounts of income and excess profits taxes for the year 1917 payable in 1918 may be included in the computation of invested capital only until the taxes become due.

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 *Frank K. Bowers, Collector*, v. *Max Kaufmann & Co., Inc.*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 5, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Frank K. Bowers, as Collector of Internal Revenue, Second District, New York, plaintiff in error (defendant below), v. *Max Kaufmann & Co., Inc., defendant in error (plaintiff below).*

Writ of error to the District Court for the Southern District of New York. Action to recover income and excess-profits tax paid under protest. Judgment for plaintiff; defendant appeals. Modified and affirmed.

MANTON, Circuit Judge: For the taxable year 1918 the defendant in error paid $15,176.15 with interest and additional excess-profits tax under protest. It sued to recover this sum and was successful below. The defendant in error and its affiliated company, Halluk Texstyle Corporation, both New York corporations, filed a consolidated return for that year. The basis of the suit for the return of the tax paid is the erroneous deduction by the Internal Revenue Commissioner of sums of money from its invested capital. Such reduction from invested capital caused an increase in the excess-profits tax.

The defendant in error was capitalized for $50,000. It had four stockholders, who controlled all the stock, and they paid $11,190.34 in cash, and for the balance as subscription to the capital stock they gave their promissory notes, bearing interest, payable on demand. In July, 1918, the company issued $350,000 capital stock to the same stockholders and accepted in payment therefor demand notes, bearing interest, for the full amount. The Hallukk Corporation at the same time issued $99,000 of capital stock to the same individuals and accepted in payment therefor demand notes for the full amount. Thereafter, from time to time, demand was made for payment of some of the notes and they were paid. In making the tax return in 1919 for the calendar year 1918, these notes were included in the invested capital for face value. The Commissioner excluded the amount of the unpaid notes. The reason given therefor was that since they were New York corporations, their capital stock could not be issued for notes under the stock corporation law of New York and therefore the notes held and unpaid represented no part of the capital stock or the invested capital of the company.

An adjustment was made of the tax paid by the defendant in error in 1918, when it paid $8,190.42 more on account of its income and excess-profits tax for the year 1917. The Commissioner deducted this sum from invested capital.

The Revenue Act of 1918 (secs. 325–326) provided as follows:

"SEC. 325. (a) That as used in this title—

"The term 'intangible property' means patents, copyrights, secret processes and formulas, good will, trade-marks, trade-brands, franchises, and other like property;

"The term 'tangible property' means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property;

"The term 'borrowed capital' means money or other property borrowed, whether represented by bonds, notes, open accounts, or otherwise * * *.

"SEC. 326. (a) That as used in this title the term 'invested capital' for any year means (except as provided in subdivisions (b) and (c) of this section):

"(1) Actual cash bona fide paid in for stock or shares;

"(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus; * * *

"(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year; * * *

"(b) As used in this title the term 'invested capital' does not include borrowed capital. * * *

"(d) The invested capital for any period shall be the average invested capital for such period, * * *."

Regulations 45, article 833, promulgated by the Commissioner, referring to tangible property paid in, says:

"*Tangible property paid in: evidences of indebtedness.*—Enforcible notes or other evidences of indebtedness, either interest bearing or noninterest bearing, of the subscriber received by a corporation upon a subscription for stock may be considered as tangible property in computing its invested capital to the extent of the actual cash value of such notes or other evidences of indebtedness at the time when paid in, but only (a) if such notes or evidences of indebtedness could under the laws of the jurisdiction in which the corporation was organized legally be received in payment for stock, and (b) if they were actually received by the corporation as absolute, and not as conditional, payment in whole or in part of the stock subscription."

The New York stock corporation law, section 69, provides that no corporation shall issue either shares of stock or bonds except for money, labor done, or property actually received for the use and lawful purposes of such corporation. By its terms, stock may be issued for property actually received, and under section 325 of the Revenue Act of 1918 promissory notes are included as tangible property. The question is therefore presented whether the promissory notes issued as described and in the manner described are enforcible obligations under the New York law so as to constitute tangible property under section 325. Section 67 of the New York stock corporation law, referring to subscriptions to stock, requires every subscriber of stock to pay in 10 per cent of the amount subscribed by him and no subscription can be received without such payment. A subscription to stock has been held unenforcible in the State courts of New York where such 10 per cent in cash has not been paid. (*New York Co.* v. *Van Horn*, 57 N. Y., 473; *Mills* v. *McNamee*, 111 Misc., 252, affd. 233 N. Y., 517.) The Court of Appeals said, in *Buffalo & Jamestown Ry.* v. *Gifford* (87 N. Y., 294), that the precise purpose of this section is not apparent but that in its absence the directors might be authorized to open books of subscription for the purpose of filling up the capital stock but that it does not prohibit or forbid any other mode of subscription and it was not perceived that any public policy would be subserved by holding that any subscription valid at common law is invalid in this section of the statute, and said, "We are inclined to the opinion that it was not intended by this section to prescribe a fixed statutory mode of making a subscription and that any contract of subscription good or valid at common law is still valid notwithstanding this section." The same court later held that a trustee in bankruptcy could recover from subscribers to the stock the amount of their subscription notwithstanding the fact that 10 per cent of such amount was not paid at the time the subscription was required to be paid. (*Jeffrey* v. *Selwyn*, 220 N. Y., 77.) In that case it was pointed out that even if a subscription was invalid for want of such payment, it may become enforcible not only by subsequent cash payment but by a course of dealing between the corporation and its stockholders. Within that determination the allegations of the complaint at bar show dealings between the stockholders and these corporations upon the basis that some stock had actually been paid for and further that all of the demand promissory notes herein referred to were paid by the makers immediately upon payment being demanded. In *Furlong* v. *Johnson* (239 N. Y., 147) the same court said that the spirit, if not the letter, of the statute was satisfied when a subscriber gave to the corporation a negotiable instrument for 10 per cent or more of the amount subscribed for and the corporation obtained cash therefor by negotiation of the instrument. It is established here that the existence of the notes was made known to a bank and that it extended credit

to the defendant in error and its allied corporation on the strength of its statement that it possessed the notes, thus establishing a line of credit. Therefore, the notes given for the stock and used by the defendant in error as invested capital produced actual cash (for which credit was given by the plaintiff in error). Such credit was granted on the faith of the acceptance of the notes. We think, within the sections of the Revenue Act referred to defining what shall constitute invested capital for the purpose of computing the amount of excess profits tax to be paid by these corporations, notes issued in good faith and paid for by the corporation with its stock, is property within the statute. The language of section 326, in ordinary and usual meaning, in referring to bona fide payments means actual, sincerely, and in good faith paid. It is not necessary to hold that it means moneys legally paid in. If so, Congress would have used the phrase "legally paid in." (*Ware* v. *Hylton*, 3 U. S., 199.) It is necessarily implied that the notes had an actual value equal to their face value. There is a presumption that they are worth at least that much in the absence of testimony to the contrary.

They are presumed to be valid and enforcible. Where a note is given in good faith for stock subscribed, it is not enough to point to a possible defense which might be interposed as between the parties in the event of a suit on the note between a corporation and the maker of the note. To eliminate it as invested capital it must be shown that the sale was void and not enforcible or that the purchase of the stock and giving the note in payment was in bad faith and for the purpose of avoiding the provisions of the tax law. The defendant in error has established that in arriving at its invested capital, and that of its affiliated corporation, for the purpose of taxation, it had the right to consider the face value of these interest-bearing demand notes, made by solvent makers in good faith, as part of its invested capital.

The sum paid in 1918 for income and excess-profits tax of 1917 was included in the invested capital by the defendant in error and its affiliated company. Under the statute these taxes were not payable until 1918 and were paid during that year. In computing invested capital for 1918, the Commissioner adjusted these taxes as paid, deducting the amount of the 1917 taxes paid in 1918 from the invested capital of that year as and of the date when they were actually paid in.

Regulations 45, article 845, promulgated by the Commissioner, reads:

"For the purpose of computing invested capital Federal income and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which they are levied. It is immaterial, therefore, whether reserves for the payment of such taxes for the preceding year have been set up or not, or if set up whether such taxes when paid have actually been charged against such reserves. Amounts payable on account of such taxes for the preceding year may be included in the computation of invested capital only until such taxes become due and payable. A deduction from the invested capital as of the beginning of the taxable year must therefore be made for such taxes or any installment thereof, averaged for the proportionate part of the taxable year after the date when the tax or installment is due and payable."

By its terms, corporations doing business in 1917 became obligated to the Government for income and excess-profits tax. These taxes were paid in 1918. At the end of 1918 it became necessary to compute the tax for that year, and for the purpose of excess-profits tax to compute the invested capital of that year. The Commissioner permitted the taxpayer to include the amount paid as the tax in its invested capital for 1918 until the tax was actually due in 1918. After that date the amount of the tax was deducted from invested capital, prorating the amount over a period in which the tax had become due. This was upon the theory that the taxes were due and determined at the end of the year and if paid then would have come out of the invested capital. But since the taxes were not paid at the end of the year and the taxpayer retained the money for several months thereafter, he could include the amount in his invested capital until the due date. Therefore it was capital so long as he had it in his possession. This construction of the Act has been approved, where the books were kept on an accrual basis. (*Nichols* v. *Sylvester Co.*, 16 F. (2nd), 98.) In that case it was held that the corporation keeping its books on an accrual basis and making its returns accordingly could not include in its invested capital for the fiscal year ending June, 1918, the amount of the Federal income and excess-profits tax for 1917 until the date of the payment

of those taxes in 1918. It was pointed out that the taxes deemed to have been paid in one period could not therefore be treated as unpaid and an asset in a succeeding period, and the court cited as authority *United States* v. *Yale & Towne Mfg. Co.* (269 U. S., 422 [T. D. 3839, C. B. V-1, 179]).

In that case, the Supreme Court considered a munition tax of 1916, paid in 1917. It was contended that the tax should be deducted from its 1917 income upon the ground that it did not become an accrual liability until it was due and payable. The Government contended that the amount of the tax was a proper deduction for the year 1916 and assessed a tax upon 1916 income upon that basis. It was pointed out that while it is true that in advance of the assessment of the tax all the events must occur which fix the amount of the tax and determine the liability of the taxpayer to pay it, it was said that in this respect, for the purpose of accounting and ascertaining true income from a given accounting period, the munition tax in question did not stand on any different footing than other accrued expenses appearing on the books. And it said:

"It should be noted that section 13(d) makes no use of the words 'accrue' or 'accrual,' but merely provides for a return upon the basis upon which the taxpayer's accounts are kept, if it reflects income—which is precisely the return insisted upon by the Government. We do not think that the Treasury decision contemplated a return on any other basis, when it used the terms 'accrued' and 'accrual' and provided for the deduction by the taxpayer of items 'accrued on their books.'"

It does not appear whether the defendant in error's books were kept on a cash or accrual basis. In the absence of proof as to this, we must infer from the reference in the pleadings and action of the Commissioner that they were kept on an accrual basis. Therefore, the Yale & Towne case applies and the deduction of tax at the time they accrued from the invested capital would be proper.

In the view we take of the deduction of the 1917 taxes from invested capital for 1918, it becomes unnecessary to consider the effect of section 1207 of the Revenue Act of 1926 (44 Stat., 129).

Judgment reversed unless the defendant in error stipulates to reduce the judgment to a sum which will make due allowance for the deduction from the invested capital of the 1917 taxes paid in 1918, and with such stipulation and allowance made, the judgment will be affirmed as thus modified, without costs.

ARTICLE 842: Surplus and undivided profits: property paid in and subsequently written off. VI–52–3555 T. D. 4109

EXCESS PROFITS TAX—REVENUE ACT OF 1921—DECISION OF COURT.

INVESTED CAPITAL—EARNED SURPLUS—AMOUNT PAID IN REDEMPTION OF BONDS PAYABLE OUT OF EARNINGS.

Where a corporation acquires the business and assets of another corporation and issues therefor, in addition to its capital stock, certain income bonds which are payable only from future net earnings, it can not include in invested capital any part of the amount paid for the redemption of said bonds.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the District Court of the United States for the Southern District of New York, in the case of *The Baker & Taylor Co., plaintiff*, v. *The United States, defendant*, and *The Baker & Taylor Co., plaintiff*, v. *Frank K. Bowers, Individually and as Collector of Internal Revenue, Second District of New York, de-*

fendant, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 19, 1927.

A. W. MELLON,
Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

The Baker & Taylor Co., plaintiff, v. *United States of America, defendant.*

The Baker & Taylor Co., plaintiff, v. *Frank K. Bowers, Individually and as Collector of Internal Revenue, Second District of New York, defendant.*

[September 9, 1927.]

OPINION.

MACK, Circuit Judge: Plaintiff claims the recovery of income and profits taxes paid under an alleged erroneous assessment for the years 1917 to 1921, inclusive.

The charter of plaintiff's predecessor, the Baker & Taylor Corporation, expired by limitation in February, 1906, and its assets vested by operation of law in its two stockholders in the proportion of 9 to 1. Plaintiff corporation was organized a few days thereafter, and four months later the two stockholders sold all of the assets of the old company to the new one. These assets, exclusive of good will and of the undivided profits of the preceding year, which latter were taken over by the old company as an indebtedness to the two stockholders, aggregated over and above the assumed liabilities exactly the amount of the capital stock, $40,000. The agreement for the transfer provided that the two stockholders sell their undivided nine-tenths and one-tenth respective interest or shares in the business and assets of the old corporation in exchange for 360 and 40 shares, respectively, of the capital stock of the new corporation, par value $100, and 36 and 4, respectively, of income bonds of $10,000 each of the new corporation. These income bonds bore interest at the rate of 6 per cent per annum and were payable "only from the net earnings of the * * * Company, ascertained and declared by its board of directors to be applicable to such payment of principal and interest after appropriating to the capital account of said corporation such portion of said earnings as the said board of directors may deem advisable. In the event that the accumulated net earnings of the said * * * Company are insufficient to pay the principal hereof at maturity or any unpaid interest due thereon, then this obligation shall be paid from said net earnings as, when, and as soon as said net earnings are ascertained and declared by its board of directors." The bonds were redeemable at the company's option at any time before maturity and were payable to the two stockholders respectively by name "or assigns."

The resolution of purchase recited that the undivided shares in the business and assets is reasonably worth the stock, bonds, and the undivided interest in the last year's profits.

The bonds were not carried on the books of the company as a liability and good will was not carried as an asset. From time to time during the succeeding seven years the entire issue of bonds with interest was paid off, and each payment so made was charged against surplus account, created by crediting thereto the profits annually as earned.

For the four years preceding plaintiff's incorporation the net earnings of the predecessor corporation had averaged $42,000, and its net tangible capital $154,000.

Plaintiff's capital stock was increased to $200,000 in April, 1913. The $160,000 increase was paid to the extent of $86,000 by notes previously given by the corporation to the stockholders in partial redemption of the bonds and the balance was paid in cash.

The question presented is whether or not the claimed cost of the good will, $400,000, was properly excluded from claimed invested capital by the Commissioner, whose ruling was sustained by the Board of Tax Appeals.

Undoubtedly the good will of the old corporation had a substantial value in April, 1906, a value of approximately $200,000. Such a value would be arrived at by charging against the earnings interest on the net tangible assets at 8 per cent and treating the balance of the earnings as representing approximately 15 per cent of the value of the good will. (See appeal of Herald Despatch Co., 4 B. T. A., 1096, 1100, 1108 [C. B. VI-1, 3].)

The difficulty in the instant case is not due to the mere failure to make proper entry in the books of account; this is always susceptible of correction in ascertaining the facts themselves on which taxes are to be computed; the trouble here is that these bonds were not definite liabilities of the corporation, and as such representing the purchase price of the good will; they could not properly have been entered as corporate liabilities to offset a good-will asset of the same amount or indeed of any amount. Indeed, the resolution respecting the purchase from the two stockholders does not assert that the business is reasonably worth the face of the stock, bonds, and undivided profits, but that it is reasonably worth "the said stock, bonds, and the said * * * profits" of the past year. That assertion is sound, but it leaves unsolved either the actual value of the bonds or the value placed upon them by the plaintiff or the stockholders who accepted them.

These bonds were payable until maturity only out of so much of the net earnings as the board of directors might not set aside for capital account, and after maturity only out of the net earnings of the company. They had no standing as against creditors. The relative rights of these bondholders and of stockholders need not be determined. The only fund out of which they could be paid was the same fund out of which stockholders could be paid a dividend, namely, the net earnings of the company.

The bonds were not negotiable. They were payable to the stockholder or his assigns. They were assignable, however, without a contemporaneous assignment of the stock. Theoretically, at least, the stock and the bonds might have been held by different persons. That they were not in fact so held is immaterial.

It must, however, have been clear that bonds of this character when issued had no real value in the market, and that despite the earnings of the predecessor company, which would have justified the issuance of full liability bonds to the extent of approximately $200,000. In substance the transaction amounted to a present transfer of the good will to be paid for only as an actual value thereof might be demonstrated through future earnings, but in that event, up to a valuation of $400,000 as of April 1, 1906. In other words, instead of valuing the good will and taking it over for a present liability of $200,000, the parties agreed that it should be taken over without valuation, to be paid for only if and to the extent that it demonstrated by reason of future earnings that it had a value, but in that case the demonstration was to be permitted to double the fairly permissible valuation as of April 1, 1906. It follows, therefore, that it can not be said that in April or in June, 1906, anything was paid for good will.

Plaintiff contends, however, that when and as the bonds were redeemed the good will was paid for, and as the entire redemption was made before 1917, the good will must be deemed to have been purchased for the $400,000 in cash, and thus have taken the place of earned surplus to that amount; that therefore, even though not entered as an asset on the books of the company, it must be deemed as part of the invested capital for the period in question. It contends that the situation is the same as if it had borrowed $400,000 in cash on its note with which to purchase the good will, and had subsequently paid off the note out of earnings. But even in such a case the good will bought for $400,000 would not be included in the invested capital at that amount unless at the time of purchase it were actually worth that much. The analogy, however, does not hold good. The income bonds did not represent a present liability of the company; they represented merely a right to payment if and when the fund out of which they are to be paid comes into existence.

In substance and fact the fund out of which dividends could be paid was at the very inception divided into two parts. One of those parts was to have priority over the other, and in consideration thereof the good will was granted. It was not purchased from time to time and to the extent that payment was made pursuant to the original agreement. It was completely acquired in 1906,

and when acquired nothing was given therefor except the agreement to pay if and when it might demonstrate a value by reason of earnings thereafter to be made.

It is unnecessary to discuss in detail section 207(a) of the Revenue Act of 1917; 326 (a) (b) of the Revenue Acts of 1918 and 1921; article 60 of the Treasury Department Regulations No. 41, Act of 1917; article 842, Treasury Department Regulations No. 45, Act of 1918; or article 842, Treasury Department Regulations No. 62, Act of 1921. It suffices to say that the good will was not paid for in cash or tangible property or shares of the capital stock, that in no sense can it be deemed earned surplus, and that if in any sense it could be called paid-in surplus, such surplus is included in invested capital only when represented by tangible property.

Agreeing substantially with the opinion rendered by the Board of Tax Appeals, I conclude that the motion to dismiss must be granted.

ARTICLE 854: Computation of average invested capital. VI-31-3344 G. C. M. 2080

REVENUE ACT OF 1917.

Method outlined for computing that part of the excess profits deduction which is based upon invested capital as provided in section 203, Revenue Act of 1917.

An opinion is requested concerning the method of computing that part of the excess profits deduction which is based upon invested capital as provided in section 203 of the Revenue Act of 1917. According to that section, such deduction is "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)." Section 207 of the Act provides in part as follows:

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.

Article 43 of Regulations 41 provides in part that:

The invested capital for any prewar or taxable year (or where the tax is computed upon the basis of *a period less than a year*, for such period) *is the average invested capital for the* year or *period averaged monthly*, according to the following rules:" [Italics supplied.]

It will be noticed that article 43 covers both the case where the tax is computed for a "taxable year" and the case where the tax is computed for a "period less than a year." The statute does not speak of "a period less than a year," but the regulations distinctly provide that the invested capital for any such period shall be determined in the same manner as the invested capital for a year except as to the number of months over which it is to be averaged.

The rules for the ascertainment of invested capital for a year, or for a shorter period, set forth in article 43, are as follows:

(a) Add the capital for each of the several months during which no change occurs, and the average capital (ascertained as provided in subdivision (b) of this article) for each month in which a change occurs and divide the total by the number of months in the year *or period*.

(b) To ascertain the capital for any month in which a change occurs multiply the capital as of the first day of the month by the number of days it

remains constant and the capital after each change by the number of days (including the day on which the change occurs) during which it remains constant, add the products, and divide the sum by the number of days in the month. [Italics supplied.]

The capital for any month is the whole invested capital of the business for the month, without proration except such as is necessary to average an addition or a reduction of such capital over the month in case of a change during the month. The regulations provide that the capital for each of the several months in the year *or period* shall be added and the sum thereof divided by the number of such months. The quotient is the invested capital of the taxpayer for the taxable period, averaged monthly.

Assume a return is properly filed for a fractional part of a year, for example, four months beginning January 1, 1917, the taxpayer having a capital of $1,500,000 on January 1, 1917, and having added thereto on March 1, 1917, $600,000. Applying the regulations, the following computation results:

	Dollars.
January	1,500,000
February	1,500,000
March	2,100,000
April	2,100,000
	7,200,000

$7,200,000÷4=$1,800,000, invested capital for the four months' period, averaged monthly.

This is the correct computation and is in agreement with Treasury Decision 3848 (C. B. V–1, 290) and article 43 of Regulations 41. Accordingly, $1,800,000 would be the base for computing the excess profits deduction under section 203 of the Revenue Act of 1917, the return being for a fractional part of a year.

It should be noted, however, that the foregoing computation of average invested capital has reference to a case where a return is properly filed for a fractional part of a year. In a case where a corporation liquidates and dissolves, or comes into existence, other than at the beginning or end of the corporation's taxable year, the return required is not a return for a fractional part of a year but a return for a full taxable year of 12 months, regardless of the fact that the period during which income is received or earned is less than a full year. (*Bankers' Trust Co.* v. *Bowers*, 295 Fed., 89; *Louis Hymel Planting & Manufacturing Co.* v. *Commissioner*, 5 B. T. A., 910; I. T. 2239, C. B. IV–2, 58.) Therefore, in such a case the invested capital should be averaged over 12 months, and the proper computation (using similar figures to those used in the computation for a fractional part of a year) would be:

	Dollars.
January	1,500,000
February	1,500,000
March	2,100,000
April	2,100,000
Each succeeding month during the taxable year	0,000,000
	7,200,000

$7,200,000÷12=$600,000, invested capital for the year or 12 months' period, averaged monthly.

Accordingly, the return in such a case not being properly classified as a return for a fractional part of a year, $600,000 would be the base for computing the excess profits deduction under section 203 of the Revenue Act of 1917.

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

ARTICLE 857: Method of determining available net income. VI–35–3402 T. D. 4068

EXCESS PROFITS TAX—REVENUE ACT OF 1917—DECISION OF COURT.

1. INVESTED CAPITAL—COMPUTATION—WITHDRAWALS—TAX ACCRUED.

Where during the year 1917 the members of a partnership, keeping its books and filing its returns on the accrual basis, withdrew amounts in excess of the earnings for that portion of the year, the invested capital of the partnership must be reduced by the excess of the withdrawals over the earnings, and in determining such earnings deductions should be made for the excess-profits tax estimated to have accrued at the date of the withdrawals.

2. CASE FOLLOWED.

D'Olier et al. v. *United States* (61 C. Cls., 895 (T. D. 3855 [C. B. V–1, 339])) 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 *Charles S. Child and William J. Fullerton, formerly partners doing business as Wilson & Bradbury*, v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 19, 1927.

S. LOWMAN,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

Charles S. Child and William J. Fullerton, formerly partners doing business as Wilson & Bradbury, v. *The United States.*

[April 4, 1927.]

OPINION.

HAY, Judge, delivered the opinion of the court.

This is a suit brought by the plaintiffs against the United States to recover certain excess-profits taxes for the calendar year 1917, alleged to have been erroneously assessed against and collected under protest from the partnership of Wilson & Bradbury.

The facts are agreed to by the parties, and are set out in the findings of fact made by the court. The plaintiffs, formerly partners doing business under the firm name of Wilson & Bradbury, paid net excess-profits taxes assessed against

the partnership for the calendar year 1917 in the sum of $371,592.59, based on an invested capital determined and found by the Commissioner of Internal Revenue to be $1,775,862.98.

On December 31, 1916, the invested capital of the partnership was $2,151,634.54, and its net income for the calendar year 1917 subject to excess-profits taxes was $976,493.77. How much of the net income of the said partnership for the year 1917 was earned in any given month can not be stated, but it is shown that during the first three months of 1917 plaintiffs withdrew from the partnership's funds the sum of $645,840.33, of which $299,193.94 was withdrawn prior to March 1, 1917, and $346,645.39 during the said month of March, and that the total withdrawals by the partners for the year 1917 amounted to the sum of $778,904.28.

It is also shown that plaintiffs' books for the calendar year 1917 were kept on the accrual basis of accounting both as to debits and credits as distinguished from the cash receipts and disbursements basis of accounting.

The Commissioner of Internal Revenue, under the provisions of section 207 of the Revenue Act of October 3, 1917, and regulations 41, articles 43 and 53, in determining the amount of invested capital used and employed in the partnership business during the year 1917, made certain deductions from the partnership invested capital of $2,151,634.54 existing at the beginning of the taxable year 1917. These deductions and the method of their ascertainment are set forth in the findings of fact, the amount on which the tax was based having been ascertained to be the sum of $1,775,862.98.

This court had before it in the case of *Franklin D'Olier et al.* v. *The United States* (61 C. Cls., 895) the same questions which are presented in this case. In the D'Olier case this court held as follows:

"Where a partnership in 1918 makes return of its excess-profits tax for the year 1917 on an accrual basis, and during the year 1917 withdraws certain amounts from its invested capital, the Commissioner of Internal Revenue is authorized, for the purpose of computing the tax, to reduce the invested capital shown in said return for 1917 by deducting, as of the dates of withdrawal, that part of the excess-profits tax for the taxable year estimated to have accrued at that date, although such tax was not assessed and did not become due and payable until a year after the withdrawal."

The plaintiffs in their brief ask us to reexamine the question decided by us in the D'Olier case. This we have done, and we find no reason to change our conclusion, especially as in that case an application was made for a certiorari to the Supreme Court of the United States and that application was denied.

We are of opinion that the petition of the plaintiffs must be dismissed. It is so ordered.

ARTICLE 862: Purchase of stock. VI–48–3523
T. D. 4102

Invested capital—War profits and excess profits taxes—Revenue Act of 1918.

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

To Collectors of Internal Revenue and Others Concerned:

Article 862 of Regulations No. 45 is hereby amended to read as follows:

ART. 862. *Purchase of stock.*—Where a corporation either directly or indirectly, as for example through a trustee, purchases its own stock, either for the purpose of retiring or of holding it in the treasury or for other purposes, the cost of such purchase to an amount equal to the capital paid in to the company for such stock must be deducted from the aggregate invested capital from the date of such purchase. Where any such purchase is made within the first 60 days of the taxable year, any sum paid in excess of the above amount will be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any such excess paid in such a purchase which occurs during the remainder of the taxable year will be deemed to have been

made from the earnings or profits accumulated between the close of the preceding taxable year and the date of payment, to the extent of such earnings or profits. See article 857. The full amount derived in cash or its equivalent from the resale of such stock may be included in invested capital from the date of such resale. See article 542.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved November 23, 1927.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 862: Purchase of stock. VI–48–3524
T. D. 4103

Invested capital—War profits and excess profits taxes—Revenue Act of 1921.

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

To Collectors of Internal Revenue and Others Concerned:

Article 862 of Regulations No. 62 is hereby amended to read as follows:

ART. 862. *Purchase of stock.*—Where a corporation either directly or indirectly, as for example through a trustee, purchases its own stock, either for the purpose of retiring or of holding it in the treasury or for other purposes, the cost of such purchase to an amount equal to the capital paid in to the company for such stock must be deducted from the aggregate invested capital from the date of such purchase. Where any such purchase is made within the first 60 days of the taxable year, any sum paid in excess of the above amount will be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any such excess paid in such a purchase which occurs during the remainder of the taxable year will be deemed to have been made from the earnings or profits accumulated between the close of the preceding taxable year and the date of payment, to the extent of such earnings or profits. See article 857. The full amount derived in cash or its equivalent from the resale of such stock may be included in invested capital from the date of such resale. See article 543.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved November 23, 1927.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 870: Insurance companies. VI–33–3373
T. D. 4053

PROFITS TAX.

Invested capital: Article 870, Regulations 45 (1920 edition), as amended by Treasury Decision 3153 [C. B. 4, 280, 398], amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 870, Regulations 45 (1920 edition), as amended by Treasury Decision 3153, is hereby amended to read as follows:

ART. 870. *Insurance companies.*—The reserve funds of insurance companies, other than stock life insurance companies, the net additions to which are deductible from gross income under the provisions of section 234 of the statute, may be included in computing invested capital. A life insurance company substantially all of the stock of which has been trusteed for the benefit of its policyholders shall be deemed to be a mutual company and not a stock company within the contemplation of this article.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 2, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

SECTION 327.—SPECIAL CASES.

ARTICLE 901: Treatment of special cases. VI–29–3319
T. D. 4038

EXCESS-PROFITS TAX—REVENUE ACT OF 1917—DECISION OF COURT.

1. INVESTED CAPITAL—SPECIAL ASSESSMENT—JURISDICTION.

Where the Commissioner of Internal Revenue finds that invested capital can be satisfactorily determined under section 207, a court is without jurisdiction to compute the excess-profits tax under the provisions of section 210 of the Revenue Act of 1917 in the absence of proof that the Commissioner's determination was arbitrary or capricious.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the District Court of the United States for the Northern District of Ohio, Western Division, in the case of *The Feilbach Co.* v. *Frank B. Niles, Collector*, is published for the information of internal revenue officers and others concerned.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

Approved July 8, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF OHIO, WESTERN DIVISION.

The Feilbach Co., plaintiff, v. *Frank B. Niles, Collector of Internal Revenue, defendant.*

[March 25, 1927.]

MEMORANDUM OPINION.

KILLITS, J.: Section 210 of the Revenue Act of 1917 must be considered to be an administrative provision for the guidance of the Commissioner of Internal Revenue in the determination of invested capital, upon which computation of excess-profits tax may be made in those somewhat unusual occasions when the very definitive section (207) can not be applied. It seems obvious that the circumstances which would clothe the Commissioner with the discretion to apply section 210 would occur somewhat rarely in the administration of the law,

because Congress was somewhat meticulous in its definition of what invested capital should be considered to be, and how it should be ascertained, in the writing of section 207, whose terms manifestly would meet the conditions in a vast majority of cases.

The section under consideration, 210, is one whose provisions are to be invoked primarily and most generally by the Commissioner alone. Very, very rarely, and under quite extraordinary circumstances, it would seem, can the section be resorted to as a mode of relief by the taxpayer. The statute limits resort to it to only when the Commissioner finds that he can not "satisfactorily" ascertain invested capital for the computation of excess-profits tax under section 207. It would follow that, if the Commissioner or his agents actually computes capital under 207, his action should be presumed to exclude any application of section 210, the burden then being upon a claimant to relief under the provisions of the latter section to show that the Commissioner acted arbitrarily and without justification. It would be a rare case indeed wherein a court would be justified in concluding that the Commissioner could not "satisfactorily" apply the provisions of section 207 to a determination of the question, when, in fact, the Commissioner satisfied himself that he could so do.

Reading the allegations of the petition in light of this consideration of the statutes in question and the Commissioner's action thereon, we find no reason for the interposition of the court in the form of a review of his judgment.

It is evident that Congress, in framing section 207, intended not only to prevent vague and difficult determinations through the examination of circumstances hard to establish, but to set up standards of determination so rigid and so easily applicable that only a very extraordinary condition would justify a determination that the section was not workable. (*Cartier* v. *Doyle*, 277 Fed., 150; *LaBelle Iron Works* v. *United States*, 256 U. S., 377 [T. D. 3181, C B. 4, 373]). Applying the authorities just cited and going to the four reasons set up as indicating that the Secretary of the Treasury in the instant case could not satisfactorily determine invested capital, we are unable to find that such a conclusion is a proper deduction. Section 207 seems to this court to read to the exclusion of any one of these four alleged facts; nor do the four of them cumulated tend to take the present situation out of the operation of the section in question, and, therefore, afford the plaintiff relief. On the contrary, as we read section 207, it negatives the ability of the taxpayer to resort to any of these reasons to exonerate it from the provisions of that section.

The demurrer, therefore, to the petition is sustained.

ARTICLE 901: Treatment of special cases. VI-31-3345
T. D. 4048

EXCESS PROFITS TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. SPECIAL ASSESSMENT—DISCRETIONARY POWER.

The provisions of the Revenue Act of 1918 authorizing the Commissioner of Internal Revenue, in the cases specified in section 327, to determine the tax as provided in section 328 confer a discretionary power, and his determination that section 328 is inapplicable is final in the absence of bad faith or an abuse of discretion.

2. SAME—SUIT—JURISDICTION.

Where the Commissioner of Internal Revenue in good faith determines that section 328 is inapplicable, a court is without jurisdiction to award a judgment for the recovery of an excess-profits tax assessed under section 301 on the ground that it should have been computed under section 328.

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 *Williamsport Wire Rope Co.* v. *United States* is

published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved July 21, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

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COURT OF CLAIMS OF THE UNITED STATES.

The Williamsport Wire Rope Co. v. *The United States.*

[May 2, 1927.]

OPINION.

BOOTH, Judge, delivered the opinion of the court.

This is a tax case. The petition alleges a right of recovery upon two items. To the first item the defendant demurs. The facts alleged to sustain the cause of action are as follows: The plaintiff, a Pennsylvania corporation engaged in the manufacture of wire rope, on June 15, 1919, filed with the collector of internal revenue for the proper district its income-tax return for the year 1918. Plaintiff then conceded an income, excess, and war tax liability upon the return so filed of $306,381.77, and the same was duly paid in four installments without protest. Subsequently the Commissioner of Internal Revenue, through revenue agents, made an examination of plaintiff's books of account, and on April 14, 1920, advised the plaintiff that a revised computation of its income-tax return had increased its tax liability for the year 1918 to the extent of $89,094.85. Plaintiff protested this action of the Commissioner, but the Commissioner made the additional assessment, and it was finally paid by the plaintiff under protest. Thereafter the Commissioner discovered an error in his computation resulting in an overpayment of $12,393.09, which amount was on June 10, 1924, refunded to the plaintiff, leaving an aggregate tax assessed, levied, and paid by the plaintiff upon its return of $383,083.53.

On June 14, 1924, the plaintiff filed with the Commissioner a claim for a refund of $100,000, stating therein that the amount so claimed represented the amount by which its tax computed under section 301 of the Revenue Act of 1918 exceeded its tax computed under sections 327 and 328 of the Revenue Act of 1918, insisting upon a right to have its tax liability computed in accordance with sections 327 and 328, supra. The Commissioner declined to refund. The petition further alleges that as a matter of fact as well as law plaintiff is entitled to have its excess-profits tax and war-profits tax computed in accordance with sections 327 and 328 of the Revenue Act and not under the provisions of section 301 of the same law. To this end the allegation is made that it is impossible for the Commissioner or anyone else to determine the correct amount of plaintiff's invested capital as defined in section 326 of the Revenue Act of 1918; that abnormal conditions exist affecting the capital and income of the plaintiff which work upon it an exceptional hardship, evidenced by gross disproportion between the tax paid by it and its tax computed by reference to representative corporations engaged in the same trade or business.

To sustain this allegation particular instances are cited. First, it is alleged that plaintiff pursued a policy of charging large sums expended for plant additions and improvements to an expense account and not to capital; second, that prior to the year 1918 plaintiff developed valuable secret processes essential to the profitable operation of its business, and no part of the cost thereof has ever been capitalized, and the Commissioner ignored this fact in making up his adjustment of plaintiff's invested capital; third, that plaintiff, since its organization, has never undergone a reorganization or merger, but has since its organization in May, 1887, conducted an increasing and important

business and thereby acquired a good will which asset is not recorded on its books and the value thereof was ignored by the Commissioner in ascertaining plaintiff's invested capital; that under regulations of the Commissioner, its good will is an asset of the value of $1,037,713; fourth, that plaintiff, during the year 1918 borrowed money to use in its business; that on January 1, 1918, plaintiff was using in its business $114,834.91 borrowed funds, and on December 31, 1918, for a like purpose was using $122,353.82; that its capital stock was $100,000; that at the beginning of the year its percentage of borrowed money to capital stock was 114.8 per cent, and at the end of the year 122.3 per cent; fifth, it is alleged that the salaries of its officers were abnormally low, averaging but 3.76 per cent of its taxable income for the year, and finally concluding with the allegation that a comparison of the rate of tax imposed upon the plaintiff with the rate imposed upon representative corporations engaged in a like trade or business would disclose the fact that as to the plaintiff the rate exacted is 63.87 per cent of its taxable income, whereas as to representative corporations the rate is not in excess of 55 per cent of their taxable income.

The prayer for judgment is somewhat obscure. If we correctly apprehend it, suit is for the recovery of $100,000 on this item with interest thereon from date of the payment of the final installment, viz, December 31, 1919.

Sections 327 and 328 of the Revenue Act of 1918 (ch. 18, 40 Stat., 1093) provide in terms as follows:

"SEC. 327. That in the following cases the tax shall be determined as provided in section 328:

"(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

"(b) In the case of a foreign corporation;

"(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

"(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

"SEC. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

"In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

"(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

"In cases in which the tax is to be computed under this section, if the tax as computed without the benefit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance

be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installments shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid, together with interest at the rate of one-half of 1 per centum per month, on such excess from the time the installment was due.

"(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257."

Section 326 of the Revenue Act of 1918 (40 Stat., 1092) defines invested capital and is in terms as follows:

"(a) That as used in this title the term 'invested capital' for any year means (except as provided in subdivisions (b) and (c) of this section):

"(1) Actual cash bona fide paid in for stock or shares;

"(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus: *Provided*, That the Commissioner shall keep a record of all cases in which tangible property is included in invested capital at a value in excess of the stock or shares issued therefor, containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, the value of the tangible property at the time paid in, the par value of the stock or shares specifically issued therefor, and the amount included under this paragraph as paid-in surplus. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257;

"(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;

"(4) Intangible property bona fide paid in for stock or shares prior to March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest;

"(5) Intangible property bona fide paid in for stock or shares on or after March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year, whichever is lowest: *Provided*, That in no case shall the total amount included under paragraphs (4) and (5) exceed in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year; but

"(b) As used in this title the term 'invested capital' does not include borrowed capital.

"(c) There shall be deducted from invested capital as above defined a percentage thereof equal to the percentage which the amount of inadmissible assets is of the amount of admissible and inadmissible assets held during the taxable year.

"(d) The invested capital for any period shall be the average invested capital for such period, but in the case of a corporation making a return for a fractional part of a year, it shall (except for the purpose of paragraph (2) of subdivision (a) of section 311) be the same fractional part of such average invested capital.

"The average invested capital for the prewar period shall be determined by dividing the number of years within that period during the whole of which the corporation was in existence into the sum of the average invested capital for such years."

A tax case in this court is a suit against the United States founded under our jurisdictional Act (section 145, Judicial Code) upon a law of Congress. The right to sue for internal revenue tax is conditioned upon its payment, application for a refund and denial of the same. (*Rock Island, Arkansas & Louisiana R. R. Co.* v. *United States,* 254 U. S., 141.) Under the allegations of the petition, heretofore recited, it is obvious that the present suit is for a recovery of an alleged illegal tax exaction resulting from the alleged failure of the Commissioner to apply to plaintiff's tax return the applicable sections of the revenue law—i. e., sections 327 and 328, supra. Plaintiff does not allege that if section 301 of the Revenue Act of 1918 has been legally applied in the assessment and levy of the taxes involved, an over or illegal assessment follows, and judgment for the amount paid thereunder is recoverable. On the contrary, the gravamen of the complaint is that sections 327 and 328 of the statute are the applicable sections of the law under which the assessment and levy should have been made, and if so made, would result in a difference of $100,000 in the amount paid and what should have been paid. The court is manifestly without authority to *compute* a tax under sections 327 and 328 of the revenue law. The Commissioner has refused to apply the sections as requested, and we have no means to compel him to do so. Sections 327 and 328 of the statute point out the method to be pursued by the Commissioner in applying special assessment. In his office, and available to him, are the facts, the records, voluminous and important, upon which the Commissioner relies in making comparisons with representative corporations engaged in a like trade or business, and upon no possible hypothesis has the court any means of knowing, in the absence of an official computation by the Commissioner, what the amount of plaintiff's tax would be under the conditions set forth in the law. Until the Commissioner has acted, and the record of his actions is before the court, we are powerless to determine that he should have done something which under the law he positively refuses to do.

Plaintiff admits that internal-revenue taxes are justly due from it to the United States. The issue presented by the petition goes only to the amount. We are not asked to set aside the assessment and levy made under section 301 and award judgment for all the taxes paid thereunder. The relief sought by the plaintiff is a judgment founded upon a law of Congress under which the plaintiff has not incurred a tax liability, under which it has been assessed no taxes, and under which it has paid no taxes. The plaintiff's taxes were assessed under section 301. They were levied and collected under that section, and no complaint is made that if the section is applicable the amount assessed and paid is illegal. The plaintiff, in our view of the case, has mistaken the remedy. As said by the Supreme Court in the Rock Island case, supra, "Men must turn square corners when they deal with the Government. If it attaches even purely formal conditions to its consent to be sued those conditions must be complied with." Clearly the plaintiff has paid no taxes under sections 327 and 328 of the statute. The Commissioner has not levied or assessed any under the sections, and no claim for refund has been made or refused for any sum or sums exacted of the plaintiff under the above sections. What sum the Commissioner might exact or might have exacted under the special assessment provisions relied upon is a problem with which under the petition we are not concerned, and until he does apply the provisions the court is powerless to proceed.

In addition to what has been said, the provisions of the revenue law authorizing special assessment confer upon the Commissioner discretionary power. He is vested by Congress with the right to determine from the facts of each case when the abnormal conditions obtain to warrant the application of the law, which by its very terms indicates that only in exceptional cases is he to resort thereto. The plaintiff does not question the authority of Congress to confer the jurisdiction upon the Commissioner, and does not challenge in the petition his good faith or charge abuse of discretion in refusing it classification under the special assessment sections. Plaintiff did not in the beginning question the amount of taxes it should pay, the return made by it, and the taxes due as per the same were voluntarily paid. No complaint was lodged against the exaction until additional taxes were assessed and demanded. Then for the first time the plaintiff insists upon its alleged right to special assessment. Then and only then was the Commissioner acquainted with its allegations of an abnormal

status and the many unusual factors which prevented him from ascertaining invested capital under section 326. The presumption is that the Commissioner discharged his duty under the law. In the absence of any information to the contrary, we may not presume that the Commissioner found the statutory difficulties which precluded an assessment under section 301. On the contrary, his inaction indicates that no such difficulties were encountered. We are without jurisdiction to substitute our judgment for the Commissioner's until he exacts taxes under sections 327 and 328 and the same are paid thereunder, and a refund asked and refused. We are without jurisdiction to award a judgment as claimed upon the court's computation of what might under the law be due. (*Louisiana* v. *McAdoo*, 234 U. S., 627; *United States* v. *Babcock*, 250 U. S., 328; *Ray Consolidated Copper Co.* v. *United States*, 268 U. S., 373.)

The demurrer to the first item of the petition will be sustained and as to that item the petition is dismissed. It is so ordered.

TITLE XIII.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTION 1312.—FINAL DETERMINATIONS AND ASSESSMENTS.

ARTICLE 1141: Final determination of tax or penalty.

REVENUE ACT OF 1921.

Effect of settling the taxes as of one member of a consolidated group on erroneous basis on the "determination and assessment" in the cases of other affiliated corporations. (See G. C. M. 2189, page 252.)

SECTIONS 1318, 1319, AND 1320.—LIMITATIONS UPON SUITS AND PROSECUTIONS.

ARTICLE 1050: Suits for recovery of taxes erroneously collected.

REVENUE ACT OF 1921.

Tax paid after statutory collection period, prior to expiration of which the taxpayer deposited bonds as security for payment of the tax upon demand. (See T. D. 4093, page 145.)

SECTION 1324.—INTEREST ON REFUNDS AND JUDGMENTS.

ARTICLE 1040: Interest on refunds and judgments.

REVENUE ACT OF 1921.

Item on refund schedule signed on June 2, 1924, but prior to 4.01 p. m. of that date. (See G. C. M. 2020, page 137.)

MISCELLANEOUS.

VI–41–3463
Mim. 3569

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., October 1, 1927.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, Officials and Employees of the Bureau of Internal Revenue, and Others Concerned:

Effective as of October 1, 1927, the Income Tax Unit of this Bureau will be divided.

Charles B. Allen is appointed deputy commissioner and assigned in charge of the Income Tax Unit at Washington, D. C.

The field service of the Income Tax Unit will remain under the immediate direction of Charles R. Nash, Assistant to the Commissioner.

D. H. BLAIR, *Commissioner.*

VI–41–3464

Announcement is made of the following personnel change, effective October 1, 1927:

William T. Sherwood, head of clearing division, is promoted and designated assistant deputy commissioner.

SALES TAX RULINGS.

TITLE V.—TAX ON ADMISSIONS AND DUES. (1926)

LEASES OF BOXES OR SEATS.

REGULATIONS 43–I, ARTICLE 6: Basis, rate, and computation of tax. VI–30–3339 T. D. 4041

TAX ON ADMISSIONS: LEASES OF BOXES AND SEATS.

Article 6 of Regulations 43, Part 1, relating to the tax on admissions (section 500, Revenue Act of 1926), amended.

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

To Collectors of Internal Revenue and Others Concerned:

The examples in article 6 of Regulations 43, Part 1, relating to the tax on leases of boxes or seats imposed by section 500(a)4, Revenue Act of 1926, are hereby amended so as to read as follows:

Examples.—(1) The season of a certain professional baseball league runs from April 15 to October 15. One club leases 6-seat boxes under contracts which entitle the holders to occupy the same on all occasions when attractions are presented on the field between those dates. There are 70 games scheduled for the season, and the price of a 6-seat box for a single game (including general admission of 6 persons to the grand stand) is $10. In the case of the lease of a box under the above-mentioned contract the tax to be collected from the holder at the time the contract is made is $70 (70 times 10 per cent of $10), and if extra attractions, to which the holder would be entitled to the use of such box, are presented on the field at any time during the period for which the box is held, additional tax equivalent to 10 per cent of the established price of a similar box must be collected on each such occasion, whether or not the box is occupied.

(2) Another club leases box seats under contracts which entitle the holders to occupy the same on all occasions when attractions are presented on the field between April 15 and October 15, but do not entitle them to general admission to the grand stand. The price of one of these seats for a single game (not including a taxable general admission to the grand stand of $1) is 50 cents. In the case of the lease of a seat under the above-mentioned contract the tax to be collected at the time the contract is made is $3.50 (5 cents for each of the 70 games scheduled). The person who occupies the seat will, of course, be also required to pay tax on the $1 paid for general admission to the grand stand, but this tax should be collected only when such payment is made for general admission.

(3) Another club leases box seats under contracts which entitle the holders to occupy the same on all occasions when attractions are presented on the field between April 15 and October 15, but do not entitle them to general admission to the grand stand. The price of one of these seats for a single game (not including a *nontaxable* general admission to the grand stand of 75 cents) is 25 cents. In the case of the lease of a seat under this contract the tax to be collected at the time the contract is made is $7, which is 10 per cent of the amount that would be paid for the 70 games scheduled at the established price, for admission, and the use of similar accommodations, at the rate of $1 for each game.

If, under either of the two above-mentioned contracts extra attractions at which the lessee is entitled to occupy his seat are presented on the field at

any time during the period for which the seat is held, additional tax equivalent to 10 per cent of the established price of a similar seat must be collected on each such occasion, whether or not the seat is occupied.

(4) The owners of a certain opera house, in leasing it to an opera company, reserve for their own use the whole parterre tier of thirty-five 6-seat boxes, paying therefor annually the sum of $70,000. These boxes are distributed among the various owners, $2,000 a year being paid for an annual lease of each. There are no similar boxes in the house, but the established price of each seat in the box in the next tier, which is less desirable, is $10 per seat. The number of performances during the season is fixed in advance at 100. Each lessee of such a box on paying the $2,000 for the season must pay a tax of at least $600 (100 times 10 per cent of 6 times $10), to be paid over in turn to the opera company and the collector of internal revenue. This minimum figure for the tax is based on the established price of the box seats which are the most nearly similar, but which are less desirable. If extra attractions are presented at any time during the period for which the box is leased additional tax equivalent to 10 per cent of the established price of a similar box must be collected on each such occasion, whether or not the box is occupied.

C. R. NASH,
Acting Commissioner.

Approved July 18, 1927.
CARL T. SCHUNEMAN,
Acting Secretary of the Treasury.

TAX ON ADMISSIONS.

REGULATIONS 43–I, ARTICLE 41: Returns and payments. VI–32–3360 S. T. 459

Admissions tax returns are not to be open to inspection by anyone other than officials of the United States Government.

A request is made that a collector of internal revenue be authorized to permit officials of his State for purposes of the State to inspect the returns of admissions taxes made by certain organizations.

Section 257 of the Revenue Act of 1926 authorizes the inspection of income tax returns under rules and regulations prescribed by the Secretary of the Treasury and approved by the President of the United States. However, there is no such authority in existing law permitting the inspection of admissions tax returns. These returns are made under duress of law and are considered to be privileged communications and of such a confidential nature as not to be open to inspection by anyone other than officials of the United States Government requiring information afforded thereby for use in the discharge of their official duties.

In view of the confidential character of the admissions tax returns and of the absence of any statutory authority permitting the inspection thereof by persons other than officials of the United States Government, the authority requested can not be granted.

TITLE V.—TAX ON ADMISSIONS AND DUES. (1924)

TAX ON ADMISSIONS.

REGULATIONS 43–I, ARTICLE 2: Meaning of the term "place." VI-36-3415 T. D. 4075

ADMISSION TAX—REVENUE ACTS OF 1918, 1921, AND 1924—DECISION OF COURT.

ADMISSIONS—CHARGES TO USERS OF ROAD TO PARK.

Where a company maintains a park for the enjoyment of the general public accessible by a private road 3 miles long, on which at a point a half mile from the park each person entering the park is required to purchase a ticket which admits the purchaser to its attractions, such charges are admissions subject to the tax imposed by section 800(a) of the Revenue Acts of 1918 and 1921 and section 500(a) of the Revenue Act of 1924.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the Court of Claims of the United States in the case of *Chimney Rock Co.* v. *The United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 26, 1927.

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

COURT OF CLAIMS OF THE UNITED STATES.

Chimney Rock Co. v. *The United States.*

[June 6, 1927.]

OPINION.

HAY, Judge, delivered the opinion of the court.

The plaintiff is a corporation and conducts in the State of North Carolina a resort at Chimney Rock Mountain in said State. Under its charter it is given the right to engage in furnishing entertainment and amusement for the general public; to engage in the hotel and restaurant business; and to construct drives, paths, elevators, and scenic ways, and to charge reasonable tolls and fares to persons using and visiting its property. As a part of its resort it constructed an improved road over its own land and that which it had leased in perpetuity. This road is 3 miles in length and runs from a point in the State highway between Asheville and Charlotte, N. C., to a parking place at the base of Chimney Rock Mountain. This road is owned and controlled by the plaintiff, and the plaintiff exercises the right to exclude any and all persons from its use.

Since May 1, 1920, the plaintiff has charged to each person using this road $1, and this whether the person using the road was on foot or horseback or in a vehicle. If the vehicle contained more than one person, then each person

was required to pay the dollar. At a point on said road about 2½ miles from the State highway and about one-half mile from the parking place the plaintiff maintained a ticket office, which was open day and night and in which was located its representative. It was the duty of said representative to collect from each person passing his office the sum of $1. Upon its payment a strip ticket was issued to the person, which ticket was collected by the plaintiff's representative at the aforesaid parking place. This ticket was good only on the day of its purchase, and entitled the purchaser to parking space and to use the trails and stairways and visit the points of interest provided by the plaintiff at its resort.

The plaintiff was required by the collector of internal revenue for the western district of North Carolina and by the Commissioner of Internal Revenue to collect admission taxes on the amount of the charges made by it, and to pay the same to the said collector, and the amounts so paid to the said collector monthly from July 19, 1921, to June 20, 1925, amounted to the sum of $14,896.56. Within four years next after the payment of said taxes the plaintiff duly filed its application with the Commissioner of Internal Revenue for the refund thereof, which application was rejected by the said Commissioner on January 6, 1926.

The plaintiff is now suing in this court for said amount.

The plaintiff contends that the charges upon which it was required to pay these taxes were toll charges, which it had the right to exact for the use of its road. The defendant maintains that the charges made by the plaintiff were admission charges to a place within the meaning and contemplation of the statutes providing for the collection of admission charges. The statutes involved are as follows:

Section 800(a) of the Revenue Act of 1918 (40 Stat., 1057):

"(1) A tax of 1 cent for each 10 cents or fraction thereof of the amount paid for admission to any place on or after such date, including admission by season ticket or subscription, to be paid by the person paying for such admission;"

and section 800(a) of the Revenue Act of 1921 (42 Stat., 227):

"(1) A tax of 1 cent for each 10 cents or fraction thereof of the amount paid for admission to any place on or after such date, including admission by season ticket or subscription, to be paid by the person paying for such admission; but where the amount paid for admission is 10 cents or less, no tax shall be imposed;"

Section 500(a) of the Revenue Act of 1924 (43 Stat., 253):

"(1) A tax of 1 cent for each 10 cents or fraction thereof of the amount paid for admission to any place on or after such date, including admission by season ticket or subscription, to be paid by the person paying for such admission; but where the amount paid for admission is 50 cents or less, no tax shall be imposed:"

The road here in question is a private road; it is not in the general acceptation of the word a toll road; it is owned and exclusively operated by the plaintiff for its own purposes, and the plaintiff exercises the right to exclude from its use any and all persons. The road is in effect an entrance to the plaintiff's resort, and no person can be admitted to this resort without payment of a fee which the plaintiff exacts. The place to which admission is granted by the payment of this fee is one which is maintained for the amusement and entertainment of the general public, and is such a place as is contemplated by the statutes. The road is a source of revenue to the plaintiff and is an integral part of its resort. The charges are made, not as tolls, but as entrance fees to a place of entertainment for the general public; this is demonstrated by the fact that these fees are required to be paid only when the person or persons using the road enter the resort. No charges are made for the use of 2½ miles of the road. We are of opinion that these charges are admission fees and come within the provisions of the statutes.

The petition of the plaintiff must be dismissed. It is so ordered.

TITLE V.—TAX ON TELEGRAPH AND TELEPHONE MESSAGES. (1921)

REGULATIONS 57(1922), ARTICLE 9: Messages transmitted under contract. VI–30–3331 T. D. 4040

TAX ON TRANSPORTATION AND OTHER FACILITIES—REVENUE ACTS OF 1918 AND 1921—DECISION OF SUPREME COURT.

1. TELEGRAPH MESSAGES.

Telegraph messages transmitted under a contract between a telegraph company and a railroad company for a mutual exchange of services are charged for within the meaning of subdivisions (f) of sections 500 of the Revenue Acts of 1918 and 1921 and are, therefore, taxable thereunder.

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 *Hellmich, Collector*, v. *Missouri Pacific Railroad Co.* is published for the information of internal revenue officers and others concerned.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

Approved July 16, 1927.

CARL T. SCHUNEMAN,
Acting Secretary of the Treasury.

SUPREME COURT OF THE UNITED STATES.

Arnold J. Hellmich, United States Collector of Internal Revenue, petitioner, v. *Missouri Pacific Railroad Co.*

Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[February 21, 1927.]

Mr. Chief Justice TAFT delivered the opinion of the court.

The Missouri Pacific Railroad Co. brought this suit in the United States District Court for the Eastern District of Missouri against Hellmich, United States collector of internal revenue, to recover taxes amounting to $14,792.95, paid by it under protest, for the transmission of telegraph messages from March, 1920, to January, 1923, inclusive. The messages in question were transmitted under the terms of a contract dated October 24, 1911, for the exchange of services between the Western Union Telegraph Co., on the one part, and the Missouri Pacific Railroad Co. and the St. Louis, Iron Mountain & Southern Railway Co., on the other part. To the rights and obligations of these two railway companies the respondent company, the Missouri Pacific Railway Co., succeeded. The question of the legality of the taxes arises under two Acts of Congress. The first is the Revenue Act of 1918 (ch. 18, 40 Stat., 1057, 1101, and 1102), which provides in its section 500 "That from and after April 1, 1919, there shall be levied, assessed, collected and paid, in lieu of the taxes imposed by section 500 of the Revenue Act of 1917—

* * * * * * *

"(f) In the case of each telegraph, telephone, cable, or radio, dispatch, message, or conversation, which originates on or after such date within the United States, and for the transmission of which the charge is more than 14 cents and not more than 50 cents, a tax of 5 cents; and if the charge is more than 50 cents, a tax of 10 cents: *Provided*, That only one payment of such tax shall be required, notwithstanding the lines or stations of one or more

persons are used for the transmission of such dispatch, message, or conversation; * * *.

"SEC. 501. (a) That the taxes imposed by section 500 shall be paid by the person paying for the services or facilities rendered."

The second is the Revenue Act of 1921 (ch. 136, 42 Stat., 227, 284), sections 500 and 501 of which contain exactly the same language as that just quoted from the Act of 1918.

The district court held that the messages here in question came within these sections, and gave judgment for the Government. The Circuit Court of Appeals of the Eighth Circuit reversed the district court, holding that the telegraph messages up to the amount of $75,000 annually thus taxed were exempt but that those in excess of that amount were subject to the tax.

The point in the case is to determine whether these messages can be construed to be messages for the transmission of which there can be said to be a charge. The contention of the railroad company is that in the sense of this section 500, the messages in question are not charged for at all, that they can not be fitted into the section, so that it can not be construed to cover them. We must, therefore, consider the contract under which the messages for the railroad company were sent by the telegraph company. The contract was dated October 24, 1911, and is of indefinite duration. By its fourth paragraph, the telegraph company agrees to perform, for the railway companies, telegraphic service between points on its lines in the United States, either on or off the lines of the railways covered by this agreement, as the railway companies may desire, for messages pertaining to their railroad business, under franks issued to their officers and agents permitting all classes of messages and telegraphic letters in public use on the lines of the telegraph company. The railway companies agree to perform promptly such transportation and distribution service over their railroads as the telegraph company may require for its employees, supplies, and material, whether for work or use along the railroads or beyond or off their lines, and to furnish special trains, engines, crews and equipment for distribution service, and outfit, boarding and tool cars for work on their lines, whenever required by the telegraph company. The transportation of employees is to be authorized by passes to be issued by the railway companies on authorized request. The service performed by either party for the other is to be charged for at its regular current telegraph rates, or its through or local transportation rates, as the case may be, for the class of services rendered. Services performed by either party for the other for which there are no regular or published rates, and not otherwise provided for in this agreement, are to be charged for at actual cost, as determined by the officers of the party rendering the service, plus not exceeding 25 per cent of such cost. At the close of each contract year, bills are to be rendered by each party to the other for all services performed by each party for the other during such year. If the bill therefor rendered by either party to the other exceeds the sum of $75,000 in any contract year, the party receiving such service is to pay to the party rendering the same the amount of such excess, provided that in the event the services of both are in excess of $75,000 in any contract year, the party in arrears is to pay to the other party the difference between the amounts of such accounts; and if the bills rendered by each party to the other for such services in any contract year do not exceed $75,000 there is to be no payment by either party to the other therefor.

By the fifth paragraph of the contract, it is provided that the telegraph or telephone operators of the railway companies at stations where the messages are less in number than 3,000 a year, are to act as the agents of the telegraph company and receive and transmit them, charging the tariff rates and rendering to the telephone company monthly statements of the business, and are to pay the receipts therefor to the telegraph company, but the railway companies are not to be liable for receipts thus to be received and paid over. The railway operators and employees in such service are to conform to the rules and regulations of the telegraph company. They are not to transmit over the wires of either party any free messages except those of the railway company's business. For messages transmitted for it by the employees of the railway company the telegraph company agrees to pay the railway companies 10 per cent of the gross cash receipts, except on ocean cable messages, receipts for which are to be retained in full by the telegraph company.

Pursuant to the authority vested in him by the Revenue Acts, the Commissioner of Internal Revenue, with the approval of the [Secretary of the]

Treasury, promulgated article 9 of Regulations No. 57 of the Treasury Department as to the proper construction of this section 500(f) of the Act of 1918, as follows:

"*Messages transmitted under contract.*—Where, by contract, a telegraph, telephone, radio, or cable company agrees, in consideration of the payment of a lump sum or of the performance of services, to transmit messages on frank, such messages are subject to the tax imposed by this section (500(f)) of the Act. The tax on each such message is to be computed upon the amount of the regular established charge for the transmission of similar messages for ordinary customers, calculated at the regular fixed rate provided in the tariffs of the transmittting carrier. The questions as to whether such messages relate to the operation of the business of a common carrier and whether they are 'on line' or 'off line' are immaterial. Thus, a telegraph company agrees to transmit over its lines on a railroad line all messages relating to railroad business 'free' and all such messages over its line off the railroad lines 'free' to an amount not exceeding $10,000 per year calculated at its regular rates, and all messages over that amount at half rates, in consideration of services to be performed by the railroad in the transportation of men and materials of the telegraph company. All such messages, whether 'on line' or 'off line,' and whether 'free' or at half rates, are subject to the tax provided by this section (500(f)) of the Act. The tax must be computed, collected, and paid upon each such message."

The case was heard upon a stipulation of facts, with some short additional testimony furnished by the officers of the railway company, as to the actual business transactions between the railway company and the telegraph company during the years in question.

The evidence shows that so far as the transportation of men and material was concerned, the railroad company kept a record of all transportation furnished to the telegraph company at tariff rates. At the end of the contract year, statements setting forth the transportation and the charges were furnished to the Western Union. After they were verified by the Western Union they became the basis for settlement under the contract. A similar arrangement was made by the Western Union Telegraph Co., as to the messages which it charged at its regular public rates.

For the contract year ending August 31, 1920, the total amount of business handled by the Missouri Pacific Railroad Co. for the Western Union amounted to $81,165.28, or $5,721.72 in excess of the $75,000 allowance under the contract. During the same year the amount of business handled by the Western Union for the Missouri Pacific Railroad Co. in telegraph messages was $71,815.17. That was $3,184.83 less than the amount provided for under the contract; and for that year there was no payment made by the Missouri Pacific to the Western Union Telegraph Co. for such messages. For the year ending August 31, 1921, the net amount of business done by the railroad company in the way of transportation, etc., for the telegraph company was $144,023.95. This was $69,023.95 in excess of the $75,000. During the same year the business handled by the telegraph company in messages for the railroad company amounted to $86,221.92, or $11,221.92 in excess of the contract allowance. During that year the Western Union Telegraph Co. paid the railroad company the difference between $69,023.95 and $11,221.92, or $57,802.03. For the year ended August 31, 1922, the net amount of business handled by the railroad company for the telegraph company in the way of transportation was $132.349.02, or $57,349.02 in excess of the $75,000 limit, while the amount of business in messages handled by the telegraph company for the railroad company was $83,342.17, or $8,342.17 in excess of the same limit, and that year the telegraph company paid the railroad company the difference between $57,349.02 and $8,342.17, or $49,006.85. It further appeared that the taxes which accrued under the construction imposed by the Commissioner of Internal Revenue from August, 1922, to January, 1923, were as follows:

August, 1922	$647.62
September, 1922	604.55
October, 1922	885.30
November, 1922	797.25
December, 1922	937.80
January, 1923	883.60
Total	4,756.10

Upon these facts we think that the telegraph messages were subject to the tax imposed by section 500 in each law. We think that the messages were charged for in the sense of that section, and that article 9 of the Regulations No. 57 of the Treasury Department was a proper regulation to carry out the statute with reference to such a contract as this. The method adopted for the mutual charges was an agreement between the companies that up to a certain amount they were willing to run the risk that the compensation to be paid by each for the service of the other would not average more than the same sum. The contract was a contract for many years, the amount of the service on the one hand and on the other might vary from year to year, but year in and year out the two companies felt that $75,000 would be a safe sum for both. In exceptional years if either had the advantage beyond $75,000 this should be made up for by the actual payment of cash for the excess of the party earning it.

In argument, extreme instances for a single year were supposed such that as between the two contracting parties no transportation would be furnished and so no compensation would be received by the telegraph company for the messages actually sent by it. Such a hypothesis is not a test of the actual equilateral character of the contract in its reciprocal obligations. Seventy-five thousand dollars, in the experience and judgment of the parties, measured the probable annual need of each for the service of the other. This was deemed a fair balance between the two, agreed upon for their mutual convenience of settlement. The contract was made long before the income tax was imposed, and we must treat it as having been the result of transactions of previous years and justified by similar experiences of other railroads and telegraph companies. Such contracts between railroads and telegraph lines were and are very frequent. (*Postal Telegraph & Cable Co.* v. *Tonopah Railroad Co.*, 248 U. S., 471.) The payment of charges for telegrams or shipments or other services was a mere substitute for the payment of the money down at the time each message was sent or each shipment made or other service was performed. Certainly no one would say that because a patron of the telegraph company paid his bills once a year, it rendered them free from taxation. The arrangement here is not substantially different. The payment for the messages, i. e., the charge for them to satisfy the statute, should be for money or money's worth, and that is what we think this contract in its ultimate and general result amounted to.

Some elaborate arguments have been made against this conclusion. The circuit court of appeals' view was that this was a mere swapping of free privileges and was not a service for a money charge. We do not think the privileges were free. We think that the one for messages was set off against the one for transportation, and that the one paid for the other.

The counsel for the respondent insist that our decision in *Postal Telegraph & Cable Co.* v. *Tonopah & Tidewater Railroad Co.*, supra, is inconsistent with our present conclusion. That case concerned the right of telegraph companies to recover against railroad companies for telegraph messages on contracts like the one here in question. The defense was that such contracts for an exchange of service, while valid under the interstate commerce law for messages and transportation on or along the line, were invalid as to messages or transportation service beyond the railway lines. The Interstate Commerce Commission had held that such extras must be charged for by the railroad upon the basis of its published rates, and by the telegraph company upon reasonable rates as charged to other customers for similar service. It arose under the amendment to the Interstate Commerce Act of June 18, 1910 (ch. 309, sec. 7), which, in bringing in under the interstate commerce law telegraph and telephone and cable companies, provided "that nothing in the Act should be construed to prevent telephone, telegraph and cable companies from entering into contracts with common carriers for the exchange of services." It was held that this proviso was general enough to allow an exchange of services off the lines as well as services on them to be exchanged. The court said that the railroad and telegraph had grown together in mutual dependence and that contracts of this sort for long terms had been nearly universal for 50 years, that as it was feared that such contracts would be unlawful if the telegraph companies were brought within the law, the amendment of 1910 was passed. This court's conclusion was that under the contract all the great benefits on one side were consideration for all those conferred upon the other, and that Congress probably allowed the exchange because it had been frequently advised by the commission that full

performance of the exchange would not affect any public or private interest adversely. Speaking of the meaning of exchange, the court said (p. 474):

"But 'exchange' is a barter and carries with it no implication of reduction to money as common denominator. It contemplates simply an estimate, determined by self-interest, of the relative value and importance of the services rendered and those received. This is admitted with regard to services on the line, and if so whatever services can be exchanged, can be exchanged in the same way."

This language is thought to show that the use of transportation service as a consideration for telegraphic messages could not properly be regarded as the equivalent of a money payment necessary to meet the requirement of section 500 as a basis of taxation. We do not think the case or the language quoted apposite. The court in the opinion cited was merely deciding what the general expression exchange of service meant, and whether it must be narrowly, meticulously, and rigidly construed exactly to conform to the general rule that all rates of tariff on the same class of service should be uniform. This court was merely pointing out that in allowing a general exchange of service between two such partners as a railroad and a telegraph company, Congress did not intend to enforce the uniformity rule strictly and require a nice mathematical or monetary equivalence between the exchanged services. The issue here is different. It concerns a tax upon telegraph messages paid for by transportation, and the question is whether such payment is a charge which can be measured, or measures itself, in money. The most significant evidence that it is appears in the conduct of the parties themselves, for in their exchange of such services they make actual payments to each other in money above a certain amount of business, which amount itself they determine by a carefully kept account of actual services in money figures.

A lengthy argument is made that the Revenue Act and the Interstate Commerce Act are *in pari materia* and therefore that the word "charge" in the Revenue Act should be controlled by the meaning of the same word in interstate commerce legislation, which it is said it could not be satisfied by a mere exchange of service. We think this is a far cry to the proper meaning of section 500 in imposing a tax, and do not think its correct interpretation is thus assisted.

Then it is said that paragraph (c) of section 501 of the Act of 1918 prevents the imposition of this tax. That paragraph is as follows:

"(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 reasons, 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 the 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 transportation 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."

Regulations No. 49, issued by the Internal Revenue Department to carry out this paragraph, was as follows:

"If a telegraph or telephone line or lines along the line of a railroad company be necessary for the use of such railroad company in the conduct of the railroad company's business as such, and if the railroad company, under contract, transports commodities necessary to maintain or operate such telegraph or telephone line or lines along the line of such railroad company, such commodities being intended to be, or having been so used, and the railroad company makes

no charge for such transportation, the charges which, but for such arrangement, would have accrued upon such transportation are exempt from the tax."

Paragraph (c) of section 501 is only to be found in the Revenue Act of 1918 and could not affect the validity of any taxes at issue in this case after August, 1922, when the Revenue Act of 1921 became applicable. In the next place, paragraph (c) with the enforcing regulation No. 49 has no application to the payment of taxes on telegraph messages. It is dealing with the transportation of goods and commodities by common carriers and the tax on rates received from their carriage. The words used make this interpretation necessary and it is supported by the fact that when in the Revenue Act of 1921 the taxes on freight and express shipments were repealed, this paragraph (c) was also repealed, though the tax on telegraph messages was retained.

It is true that this result leaves a tax on the telegraph messages in the exchange of services and exempts receipts on the transportation side of the exchange. But Congress did not fix its taxes with reference to the particular phase of this contract by which charges for messages are balanced against those for transportation, and doubtless had satisfactory reasons for exempting the one and not the other. The difference furnishes no ground for varying the meaning and scope of section 500(f) or its application to the telegrams which were exchanged for the exempted transportation.

For the reasons given, the judgment of the circuit court of appeals is reversed and the judgment of the district court is restored.

REGULATIONS 57, ARTICLE 9: Messages transmitted under contract. VI-37-3431 T. D. 4083

TRANSPORTATION TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. TELEGRAPH MESSAGES—EXCHANGE OF SERVICES.

Telegraph messages transmitted for a railroad company under a contract for mutual exchange of services are subject to the tax imposed by subdivision (a) of section 500 of the Revenue Act of 1921. The charge for the telegraph service at regular commercial rates, as provided in the contract for the maximum of exchange service, is the proper measure of the tax, even though the railroad company did not render the maximum amount of service to which the telegraph company was entitled under the terms of the contract.

2. DECISION FOLLOWED.

The case of *Hellmich* v. *Missouri Pacific Railroad Co.* (273 U. S., 242, T. D. 4040 [page 305]) 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 Second Circuit in the case of *The Delaware, Lackawanna & Western Railroad Co.* 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 August 30, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

The Delaware, Lackawanna & Western Railroad Co., plaintiff in error, v. *Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, defendant in error.*

[May 10, 1927.]

OPINION.

Writ of error to the District Court for the Southern District of New York. Suit to recover a tax paid under protest. Judgment for defendant; plaintiff appeals. Affirmed.

Per curiam: The decision in *Hellmich* v. *Missouri-Pacific R.*, decided by the Supreme Court February 21, 1927, construed sections 500–1(2) of the Revenue Act of 1918 and the Revenue Act of 1921 and held that article 11 of the Treasury Regulations No. 57 was properly promulgated by the Treasury Department. The court held that charges for telegraph service paid for by transportation service by the railroad company were taxable under section 500, and the Treasury Regulations No. 57 was proper to carry out the terms of the statute with reference to such a contract; also that it provides the proper method of measuring the charge for the messages.

We do not find that the case at bar is so different in its facts as to make the principle announced in the Missouri-Pacific case inapplicable. The plaintiff in error attempts to distinguish this case from that upon the claim that the messages were not actually paid for at the regular commercial rates because the full transportation received from the railroad company for the year 1921 was only $18,135.76. And it argues that in the Missouri-Pacific case the facts show substantial equivalents in value of free transportation service exchanged for free telegraph service. In the contract for such service the parties agreed to certain benefits moving from the railroad company to the telegraph company, such as the use of its right of way, and these must be considered as exchanged for the benefits moving from the telegraph company to the railroad company. There was the obligation to convey messages up to a maximum amount and these were paid messages. But it is argued that it is impossible to reduce to terms of money the consideration paid for such messages; however, the contract agrees that messages should be charged at regular rates in determining the maximum. The consideration moving from the railroad company was deemed worth the messages paid at commercial rates until the maximum allowance was reached.

We hold that the railroad company had, in fact, sent messages and paid for them in money's worth and, pursuant to the decision in the Missouri-Pacific case, Regulations No. 57 properly measures the price paid for these messages and the tax assessed pursuant to this regulation is proper. The fact that the method of calculating the consideration in this contract is different from that involved in the Missouri-Pacific case does not change the rule there applied. The purpose of each contract was to secure telegraphic services and transportation facilities upon terms which seemed most satisfactory to the contracting parties, each side obtaining an equivalent for what it gave. (*Postal Telegraph & Co.* v. *Tonopah & Co.*, 248 U. S., 471.) Under Articles V and IX of the contract, there was no limit to the exchange of service on the lines of the railroad, either by the railroad or by the telegraph company. The railroad company did not give services free and it paid for telegraphic services. We must assume that it was paid for in proportion as it was received.

The judgment is affirmed with costs.

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-52-3557 T. D. 4111

TRANSPORTATION TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. TRANSPORTATION OF OIL—PRIVATE CARRIER.

Under subdivision (d) of section 501, the tax imposed by subdivision (e) of section 500 of the Revenue Act of 1918 applies to the transportation of oil by a producer which owns its own pipe line through which it transports exclusively its own oil from its producing wells 8,000 feet to the main line of a railway company for transportation by rail.

2. DECISION FOLLOWED.

The decision in the case of *Motter* v. *Derby Oil Co.* (16 Fed. (2d), 717) (T. D. 3965 [C. B. VI-1, 294]) 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 District Court of the United States for the Western District of Louisiana, Shreveport Division, in the case of *Dixie Oil Co., Inc., plaintiff*, v. *United States of America, defendant*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 20, 1927.

A. W. MELLON,
Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF LOUISIANA, SHREVEPORT DIVISION.

Dixie Oil Co., Inc., plaintiff, v. *United States of America, defendant.*

[October 22, 1927.]

OPINION.

DAWKINS, J.: This is an action to recover money alleged to have been unlawfully collected of petitioner as taxes upon the transportation of oil by pipe line. Plaintiff owns a tract of some 700 acres of land in the parish of Caddo, Louisiana, upon which it has a large number of producing oil wells. Oil from these wells is first pumped into settling tanks on the property and thereafter through a pipe line some 8,000 feet in length to the main line of the Texas & Pacific Railway Co. When tank cars are available the oil goes into them direct from the loading rack, but when such facilities can not be had it has a tank of some 55,000 barrels capacity situated adjacent to the right of way, into which the oil is pumped to be held until cars can be furnished for its transportation by the railroad. The collector of internal revenue determined that the transporting of the oil through the 8,000 feet of pipe line to the railroad rendered petitioner liable to the payment of the tax imposed by sections 500 and 501 of the Revenue Act of 1918 (40 Stat. L., 1057, 1101, 1102), and accordingly collected of the plaintiff the sum of $5,329.77 as such, which was paid under protest and this suit instituted for recoupment.

The contention of plaintiff is that the pipe line in question constitutes merely a part of its production facilities and does not fall within the contemplation of the statute, whereas the Government claims that the law imposes the tax upon all transportation of oil by pipe line, in language which is plain, unambiguous, and requires no construction.

The jury was waived and the case has been submitted upon an agreed statement of facts, which is substantially as above stated. Plaintiff handles its own oil exclusively and argues that the situation is no different to what it would be if its oil-producing lands adjoined the right of way of the railroad company and it pumped the oil into cars or tanks, just as is now done after it passes through the 8,000 feet of pipe line. In other words, that what it does is nothing more than to gather or deliver the oil to the carrier upon its right of way, where the act of transporting first begins. It asks, in effect, Could the tax be collected if, instead of using the pipe line, it had hauled the oil from its settling tanks in its own trucks and delivered the same to the railroad? It occurs to me that this is a begging of the question. In the first place, the law imposes the tax upon a certain method of transportation, i. e., by pipe line, in which that by truck is not included. It is admitted that the pipe line companies (common carriers) operating independently of the large producers like the plaintiff, have gathering branches running into the oil fields to take care of the production of producers who do not have their own facilities for either transporting it to the main trunk lines of the pipe line companies or to the railroads and that an additional charge is made for this service, as well as for the use of loading racks, etc., and upon which charges the law imposes the tax that must be paid by the purchaser, or, which is the same thing, if the oil is purchased at tanks upon the property, these charges are taken into consideration as well as the amount of the taxes in the price paid for the oil. In any event, the tax comes out of the pocket of the producer. Hence, if the producer who is fortunate enough to own these facilities for the handling of his own oil is not liable for the tax, then he enjoys just that much advantage over the one who does not and discrimination becomes apparent. It would seem that Congress took cognizance of this situation when it added a new subparagraph by the Act of 1918 to the provisions of the Revenue Act of 1917, which is subdivision (d) of section 501, reading as follows:

"(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."

This clause appears to be plain and emphatic in its application to "all transportation of oil by pipe lines." It recognizes the existence of a situation identical with the one here—that is, that the producer who owns his own pipe line facilities and transports alone his own oil will not have established rates and the Commissioner of Internal Revenue in such circumstances is authorized to determine the tax by ascertaining what is paid for the same service in "like" circumstances in the same vicinity.

I do not think the court would be justified in reading into the statute an exception which it not only does not contain but which Congress evidently intended to avoid by requiring the payment of the tax upon "all transportation by pipe lines," including cases where the oil and the pipe line are owned by the same person and no transportation charge as such is made. See *Motter, Collector, v. Derby Oil Co.* (16 Fed. (2), 717). It is true that in the case just cited the oil was gathered in the field and transported by the pipe line a distance of some 30 miles to the refinery and in addition to that owned by the taxpayer it purchased from others oil which it also transported to its said refinery; but, in my opinion, this does not distinguish the case from the one at bar, for the reason that the great bulk of the oil was owned by the Derby Oil Co. and the transportation tax was held to be due upon all of it. I do not think that the length of the pipe line or the fact that in the present case there was an additional transportation by rail afterwards can affect the situation. The amount collected was the tax imposed upon the determined cost of transporting and

loading of the oil upon the cars of the railroad company and did not include the cost of transportation from that point to destination, which was the refinery of the Standard Oil Co. of Indiana, situated in that State. It is a difference only in degree and not in principle.

For the reasons assigned there should be judgment rejecting the demand of the petitioners. A decree in accordance with these views may be presented. Requests for specific findings of fact and law have been filed by the plaintiff and appropriate rulings have been indorsed thereon.

SECTION 503(c).—CASUALTY INSURANCE.

REGULATIONS 58, ARTICLE 18: Scope of tax. VI–42–3476
T. D. 4096

PREMIUM TAXES—INCOME TAX—CAPITAL STOCK TAX—REVENUE ACTS OF 1917 AND 1918—DECISION OF COURT.

1. ASSOCIATION—RECIPROCAL OR INTERINSURANCE CONTRACTS.

A number of persons acting through an attorney in fact to provide among themselves insurance or indemnity to each other through the medium of reciprocal or interinsurance contracts constitute an association within the meaning of the Revenue Acts of 1917 and 1918 which is liable for the taxes on the issuance of insurance policies, the income tax, and the capital stock tax imposed by those Acts.

2. JUDGMENT REVERSED.

The judgment of the district court (12 Fed. (2d), 998) reversed.

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 *John L. Pickering, plaintiff in error*, v. *Alyea-Nichols Co., defendant in error, United States of America, plaintiff in error*, v. *Alyea-Nichols Co., defendant in error*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved October 12, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

John L. Pickering, plaintiff in error, v. *Alyea-Nichols Co., defendant in error.*

United States of America, plaintiff in error, v. *Alyea-Nichols Co., defendant in error.*

Error to the District Court of the United States for the Southern District of Illinois, Southern Division.

[July 22, 1927.]

OPINION.

Before ALSCHULER, PAGE, and ANDERSON, Circuit Judges.

The judgments assailed by these writs are for $46,402.03 and $11,912.06, respectively, both including interest, for refund of taxes held to have been unlawfully levied and collected by the United States.

The cases were tried together, in the district court, where jury was waived, and heard together here. The actions were in assumpsit, the first brought against Pickering, former collector of internal revenue, to recover taxes assessed by Commissioner of Internal Revenue against "The Belt Automobile Indemnity Association," being (a) taxes on issuance of insurance policies under section 504, Revenue Act 1917, issued in December, 1917, January to December, inclusive, 1918, and January to April, inclusive, 1919; and under section 503, Revenue Act 1918, for May, 1919, to April, 1921, inclusive, amounting to $33,059.24; (b) income taxes for years 1917, 1918, 1919, and 1920, amounting in all to $678.77; and (c) capital stock taxes from July 1, 1918, to June 30, 1921, amounting to $126. The other action was brought under the "Tucker" Act against the United States to recover taxes likewise assessed by Commissioner of Internal Revenue against the Belt Automobile Indemnity Association, being taxes on issuance of insurance policies for May to November, inclusive, 1921, $8,755.67; income taxes for 1920, $630.02; and capital stock tax, July 1, 1921, to June 30, 1922, $48.

The plaintiff in each action described itself as an Illinois corporation suing "as attorney in fact for the subscribers at Belt Automobile Indemnity Association, an interinsurance exchange organized and existing under and by virtue of the laws of the State of Illinois."

Beginning in 1915, contracts of automobile insurance under what is called the interinsurance plan were put out through these attorneys in fact, or their predecessors, under authorization by the insurance department of Illinois. The statute authorizing this to be done was section 13½ (adopted in 1912) of the so-called mutual casualty act of Illinois, the authorizing proviso of which is: "*Provided, however*, That the insurance superintendent may authorize individuals, firms, and corporations, by themselves or their attorney in fact, to provide among themselves insurance or indemnity to each other, of the kind provided for in this act, through the medium of reciprocal or interinsurance contracts, if, in his opinion, the plan proposed and the financial strength of the parties in interest will properly safeguard the interest of the insured."

It appears no general regulations thereon were promulgated by the insurance department, but that all plans for such insurance were required to be submitted to and approved by the department before business thereunder could be transacted. Practically all of the business involved in the first suit was transacted under this statute. The forms of power of attorney and application for insurance, and of the contract, approved by the insurance department, indicate the nature of the transactions thereunder and the relations between the subscribers with each other and with the attorney in fact.

The form of the power of attorney and application is:

"The association will not accept application for any kind of insurance on a taxicab * * *."

"At the Belt Automobile Indemnity Association of El Paso, Ill., U. S. A."

Subscriber's power of attorney and application:

"The office of the Alyea-Nichols Co. in El Paso, Ill., having been selected by automobile owners as a place at which they may exchange contracts of insurance, such place being designated as 'The Belt Automobile Indemnity Association,' I, as a subscriber thereat, hereby appoint the Alyea-Nichols Co. my attorney in fact with power to substitute any other person or persons that said attorney may select, subject to the approval of the advisory committee.

"Said attorney shall exchange for me with other subscribers at said association, contracts of insurance, and shall have power to make, issue, change, modify, reinsure or cancel contracts containing such terms, clauses, conditions, warranties and agreements as said attorney shall deem best (provided, however, my attorney shall not make me jointly liable with any other subscriber, but shall bind me separately and alone, and for not more than my pro rata share on any one contract); to demand, collect, receive and receipt for all moneys due me, or for credit to my account as a subscriber; * * * to accept service of process and appear for me in suits, actions, or proceedings under contracts issued at said association, and bring, prosecute, defend; * * * or adjust same; to perform every act not herein mentioned that I could myself do in relation to any contract hereby authorized.

"Said attorney is hereby further authorized for me to execute * * * documents and to do any acts necessary to effect compliance with the laws of any State * * * with respect to the exchange of insurance * * * also, to appoint the insurance superintendent * * * of any State my agent on

whom service of process may be had in any suit, * * * brought under any policy issued at said association. There shall be no joint funds, capital or stock, but my attorney shall keep a separate account open to my inspection of all moneys paid by me as a result of this instrument.

"An advisory committee consisting of five subscribers to act for one year shall be selected at each annual meeting of subscribers; * * * If a member of the advisory committee shall cease to keep his insurance in force at the association, he shall cease to be a member of such committee, and the remaining members thereof shall have power to fill the vacancy.

"The attorney in fact shall receive as compensation the three years application fee * * * also a transfer fee of $1 * * * each time my policy is transferred from one automobile to another owned by me; and 10 per cent commission on all other money deposited or paid by me on account of this contract. From the compensation above provided, said attorney shall pay all expenses incident to the conduct of said association, except the items hereinafter mentioned.

"For the payment of losses, legal and adjustment expenses, insurance department fees and charges, taxes, premiums on surety bonds, and stationery and postage for collecting subscribers' deposit, I agree to deposit with the attorney in fact, from time to time, when called for by said attorney, a sufficient sum of money to pay my equitable proportion of the items last mentioned. From the gross amount of such deposits so made, my attorney shall pay said expenses, charging each subscriber's deposit with his equitable share thereof. The attorney in fact is also to be allowed, as part of its compensation as above provided, 10 per cent commission on all deposits made by me under this provision. Any subscriber failing to deposit the amount called for by the attorney within * * * shall forfeit all his rights as a subscriber at said association so far as losses subsequently incurred by him are concerned * * *.

"Subscribers' deposits shall be kept in banks, or invested in securities, approved by the advisory committee, and all disbursements therefrom shall be by check of the attorney in fact. * * *

"This instrument may be revoked * * * by either party giving to the other five days prior notice in writing, * * *. Thereupon, my attorney shall cancel all unexpired insurance granted by me, or to me, under this instrument, liquidate my account, and return to me my unused deposits, less the 10 per cent commission thereon * * *.

"Application fees for three years—fire and theft, $7.50; collision, $7.50; liability and property damage, $7.50.

"The undersigned * * * hereby subscribes to the above agreement and makes application for insurance for a period of three years at the Belt Automobile Indemnity Association, located at El Paso, Ill. * * * For the purpose of obtaining insurance, I warrant * * * to be true, and my insurance hereby applied for is to be considered as subject to said warranties. * * *

"I agree that the association is not bound by any knowledge of a statement made to or by any agent or solicitor * * *.

"ADVANCE PREMIUM VOUCHER.

"Amount of advance premium collected_____
"Reduction for commission_____
"Net amount forwarded with application_____ "

The contract or policy form is:

"Subscribers at the Belt Automobile Indemnity Association, El Paso, Ill. (herein called 'Association')

"Do hereby severally agree to indemnify * * * on the automobile described * * *

"Against actual loss or damage * * * in an amount not to exceed —— dollars. * * *

"The maximum amount of insurance collectible under this policy shall not be in excess of the following scale: * * *.

"On an automobile on which the association allows a special amount of insurance * * *.

"Each month the association's liability shall automatically decrease * * *:

"Provided, * * * there shall be deducted the sum of $25 and the association shall be liable for the loss in excess of that amount only * * *.

"The subscriber suffering loss * * * shall immediately notify * * * the attorney in fact of this association. The association shall be allowed 60 days * * * to find or locate the automobile * * *. If the property stole * * * shall be paid for as a total loss and * * * be subsequently found and recovered, it shall become the property of the association and shall be sold by the attorney for the best price obtainable and the proceeds credited to the individual accounts of the proper subscribers. * * *

"The association shall not be liable on any such collision claim for any amount in excess of the following scale: * * *

"On an automobile on which the association allows a special amount of insurance * * *

"Property damage.—The liability of this association for loss or damage described in this clause is limited to not more than $500 for any one accident. * * *

"Defense.—The association will also defend in the name and on behalf of the subscriber or other person or persons covered, any suits, even if groundless, brought against the subscriber or other person or persons covered * * * where the loss sustained by subscriber * * * would be covered by this policy.

"Costs.—In addition to the coverage granted above, the association will also pay the costs and expenses * * * in any legal proceeding defended by this association * * *

"The association shall not be liable beyond the actual cash value of the automobile destroyed * * * the sum for which this association is liable pursuant to this contract shall be payable 60 days after due notice * * * received by the attorney * * *

"It shall be optional, however, with the association to repair, rebuild or replace said automobile * * * but there can be no abandonment to the association of the said automobile.

"The entire policy shall be void * * * if the interest of the subscriber in the subject of this insurance be other than unconditional * * *

"The subscriber * * * shall immediately forward to the attorney every notice * * * or other process served upon them on behalf of third persons, when the association will, at its own cost, defend in the name and on behalf of the subscriber * * * covered by this policy.

"Cancellation.—This contract may be canceled by either of the parties upon giving five days prior written notice to the other * * *. Notice of cancellation * * * to * * * address as shown by the records of the association, shall be sufficient notice.

"Method of recovery.—In the event of litigation, to avoid a multiplicity of suits, no suit or other proceeding at law or in equity shall in any event be begun or maintained for the recovery of any claim upon or by virtue of this contract against more than one of the subscribers at this association at any time, nor in any court other than the highest court of original jurisdiction, and the process in such suit or proceeding, wherever filed, shall be served at least 10 days prior to the first day of the term of court to which is returnable upon the attorney in fact in El Paso, Ill., or elsewhere, or upon the insurance superintendent or corresponding official of the State where the suit is filed, appointed by the attorney in fact as agent for such service of process, and the final decision in such suit or other proceeding shall be taken to be decisive of a similar claim so far as the same may subsist against each of the subscribers at the association absolutely fixing his liability in the premises, and the final judgment in such suit or other proceeding shall be enforceable against the funds of the subscribers liable therefor, deposited by them with the attorney in fact, or advanced by such attorney in fact as guarantee fund. Each of the subscribers at the association, in consideration of this entire stipulation, so far as he individually is or may be concerned, expressly agrees to accept and abide by the result of such final decision in the same manner and to the same effect as if he had been the sole defendant in a similar suit or proceeding as to a similar suit against him so far as the same may subsist, save and except, however, as to the matter of costs and disbursements, and the attorney is hereby authorized as to each subscriber at this association to receive and admit service of process in any suit or other proceeding begun and maintained as aforesaid.

"Subrogation.—Upon payment of any loss the association shall be subrogated to the extent of such payment to all rights of recovery by the subscriber

against any third party, firm or corporation, and the subscriber shall fully cooperate with the association to secure to it such rights. The association may take over and conduct in the name of the subscriber the defense or prosecution of any claim or suit for indemnity, damages or otherwise against any third party, firm or corporation.

"Character of association.—The subscribers at the Belt Automobile Indemnity Association are individuals, firms, or corporations that have each executed an agreement (hereby made a part hereof) which vests in the Alyea-Nichols Co., herein called 'attorney,' power to issue this contract for them. It is understood and agreed that there is assumed by each subscriber, severally, and not jointly with any other subscriber, a portion of the aggregate liability hereunder not in excess of his equitable pro rata share thereof, considering the aggregate amount of all deposits, made for the period in which the loss may occur, by subscribers carrying the same kind of insurance at the association at the time of the loss.

"Any subscriber failing to deposit the amount called for by the attorney within 30 days from the date such call is mailed, directed to him at his last known address as shown by the records of the association, shall forfeit all his rights as a subscriber at said association so far as losses subsequently incurred by him are concerned; provided, he may be reinstated within such time and for such period and on such terms as may be stipulated by the attorney in fact; and provided further that all losses and claims arising or occurring, or all accidents happening after such forfeiture of subscriber's rights and prior to date of reinstatement shall not be covered or allowed by said association.

"In witness whereof, the subscribers at the Belt Automobile Indemnity Association have caused these presents to be signed by their attorney at El Paso, Ill., * * *

"Important.—Read your policy. * * * Notice to an agent is not notice to the association."

Section 13½ was repealed by the act entitled "An act concerning the business of reciprocal or interinsurance" in force July 1, 1921. This act made specific provision for doing substantially those things embodied in the above recited power of attorney, application, and contract in the manner therein specified; and these continued to be the same after as before the adoption of the act, so that the relations of the parties were not thereby materially changed, and the same forms continued to be used.

The new act made provision for a minimum number of subscribers to entitle such a company to do business, and for a minimum amount to be on hand before the company started business, and for a reserve, to be maintained at certain relation to the liability, but these things were substantially required by the department before the passage of this act as a condition for transacting business, and all these requirements were met by this concern.

ALSCHULER, Cir. J.: As to the facts there is no controversy. The taxes in question were assessed by the Internal Revenue Commissioner, and on his imperative demand paid by or through defendant in error as agent, attorney in fact, or trustee, and in the same capacity it seeks refund. Under the circumstances it alone could and did produce the funds required to pay these taxes, and if they were unlawfully levied the Government is in no position to narrowly question the right of defendant in error to maintain the suits for refund; and its contention that defendant in error has no right or title to maintain the suits is not sustained.

For defendant in error it is contended that even if the Government was entitled to the taxes—especially the policy issuance tax—it was not entitled to them from the Belt Automobile Indemnity Association, in which name the assessment was made, and that therefore the assessment and collection were void. Passing the Government's contention that no assessment was necessary, we are not impressed by the force of the suggestion that the name in which the assessment was made did not indicate who was, in fact, the taxpayer. If the taxes were payable, and were paid, it is of small concern whether the correct name or capacity was employed. Names alone can not serve to change actual conditions or to defeat lawful rights.

Tax on issuance of insurance policies constitutes the large bulk of the demand in each case. Section 504 of the Revenue Act of 1917 provides for levy and collection of "the following taxes on the issuance of insurance policies: * * * (c) Casualty Insurance: A tax equivalent to 1 cent on each dollar or fractional part thereof of the premium charged under each policy of insur-

ance or obligation of the nature of indemnity for loss, damage, or liability * * * issued or executed or renewed by any person, corporation, partnership, or association, transacting the business of * * * automobile, or other branch of insurance * * *."

Section 505 makes provision for "every person, corporation, partnership or association, issuing policies of insurance upon the issuance of which a tax is imposed by section 504" to make monthly return of and pay such tax.

The Revenue Act of 1918, in somewhat different arrangement and wording, is to same effect.

Apart from the exception in case of insurance by fraternal societies having lodges, and the like, the sections are all inclusive, and the only question respecting these policy taxes is whether this concern falls within them.

It is the contention of defendant in error that "Belt Automobile Indemnity Association" indicated merely a place, and that the "subscribers" constituted neither a corporation, association, nor insurance company, nor body of any kind; and much of the briefs on both sides is devoted to the proposition whether or not this is an association. The many cases cited on the subject of what does or does not constitute an association within the meaning of various statutes of different States are not particularly helpful here. We are of opinion that the Revenue Act does not employ the term in any narrow or technical sense. It is defined in Black's Law Dictionary: "The act of a number of persons who unite or join together for some special purpose or business. The union of a company of persons for the transaction of designated affairs, or the attainment of some common object. An unincorporated society;" and in Bouvier's Law Dictionary: "The act of a number of persons in uniting together for some purpose. The persons so joining."

If, in the transaction of this business, the subscribers were associating, or coacting or cooperating in any way to carry it on, they constituted an association, within the meaning of the Act; and this quite regardless of what, as between themselves, or between them and their attorney in fact, the contractual or financial or bookkeeping arrangements were.

Without such coaction or cooperation it is more than apparent this large business could not have been created. The statement sets out quite fully the instruments whereunder the subscribers are acting through their "attorney in fact." Let us assume there are, say, 50,000 subscribers in this so-called "exchange." It would be a practical impossibility for each to act for himself. There must not only be a common plan, but a coordinating agency. If each of the 50,000 undertook to make with the others such indemnity contract as he saw fit, each unrelated to the other, and without preconcerted uniformity of purpose and plan, nothing could possibly have been achieved. If all should meet together and agree upon a plan and carry it out through successive meetings, there would clearly be an association of the individuals. If each one constituted a different person as his attorney in fact, to act for him in the matter of granting and receiving indemnity, and these cooperate accordingly, the various attorneys, for their principals, would be associated for such purpose and it would be an association of individuals acting through their attorneys. Is it any the less an association if each subscriber appoints and constitutes the same person as his attorney in fact, and the business is conducted through this attorney? He is none the less the agent for each of the others, and it is they, through the attorney, who are agreeing upon the form of application and power of attorney, and of the contract of indemnity, and all of the various steps and acts necessary to build up such comprehensive and extensive business of insurance. The fact that the attorney is the same in each case makes it none the less an association of the various principals acting through the attorney. Through this attorney the principals cohere in the inauguration and continuance of the common plan, to which each of the subscribers is committed by his application, power of attorney, and contract of indemnity. New subscribers become part of the association.

To constitute an association within the meaning of the Act it is not requisite that each constituent should be coordinate or hold the same relation. A very important and indispensable element here is the so-called attorney in fact, who is not merely and simply an attorney in fact as ordinarily understood. With the attorneyship there is coupled a decided interest which permeates and colors the entire plan. It is the attorney who in practice and by contract inspires and dominates it, and around whom the business is built. His power is irrevocable. He is not removable, and his power of substitution is limited only by a veto of a so-called "advisory committee" which the subscribers annually choose, and which has practically no other material function save the investment of funds by

the attorney is with the advice and consent of the committee. The attorney has absolute power over who may be accepted as subscribers; what the rates of indemnity shall be; what the subscribers must pay from time to time (limited, presumably, by the necessities of the concern); the cancellation of contracts, and thus the ending of the subscriber's relation; the settlement and payment of losses, compromise of claims, and, in practical effect, every power of a corporate board of directors, plus many important powers which such boards do not have.

The attorney receives for his services in his controlling capacity of permanent and irremovable manager of the concern, from each subscriber on his application for insurance whereby on acceptance he becomes a subscriber, $7.50 for each one of the three classes of insurance which may be applied for. This is an "application fee." He also receives $1 for each transfer of the insurance to another automobile of the same owner; also 10 per cent of all assessments or premiums or deposits by the subscriber, under whatever name made. True, the expenses of the office, and of obtaining the insurance, are paid therefrom; but the losses, expenses of investigation, attorneys' fees, and all other expense, including taxes, are paid from the 90 per cent.

It is thus apparent that this functionary is far more than an attorney in fact. He is the very pulsating heart of the concern, the subscribers supplying the blood. This is not said in derogation of the organization or of the plan, with the merits or demerits of which we are not concerned. It has evidently thus far proved successful—at least in the numbers of such organization in the many States which have authorized them, as well as in the number of subscribers—and for the purpose hereof its merit may be assumed. These conditions are pointed out to indicate that the subscribers and the so-called attorney are all cooperating together to make possible this result, all constituting an association without which the business would not exist.

From what appears we are satisfied this concern falls fairly within the designation of "association" as employed in the Act which imposes the tax.

But it is not essential that this thing be classified as an association in order to subject to tax its issuance of insurance policies. The statute also says "person." This, of course, includes the plural; and if these persons, whether or not technically constituting an association, issue insurance policies, whether unto themselves or to others, the tax is payable. So if we treat all the participants as persons transacting the business, the Act subjects them to the tax.

Perhaps what has been said sufficiently answers the earnest contention which defendant in error makes that Belt Automobile Indemnity Association is but the name of the place where the business is transacted, and in no sense the name of an organization or association of the subscribers; but again we say the name is not material. The right to tax does not depend upon the name. The taxable concern may have any name, or no name at all. The Illinois statute of 1921, section 3, on the subject of interinsurance, requires that there be "a name of, or designation under which such contracts are to be issued," and if the name indicated is not the name of this concern, it has no name. That a name would be a great convenience, and, indeed, is almost indispensable, is apparent from a reading of the instruments set out in the statement, where the concern is repeatedly designated as "Belt Automobile Indemnity Association" or "Association" without any reference to a place. At the very beginning of the power of attorney it is stated, "Association will not accept application," etc., and the contract is replete with references to what the association will and will not do, concluding with the statement that notice to an agent is not notice to the association.

It is further urged that the subscribers were each extending insurance to the others—that these are separate, individual transactions, in no way connected, and that what is paid by each subscriber is not a premium but an advance deposit against which is charged, from time to time, the subscriber's proportion of expense of the business and all losses paid to subscribers.

The contention is, in effect, that each subscriber issues, say, 50,000 separate, several, and distinct contracts of indemnity, for the fifty-thousandth part of the loss (if the policies and indemnity were all alike) accruing to any one subscriber, and that at most the individual alone would be liable for the tax on his separate undertaking. This might have force if, in practice, the policies were so issued and premiums and losses paid. But such is far from the fact. There is collected in advance a premium equal to the estimated cost to the subscriber of carrying the insurance for a stated period, and as this advance is used to pay losses and expenses, another premium is levied and collected for another stated period. If more is required, more is, from time to time, de-

manded; if less is needed, the demands are less. The amount is fixed by the controlling factor, the attorney, and if not paid the insurance ceases and the relations of the subscriber are terminated. When a loss occurs the attorney alone adjusts it and pays it in a lump sum out of the accumulated funds in his hands. Investments are made by the attorney, and reserves maintained out of the funds not immediately required, and from all outward indications the business is run by the so-called attorney in fact in the same general way as any large business would be run either by a corporation or by individuals. Indeed, in the issuance of policies and collection of premiums there is no great difference in principle between this and insurance of the most orthodox type. Premiums in the latter, it is true, are fixed, and there is an absolute assumption of liability, usually by a corporation, or it may be under some mutual form; but in the last analysis it is the premiums out of which the expenses and losses are paid; otherwise the concern must eventually quit. The fact that the business is or is not conducted for profit is of no importance on the proposition of taxation.

The utter impracticability of the 50,000 each undertaking independently to indemnify each of the others is so apparent as to dispel the conclusion that each subscriber is independently and unqualifiedly the indemnifier of all. Whatever the plan of bookkeeping may be, the premiums are paid in and received in their entirety, banked, invested, or otherwise held as a whole, and losses, expenses, and other disbursements undividedly paid without action by or reference to the subscribers, individually or collectively, or contributed by them other than their payment of premiums.

Asserting that the contract is but the individual undertaking of each subscriber, and that the subscriber is not "transacting the business of automobile insurance," the claim is made that therefore no tax accrued. It goes without saying that in the placing of this indemnity, involving in a few years several millions of dollars of premiums, a large business of insurance has been transacted, and some person, association, or corporation has transacted it and actually issued the policies and received the premiums. If the cooperative subscribers and the attorney have contrived to carry on and build up this very large business of insurance, and to issue these thousands of policies, the tax thereon may not be avoided on the plea that the participation of each subscriber was so slight that he can not be said to have transacted the business of insurance.

It is upon the *issuance of the policy*, or contract of indemnity, that the tax is imposed, the amount being measured by the premium paid. The policy or contract of indemnity was issued as an entirety by the central agency, and thus fixed the liability to taxation for issuance under the Revenue Act, and the amount of the tax payable was fixed by the premiums which were received through the same agency.

We find no merit in the contention that these are not premiums but mere advance deposits to insure payment of the subscriber's share of losses and expenses. This is, in effect, the basis of all insurance in one form or another, which is to distribute among the many the burden of losses accruing to the few. The liability to tax for issuance of the policy in no measure depends upon the time when the premium is paid, whether by way of advance deposit before the loss, or collected after loss occurs. It is payment made in consideration of the indemnity afforded, and is, in every fair sense, premium as that term is understood.

The power of attorney itself authorizes the attorney to pay "taxes" out of the premium receipts; presumably all lawful taxes, whether on the accumulated funds or property in the attorney's hands, or excise taxes such as might be levied on the issuance of policies; and presumably not taxes on 50,000 individuals, each on his individual contract to indemnify each or all of them. Even though the tax, when paid, would be apportioned among the several subscribers, its initial payment by the attorney was evidently contemplated by all concerned.

What has been said applies likewise to the other items in issue—income tax aggregating $1,309.79, and capital stock tax, $174 (both without interest). The income tax was on interest from the investments of the premium receipts and reserves, and the capital stock tax was on items on which, under the revenue law, an association would have been subject to the tax.

The judgment is reversed, and the cause remanded to the district court for further proceedings in harmony with these views.

TITLE VI.—TAX ON BEVERAGES. (1918)

BEVERAGES SOLD IN BOTTLES OR OTHER CLOSED CONTAINERS.

REGULATIONS 52(1919), ARTICLE 8: Basis of tax: Sale price. VI-30-3334 T. D. 4043

TAX ON BEVERAGES—REVENUE ACT OF 1918—DECISION OF COURT.

1. FREIGHT CHARGES.

Where beverages taxable under section 628(a) of the Revenue Act of 1918 are sold by the manufacturer with freight prepaid or are invoiced at a price less freight, the purchaser paying the freight at destination, deducting it from the amount of the invoice and remitting the remainder to the seller, such charges for freight are not a part of the price for which the beverages are sold.

2. DISCOUNTS.

Where such beverages are sold with the understanding that if paid for within a certain period the purchaser may take a cash discount, and the purchaser elects to take advantage of this provision of the contract of sale, the amount of such discount is deductible in determining the price for which the beverages are sold.

3. EXPENSES.

The cost of bottles and containers and the expense of bottling and packing, included in the price charged to and paid by purchasers for such beverages, are a part of the selling price upon which the tax is based.

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. Hungerford Smith Grape Juice Co.* v. *The United States* is published for the information of internal revenue officers and others concerned.

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

Approved July 18, 1927.

CARL T. SCHUNEMAN,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

J. Hungerford Smith Grape Juice Co. v. *The United States.*

[February 14, 1927.]

OPINION.

Moss, Judge, delivered the opinion of the court.

Plaintiff, J. Hungerford Smith Grape Juice Co., is engaged in the business of manufacturing unfermented grape juice for beverage purposes, which it sells at wholesale. The product is placed in glass containers of various sizes, which are packed in boxes, cartons, or other containers for delivery to its

customers. Its manufacturing plant is located at Lawton, Mich., and sales were made to customers throughout all parts of the country. All sales were made by plaintiff under agreement that the price should be 2 per cent less than the gross invoice if paid within 10 days. Deliveries were made in several ways: (1) In carload lots directly from factory to customer, in which case the goods were invoiced "less freight" and the freight was paid by the customer at point of destination, and the amount so paid was deducted from the invoice in making remittance to plaintiff; (2) by shipments in carload lots to certain distributing warehouses at convenient distributing points, from which deliveries in smaller quantities were made to customers within convenient range of the warehouse. In this class of shipment the goods were consigned to plaintiff in care of the warehouses, the freight was prepaid from the factory to the warehouse, and again from the warehouse to the customer; (3) in less than carload lots directly from factory to the customer, in which cases the freight was usually prepaid.

By section 628 of the Revenue Act of 1918, approved February 24, 1919, and effective February 25, 1919 (40 Stat., 1116), it was provided "That there shall be levied, assessed, collected, and paid in lieu of the taxes imposed by sections 313 and 315 of the Revenue Act of 1917—(a) * * * upon all unfermented grape juice, ginger ale, root beer, sarsaparilla, pop, artificial mineral waters (carbonated or not carbonated), other carbonated waters or beverages, and other soft drinks, sold by the manufacturer, producer, or importer, in bottles or other closed containers, a tax equivalent to 10 per centum of the price for which so sold." This Act continued in force from February 25, 1919, until December 31, 1921.

Following the enactment of this statute plaintiff was required to include transportation charges in the total amount of the invoice, and the 10 per cent tax was calculated on that total.

On May 3, 1919, the Commissioner of Internal Revenue promulgated regulations relating to the tax on beverages which provided that if goods were sold and delivered at a certain point, less freight to be paid by purchaser, the freight should be deducted before computing the tax. Thereafter no further tax of this character was demanded or paid. However, the Government continued to impose and collect a tax on transportation charges in all cases where the freight was prepaid by plaintiff at the factory.

It is plaintiff's contention that it was the intent and meaning of the Act above set forth to levy a tax upon the sales price of grape juice alone exclusive of transportation cost, and also exclusive of the value, cost, and expense of bottles and containers, and the expense of bottling and preparing the goods for shipping. Proceeding upon this theory, plaintiff filed with the Commissioner of Internal Revenue a claim for refund of tax collected on sums which included such items as the basis for the application of the 10 per cent tax, which claim was denied by the Commissioner.

With reference to plaintiff's claim with regard to transportation charges, we are of the opinion that it was improper to compute the tax on amounts including freight charges in either class of shipment. The price or return actually received by the manufacturer was precisely the same, whether the goods were invoiced at a price less freight, the customer paying the freight and deducting it from the amount of invoice, or whether the freight was prepaid by the plaintiff at the factory. In both cases the customer paid the transportation charges, and such charges did not constitute a part of the price for which the goods were sold. Plaintiff should recover on this item the sum of $9,044.94 with interest.

It was also improper to include in the total sum upon which the tax was computed the cash discount. Under the language of the statute "tax equivalent to 10 per centum of the *price for which so sold*," fairly construed, means the price fixed by agreement of the parties and paid to the manufacturer. In this case the manufacturer offered its goods at two prices, one being the regular selling price payable in 30 days, and the other being the regular selling price less 2 per cent if paid within 10 days. The customer could accept either price, and the acceptance of the latter proposal constituted the agreement between the parties as to the price for which the goods were sold. Plaintiff is entitled to recover on this item $4,011.22 with interest.

It is the opinion of the court that plaintiff's claim in the matter of cost of bottles and containers, and the expense of bottling and preparing goods for shipment should not be allowed. It is clear from the evidence, as shown by certain exhibits illustrating the type of invoice used by plaintiff, that all

expenses, including cost of bottles and containers, expense of bottling and preparing for shipment, were included in the price charged by plaintiff and paid by the customers. It is the judgment of the court that plaintiff herein recover the two items mentioned with interest. And it is so ordered.

REGULATIONS 52 (1919), ARTICLE 8: Basis for tax: Sale price. VI–51–3543 T. D. 4105

TAX ON BEVERAGES—REVENUE ACT OF 1918– DECISION OF COURT.

1. SALES TAX—MEASURE OF TAX.

Where a manufacturer of beverages, upon which sales taxes are imposed by Title VI, section 628, of the Revenue Act of 1918, sold and invoiced such product to his customers at a specific price with the understanding that the tax was included in that price, such price constitutes the measure of the tax.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the Court of Claims of the United States in the case of *Lash's Products Co.* v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 9, 1927.

A. W. MELLON,
Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

Lash's Products Co. v. *The United States.*

[November 7, 1927.]

OPINION.

GRAHAM, Judge, delivered the opinion of the court.

The plaintiff was a manufacturer and seller of certain so-called soft drinks and beverages. Sales were made to the retail trade, who were informed by the salesmen that the price of plaintiff's product would not be increased on account of the beverage tax imposed by the Revenue Act of 1918, but that the price would remain the same as before the Act was passed. Plaintiff's customers understood that it would pay the tax on beverages, and that they would not be billed therefor. During the period involved in the instant case the plaintiff received $2,475,031.44 from sales and paid to the collector of internal revenue 10 per cent thereof. This suit is brought to recover the sum of $22,500.03, with interest, upon the ground that in paying 10 per cent on the amount received from sales under the aforesaid arrangement with its customers it had paid a tax on a tax, and that the price at which its product was sold was not the price actually received from its customers, but that sum less the tax paid; that the product having been sold for $8, the 10 per cent tax paid amounting to 80 cents, the price the plaintiff received for its product was $7.20, and that it was only liable to pay a tax of 10 per cent on this latter sum.

The statute provides that the manufacturer shall pay "10 per centum of the price for which (the product is) so sold." The question involved is, What shall be taken as the selling price, the sum actually received or another sum less the tax paid?

The plaintiff contends that if the tax is levied upon the sum received it is being taxed upon a tax; that it pays not only a tax upon the sum received for

its product but also upon the tax paid on it. The defendant, on the other hand, contends that the "price" at which sold means what it says; that is, the sum actually paid by the buyer to plaintiff, the price which the plaintiff on its contract with the purchaser could collect from the purchaser. In the case of the *J. Hungerford Smith Grape Juice Co.* (63 Ct. Cls., 140), decided February 14, 1927 [T. D. 4043, page 322], this court, in passing upon the question whether goods sold with a discount of 2 per cent on the price if paid within 10 days were to be taxed on the billing price or the price less 2 per cent where the bill had been paid within 10 days, held that the manufacturer was only liable for tax on the price fixed by the agreement between the parties and paid to the manufacturer. The price was not determined until the buyer elected to pay in 10 days.

Plaintiff says in effect: "I billed the goods at $8, but I paid a tax of 80 cents, which is more than I should have paid, because as $8 embraced the tax, the tax being 10 per cent, the amount that I actually received could only be ascertained by dividing $8 by 110, or $7.263+, and the tax on this sum would be $0.726+, and as 80 cents was paid I have overpaid my tax by the difference between the last-named sum and $0.726+."

The regulation of the Commissioner of Internal Revenue allowed the plaintiff to either add the tax to the selling price or, if it intended, as in this case, to pay the tax, to bill the goods with the price and the tax stated separately, and of this regulation the plaintiff must be visited with notice. It was a reasonable regulation and intended to save time, labor, and complications on the part of both the Government and plaintiff. The plaintiff did not observe the regulation. It billed the goods at $8, received that amount in payment therefor, and paid the tax upon this basis during six months of 1919 and for the years 1920 and 1921; in all, 30 months. It is evident that plaintiff thought that the tax was to be levied upon the price at which it sold the goods and which the customer paid therefor, and we think it reached the right conclusion.

The petition should be dismissed, and it is so ordered.

TITLE IX.—EXCISE TAXES. (1918)

SALES BY THE MANUFACTURER.

REGULATIONS 47, ARTICLE 3: Basis of tax. VI–33–3375
T. D. 4060

EXCISE TAXES—REVENUE ACT OF 1918—DECISION OF COURT.

SALES TAX—BASIS OF TAX.

Where candy is sold at the price fixed by trade catalogues or price lists, the basis of the tax is the amount paid to the vendor by the purchaser without deduction of the 5 per cent tax paid by the manufacturer pursuant to section 900(9) 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 District Court of the United States for the Eastern District of Louisiana, New Orleans Division, in the case of *Elmer Candy Co.* v. *Fauntleroy, former Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 8, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF LOUISIANA, NEW ORLEANS DIVISION.

Elmer Candy Co., Inc., v. *John Y. Fauntleroy.*

[May 12, 1927.]

The plaintiff corporation is a manufacturer and wholesale vendor of candy. It prays for a judgment against the defendant collector of internal revenue for the refund of some $2,174.14, which claim had, on formal application, been rejected by the Commissioner of Internal Revenue.

The plaintiff admits that sale of its product was taxable under subdivision (9) of section 900 of the Revenue Act of 1918, which reads:

"That there shall be levied, assessed, collected, and paid upon the following articles sold or leased by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold or leased— * * *

"(9) Candy, 5 per centum; * * *."

Section 903 provides that every person liable for any tax imposed by section 900 shall make monthly returns in such manner as the Commissioner, with the approval of the Secretary of the Treasury, shall prescribe, and that tax, without assessment or notice, shall be due and payable to the collector at the time fixed for filing such return.

Plaintiff contends that the amount of refund claimed by it resulted from its computation of the tax paid by it on the whole price received from its customers, whereas such computation was erroneous, because it was actually a payment of the tax on a tax as well as on the actual price of the candy sold, which was only 95 cents in each dollar of candy sold.

Plaintiff admits that the sales made by it as manufacturer were taxable under the statute, and that the price of candy per pound to its customers was the same after as before the Act went into effect. The evidence shows that it did instruct its salesmen just prior to the effective date of the tax to notify their customers that the new tax law would not increase the price per pound of their product and that it would absorb the war tax. The salesmen testified that they had so advised the customers, and two of the customers were produced who corroborated the salesmen. One of these bought five or six thousand dollars of candy per year, and the other two or three hundred, whereas the plaintiff's monthly sales amounted to more than $50,000.

The sole issue presented involves an interpretation of the phrase used by Congress: "of the price for which so sold." This language of the statute could not conceivably be simpler. Certainly, if the price at which candy was sold was fixed by trade catalogues or price lists such as appear in the evidence, the manufacturer selling at that price can not be heard to say that he is entitled to deduct the 5 per cent tax and pay tax at that rate on the 95 per cent remaining.

The price for which the article sold can certainly mean nothing more nor less than the amount paid by the purchaser to the seller, and under the plain terms of the Act that price measures the tax at the prescribed rate. It might be otherwise, as Government counsel very pertinently suggests, if the tax was designed to be measured by profits on sales, in which event there might be numerous deductions of costs, charges, and expenses, including taxes paid.

There is nothing in the Act to justify plaintiff's contention that by simply telling its customers that the prices would remain unchanged and that it would absorb and pay the tax, it might relieve itself of the statutory duty to pay the tax on the full price for which its goods were actually sold. A very strained, artificial interpretation of plain, unambiguous terms would be necessary to support the contention that the tax should be borne by a fractional part of the actual price. In the language of the Supreme Court, in *Worth Bros. Co.* v. *Lederer* (251 U. S., 507, 510): "Congress did not intend to subject its legislation to such artificialities and make it depend upon distinctions so refined as to make a part of a shell not the taxable 'part' of the law."

My conclusion is that the "price" which the plaintiff's customers paid for the candy (and not a part of the price received by plaintiff) was the "price for which so sold," which Congress made the measure of the tax.

Accordingly, a judgment may be entered in favor of defendant, dismissing plaintiff's suit at its cost.

REGULATIONS 47 (1921), ARTICLE 39: Aids to collection of tax. VI-28-3306 T. D. 4031

BOND—SUIT AGAINST SURETIES—DECISION OF COURT.

1. BOND—SURETIES—NOTICE—BANKRUPTCY.

A bond given in connection with a claim in abatement reading in part that "A * * * as principal and B and C * * * as sureties are * * * jointly and severally held and firmly bound unto the United States of America in the sum of $15,000 * * * for payment of which well and truly to be made unto Frank K. Bowers * * * the parties hereby bind themselves * * *" is a contract of suretyship by which the sureties incurred a joint and several obligation which was not affected by the failure of the United States to give prompt notice to the sureties of the default of the principal, by the failure to commence action against him, or by his bankruptcy.

2. COMPROMISE—LACHES—ESTOPPEL.

Delay on the part of the Government in rejecting an offer in compromise and the retention meanwhile of an amount that accompanied the offer are not facts that can be regarded as effecting an agreement to compromise and they do not estop the Government to maintain an action on the bond.

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 *United States of America* v. *Morris Drielinger et al.* is published for the information of internal revenue officers and others concerned.

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

Approved July 2, 1927.

CARL T. SCHUNEMAN,
Acting Secretary of the Treasury.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

United States of America, plaintiff, v. Morris Drielinger and Gustave Henry, defendants.

[April 11, 1927.]

OPINION.

GODDARD, District Judge: This action is brought by the United States against the defendants to collect on a bond executed by them on the 15th day of May, 1923.

Trial by a jury of 12 was waived, and trial by a jury of 1 had, and both sides have respectively moved for a direction of a verdict in their favor.

On the February, 1923, list of the United States Commissioner of Internal Revenue H. Zierler, Lambrose & Co. were listed for $44,064.05 for sales taxes accruing during the period from March, 1919, to December, 1921, with penalties and interest. H. Zierler, Lambrose & Co. desired to file a claim to abate this tax, which they said was incorrect, and as a condition for withholding

or deferring the collection of the tax, the Commissioner of Internal Revenue consented to accept and did accept a bond in the penal sum of $15,000 pending the determination of the claim in abatement filed by the said taxpayer; this bond was duly executed by the defendants, Morris Drielinger and Gustave Henry, and filed with the Commissioner of Internal Revenue. It reads as follows:

KNOW ALL MEN BY THESE PRESENT: that H. Zierler, Lambrose & Co., of 212 West 29th Street, New York, N. Y., as principal, and Morris Drielinger, having an office and principal place of business at 467 Greenwich Street, New York, N. Y., and Gustave Henry, having an office and principal place of business at 606 Fifth Avenue, Brooklyn, N. Y., as sureties are hereby and by these presents jointly and severally held and firmly bound unto the United States of America in the sum of $15,000 lawful money of the United States of America, for payment of which well and truly to be made unto Frank K. Bowers, collector of internal revenue of the second district of New York, or his successor in office, the parties hereby bind themselves, their heirs, executors, administrators, successors and assigns.

Signed and sealed this 15th day of May, 1923.

The conditions of the above obligation are such that

WHEREAS the said H. Zierler, Lambrose & Co. has been assessed a tax by the Commissioner of Internal Revenue in the principal sum of $44,084.05, and whereas, the said H. Zierler, Lambrose & Co. has filed or will file its claim in abatement against said tax;

NOW, THEREFORE, if the said claim in abatement shall be denied in whole or in part by the Bureau of Internal Revenue, and upon notice and demand of the said Frank K. Bowers, collector of internal revenue, or his successor in office, the said H. Zierler, Lambrose & Co. pays to the said Frank K. Bowers, as collector of internal revenue, or his successor in office, the said tax, or such amount thereof as may be found due, together with such penalties and interest as may accrue thereon, then this obligation to be null and void; otherwise to be and remain in full force and effect.

H. ZIERLER, LAMBROSE & CO. (LS.)
By H. ZIERLER.
GUSTAVE HENRY. (LS.)
MORRIS DRIELINGER." (LS.)

(Then follows the respective acknowledgments and sworn statements of Drielinger and Henry that they are respectively worth over the sum of $30,000, exclusive of debts and exempt property.)

Following are the facts leading up to the litigation.

On June 11, 1923, the firm of H. Zierler, Lambrose & Co. filed with the Bureau of Internal Revenue a claim in abatement of the tax referred to in the said bond, which claim was denied on December 14, 1923. Notice of said denial was forwarded by registered mail on December 15, 1923, to the firm, together with further demand for payment of the tax as assessed; that the tax has not been paid; that on March 28, 1924, an offer to compromise said tax pursuant to the provisions of section 3229 of the United States Revised Statutes was made to the Commissioner of Internal Revenue by one Harry Zierler in behalf of said firm, which offer of compromise was accompanied by $3,000 in cash; that on the 30th day of October, 1926, this offer of compromise was rejected, the $3,000, in the meanwhile, having been retained by the Commissioner of Internal Revenue or his representative, the collector of internal revenue for the second district of New York; that on July 24, 1924, the collector of internal revenue for the second district of New York duly filed a notice of lien for the amount of said tax in the office of the clerk of the United States District Court for the Southern District of New York against the abovementioned firm pursuant to the provisions of section 3186 of the Revised Statutes of the United States as amended; that on the 20th day of August, 1924, the said firm of H. Zierler, Lambrose & Co. became insolvent and bankrupt. On November 28, 1924, the United States had its proper representative notify the defendants of the rejection of said claim for abatement and demanded of them the sum of $15,000, the principal sum of the bond. That on May 19, 1926, proof of claim was filed by the United States of America with the referee and said claim amended May 25, 1926. The correctness of the amount of the tax assessed is not attacked.

The defendant contends that the contract is one of guaranty and analogous to a conditional rather than to an absolute guaranty of payment, and that

the failure by the plaintiff, the United States, to give notice to the defendants of the default of the taxpayer until 11 months after the said default discharged the defendants from liability on the bond; furthermore, that it was the duty of the Government to prosecute promptly and diligently the claim against the taxpayer, and having failed to institute a suit for a period of 8 months before the bankruptcy occurred, they, as guarantors, are thereby discharged. The defendant also urges that the offer of compromise made on May 28, 1924, by the taxpayer, accompanied by the cheque of $3,000, which was retained by the Government for about two and one-half years, is to be regarded as an acceptance by the plaintiff of the offer of compromise, and that the legal consequence thereof was to discharge the defendants on the bond.

The fundamental question here to be decided is whether the bond executed by the defendants was a contract of suretyship or merely a guaranty of collection, for, as stated in Corpus Juris, volume 28, page 891—

"A surety is an insurer of the debt or obligation, while a guarantor is an insurer of the ability or solvency of the principal. A strict guarantor is entitled to notice of his principal's default, while a surety is held to know every default of his principal and is liable without such notice."

As a general proposition of law, a surety is not entitled to notice of the default of the principal for the reason that the surety is primarily liable and is not discharged by the mere indulgence of the creditor to the principal or by want of notice of the default of the principal. *McIntosh-Huntington Co.* v. *Reed* (89 Fed., 464); see also Brandt on Suretyship and Guaranty, second edition, section 200; *Douglass* v. *Howland* (24 Wend., 35).

It is therefore evident that if the bond now under consideration was that of a surety, the direct obligation of the defendants was not affected by the Government's failure to give them prompt notice of the nonpayment by H. Zierler, Lambrose & Co., to commence action against the taxpayer, or by the bankruptcy of the taxpayer.

The bond reads that "H. Zierler, Lambrose & Co. * * * as principal and Morris Drielinger * * * and Gustave Henry * * * as sureties are hereby and by these presents jointly and severally held and firmly bound unto the United States of America in the sum of $15,000 * * * for payment of which well and truly to be made unto Frank K. Bowers * * * the parties hereby bind themselves * * *." It then provides that if the claim should be denied in whole or in part so much as may be found due will be paid upon notice and demand. Clearly this is a joint and several obligation of the taxpayer and these defendants. It was an obligation not that the taxpayer would pay, but that they themselves would pay if the claim was denied in whole or in part, and provided that notice of the rejection of the claim and demand for payment be given. The defendants were jointly and severally bound to pay the $15,000 unless the tax was abated and were obligated to pay if and when notified of the rejection of the claim for abatement and payment was requested. Such notice and demand have been given them and they have not paid.

While it is true that on March 28, 1924, the taxpayer made an offer of compromise of $5,000, accompanying the offer with $3,000, and that the Commissioner of Internal Revenue did not reject the offer until December 30, 1926, meanwhile retaining the $3,000, I do not find facts which justify regarding this as an agreement to compromise by the Government of its claim, or that the Government is equitably estopped. This may be an unexcusable delay on the part of the Government, but section 3229 of the Revised Statutes, referred to by counsel for the defendants, does not prescribe any period of time in which the Commissioner of Internal Revenue is to pass upon an offer of compromise. The rule laid down in *Dox* v. *Postmaster General* (26 U. S., 318, at 325) that "a claim of the United States is not released by the laches of the officer to whom the assertion of that claim was intrusted" can not be disregarded in considering the effect of the long delay in replying to the offer of compromise.

Accordingly, a verdict for the sum of $15,000, together with interest and costs as demanded in the complaint, will be directed in favor of the plaintiff and against the defendant, Morris Drielinger, as he was the only defendant served.

ESTATE TAX RULINGS.

TITLE IX.—BOARD OF TAX APPEALS. (1924)

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

[1] VI–52–3553

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

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
B.			
Borden, Spencer, estate of	5909	6	255
Borden, Spencer, jr., executor	5909	6	255
Burkitt, George W., estate of	2038	3	1158
C.			
Crews, David W., estate of	9010	8	949
Crews et al., Frank H	9010	8	949
D.			
Dibble, Leon N., executor	2528	6	732
Dibble, Louis N., estate of	2528	6	732
Dyer, George R., executor	3351	5	711
F.			
Farlow, Samuel, estate of	7268	7	172
H.			
Henry, Mattie F., conservatrix	7268	7	172
Hudson, Charles I., estate of	3351	5	711
Hudson, H. Kierstede, executor	3351	5	711
L.			
Lozier, Charlotte M., estate of	7513	7	1050
M.			
Meinel, Edward, estate of	3098	6	341
Meinel, Ethel G., executrix	3098	6	341
Milliken, George W., estate of	10123	7	785
P.			
Peebles, W. S., administrator	9380	5	386
Powers, Mary A., executrix	5422	6	633
Powers, Richard J., estate of	5422	6	633
Pryor, Luke, estate of	9380	5	386
Pryor, Lutie Patton, administrator	9380	5	386
R.			
Real Estate & Trust Co. and Samuel M. Gayley, executors	10123	7	785

[1] Ruling No. 3553, includes rulings Nos. 3321, 3332, 3347, 3356, 3428, 3447, 3472, 3482, 3491, 3503, 3510, and 3544. These rulings, published in the weekly Bulletins during the semiannual period July 1 to December 31, 1927, have been combined and the decisions arranged in alphabetical order.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
S.			
Serrien, Anna A., executrix	8836	7	1129
Serrien, John, estate of	8836	7	1129
Smith, Harry A., executor	3098	6	341
V.			
Voelbel, Jacob, estate of	6009	7	276
Voelbel, Walter W., executor	6009	7	276
W.			
Walter, T. Hendry, executor	3351	5	711

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.
B.			
Bronson, James D., trustee	7702	7	127
G.			
Gibson, Kate Viola, estate of	7402	7	1144
H.			
Hoffman, Isabella C., estate of	5338	3	1361
Hoffman, et al., Meyer C., executors	5338	3	1361
M.			
Mercantile Trust & Deposit Co., executor	4166	5	952
Murphy, James C., executor	4166	5	952
N.			
Nelson, C. N., estate of	7702	7	127
P.			
Pelton, Honoro Gibson, executrix	7402	7	1144
Pietsch, Amy Lake, deceased, estate of	5424	6	582
Pietsch, Walter G., executor	5424	6	582
Prince, George H., trustee	7702	7	127
Provident Trust Co., administrator	4976	5	1004
S.			
Sinkler, Charles, administrator	4976	5	1004
Stanton, John, jr., estate of	5892	[1]	[1]
W.			
Windfelder, John H., estate of	4166	5	952
Y.			
Young, James K., estate of	4976	5	1004

[1] Unreported in Board of Tax Appeals reports.

TITLE III.—ESTATE TAX. (1926)

GROSS ESTATE—GENERAL.

REGULATIONS 70, ARTICLE 10: Character of interests included. VI–37–3429 G. C. M. 2027

(1) Nonresident decedents, resident within Germany when they died before the beginning of the war, or before the passage of the Trading with the Enemy Act, were not enemies within the meaning of the Act; and property of such decedents seized and held by the Alien Property Custodian was seized and held as the property of the heirs or representatives of the deceased, and was therefore returnable for purposes of estate tax.

(2) Where property was seized and held by the Alien Property Custodian before the deaths of enemies, and the deaths occurred prior to any amendment to the Trading with the Enemy Act which authorized the return of property to claimants, any interests of the decedents therein at the date of death were so uncertain and contingent as to have no value.

(3) An enemy who died in 1918 entitled to a distributive share in an estate being administered under the laws of Ohio had an interest so contingent and uncertain as to be of no value as of the date of death, the share being then held by the court for delivery to the Alien Property Custodian.

(4) Property of an enemy held at the date of his death by the Alien Property Custodian, but returnable under the amendment to the Trading with the Enemy Act of March 4, 1923, has a taxable value for estate tax purposes. Any amount so held which was not returnable under this amendment but the income from which, not to exceed $10,000 in any one year, was payable to the decedent's representatives, has a value for estate tax purposes.

The administrative files in the estates of certain nonresident decedents were forwarded to this office for an opinion as to whether the:

1. Value for Federal estate tax purposes of the property which any of the decedents owned, and which at the times of death was situated in the United States, was at those times affected in any manner by the Trading with the Enemy Act (hereinafter called the Act) and the Executive orders issued pursuant thereto, or by the Act as amended on March 4, 1923.

2. Action of the Bureau in regard to the Federal estate tax liability of certain estates is correct.

3. Claims filed in some of the estates for refund of Federal estate tax should be allowed or rejected.

The pertinent definitions and provisions of the Act are as follows:

SEC. 2. That the word "enemy" as used herein shall be deemed to mean, for the purposes of such trading and of this Act—

(a) Any individual * * * of any nationality, resident within the territory (including that occupied by the military and naval forces) of any nation with which the United States is at war * * *.

The words "to trade" as used herein shall be deemed to mean—

(a) Pay, satisfy, compromise, or give security for the payment or satisfaction of any debt or obligation.

(b) Draw, accept, pay, present for acceptance or payment, or indorse any negotiable instrument or chose in action.

(c) Enter into, carry on, complete, or perform any contract, agreement, or obligation.

(d) Buy or sell, loan or extend credit, trade in, deal with, exchange, transmit, transfer, assign, or otherwise dispose of, or receive any form of property.

(e) To have any form of business or commercial communication or intercourse with.

SEC. 3. That it shall be unlawful—

(a) For any person in the United States, except with the license of the President, granted to such person, or to the enemy, or ally of enemy, as provided in this Act, to trade, or attempt to trade, either directly or indirectly, with, to, or from, or for, or on account of, or on behalf of, or for the benefit of, any other person, with knowledge or reasonable cause to believe that such other person is an enemy or ally of enemy, or is conducting or taking part in such trade, directly or indirectly, for, or on account of, or on behalf of, or for the benefit of, an enemy or ally of enemy.

* * * * * * *

SEC. 7. * * *

(c) If the President shall so require, any money or other property owing or belonging to or held for, by, on account of, or on behalf of, or for the benefit of an enemy or ally of enemy * * * which the President after investigation shall determine is so owing or so belongs or is so held, shall be conveyed, transferred, assigned, delivered, or paid over to the Alien Property Custodian.

* * * * * * *

SEC. 12. * * *

The Alien Property Custodian shall be vested with all of the powers of a common-law trustee in respect of all property, other than money, which shall come into his possession in pursuance of the provisions of this Act, and, acting under the supervision and direction of the President, and under such rules and regulations as the President shall prescribe, may manage such property and do any act or things in respect thereof or make any disposition thereof or of any part thereof, by sale or otherwise, and exercise any rights which may be or become appurtenant thereto or to the ownership thereof, if and when necessary to prevent waste and protect such property and to the end that the interests of the United States in such property and rights or of such person as may ultimately become entitled thereto, or to the proceeds thereof, may be preserved and safeguarded. * * *

After the end of the war any claim of any enemy or of an ally of enemy to any money or other property received and held by the Alien Property Custodian * * * shall be settled as Congress shall direct: * * *

An Executive order was issued pursuant to the Act on February 26, 1918, the pertinent parts of which are:

(1) DEFINITIONS.

* * * * * * *

(c) The words "right," "title," "interest," "estate," "power," and "authority" of the enemy, as used herein, shall be deemed to mean respectively such right, title, interest, estate, power, and authority of the enemy as may actually exist and also such as might or would exist if the existing state of war had not occurred, and shall be deemed to include respectively the right, title, interest, estate, power and authority in law or equity or otherwise of any representative of or trustee for the enemy or other person claiming under or in the right of, or for the benefit of, the enemy.

(d) Any requirement made by the Alien Property Custodian pursuant to section 7, subsection "c," of the "Trading with the Enemy Act" may be known as and called a demand and will be hereinafter referred to as a demand.

(2) DEMANDS PURSUANT TO SECTION 7, SUBSECTION "C."

(a) The Alien Property Custodian may make demand for the conveyance, transfer, assignment, delivery, and payment of any money or other property owing or belonging to or held for, by, on account of, or on behalf of or for the benefit of an enemy not holding a license granted by me or in the exercise of my power and authority, which the Alien Property Custodian after investigation, shall determine is so owing or so belongs or is so held, together with every right, title, interest, and estate of the enemy in and to such money or other property and every power and authority of the enemy thereover, * * *

(b) Notice of any demand made by the Alien Property Custodian may be given to any person who, alone or jointly with others, may hold or have the custody or control of or may be exercising any right, power, or authority in or over or may be performing any duty concerning the money or other property mentioned in the demand; * * *

(c) When demand shall be made and notice thereof given, as hereinbefore provided, such demand and notice shall forthwith vest in the Alien Property Custodian such right, title, interest, and estate in and to and possession of the money or other property demanded and such power or authority thereover as may be included within the demand, * * *.

The Act was amended March 4, 1923. That amendment authorized the return of property held by the Alien Property Custodian to the enemy in an amount not to exceed in value in any case the sum of $10,000 and directed that officer to pay to the enemy in amounts not exceeding $10,000 in any one year the net income, dividends, interest, and other earnings accruing on property taken from them by the Alien Property Custodian.

For convenience the cases will be considered in divisions.

1. A died in Germany in 1916. At that time she was entitled to a legacy of $500 under the will of one who died in Kentucky. This legacy was delivered by the Kentucky executor to the Alien Property Custodian in 1919.

B died in Germany on April 12, 1917. When he died he was the owner of certain railroad bonds and a life insurance policy issued by an American company through its office at Berlin, Germany. This property, or the proceeds thereof, was seized by the Alien Property Custodian.

In July, 1917, C died in Germany. On the date of his death he was the owner of certain railroad bonds, as well as of shares in several railroad companies. This property was seized by the Alien Property Custodian.

It will be noticed that one of these three decedents died before the beginning (on April 6, 1917) of the war and before the passage (on October 6, 1917) of the Act, and that the other two died after the beginning of the war but prior to the passage of the Act. Though all three of the decedents at the times of death were resident within Germany, a nation with which the United States was at war when the Act was passed, still they are not enemies within the meaning of the Act. The word "enemy" as it has been hereinbefore shown, is defined in the Act to be "Any individual * * * of any nationality resident within the territory (including that occupied by the military and naval forces) of any nation with which the United States is at war." Manifestly, this definition can not be construed to include within its terms individuals who were resident within Germany when they died but whose deaths occurred before the Act was passed. That the property which the decedents owned was seized by or delivered to the Alien Property Custodian after their deaths is of no moment. It was so seized or delivered not because the decedents were the owners thereof at the times of death, but because it was duly determined after the Act became a law that the decedents' representatives or beneficiaries who were entitled to receive the property were enemies within the meaning of the Act. Under the circumstances it is the opinion of this office that neither the value of, nor any decedent's interest in, the property was in any

manner affected, as of the dates of death, by the Act and the order made pursuant thereto.

The Bureau determined in due course that the estates of A and C were liable to the Federal estate tax and it appears that tax has been paid by these estates. That action is correct. In the C estate a claim for refund based on the ground that "The decedent was an alien enemy whose property was in the hands of the Alien Property Custodian and had no ascertainable value for estate tax purposes" has been filed. This claim should be rejected in its entirety.

With reference to the estate of B, it has been determined by the Bureau "that the property of this decedent, seized and held by the Alien Property Custodian, is not subject to the Federal estate tax * * *."

For the reasons hereinbefore given, this office concludes that such of the property of the decedent B as had its situs in the United States at the time of death constitutes his gross estate and that his estate is liable to the tax.

2. When D died in Germany, on July 20, 1918, he, it seems, would have owned, had the Act not been in force, certain shares and bonds of a railroad company. These shares and bonds were received by the Alien Property Custodian on July 18, 1918.

E died in Germany in 1921. If the Act had not at that time been in force, he would have been, it seems, the owner of 30 shares and $3,000 bonds of a railroad company. The Alien Property Custodian made demand for these items. Upon the making of the demand the decedent's possession of the items became vested in the Alien Property Custodian, notwithstanding the fact that the shares and bonds being situated abroad were not actually delivered to him.

It will be seen that in both of these estates the Alien Property Custodian had taken possession of the property of the decedents prior to their deaths. A similar state of facts was presented in the estate of F, deceased. In that matter it appears that the decedent was a resident and citizen of Germany at the time of her death. Prior to her death the Alien Property Custodian of the United States had seized and taken possession of all her property situated in the United States. She died in 1919, prior to the passage of the Act of June 5, 1920, authorizing the Alien Property Custodian to return certain funds seized. Under this Act the property was returned to the decedent's representatives and the Estate Tax Division included in the decedent's gross estate the value of the property returned. In passing upon the question involved the Solicitor said, in effect, that any property right which F had at the time of her death in the seized property was so contingent and uncertain as to have no value at the date of death. The value of the right after the passage of the Act of June 5, 1920, directing the return of alien property can not be taken as the value as of the date of death.

For the reasons given by the Solicitor in the F estate, this office concludes that the property seized by the Alien Property Custodian in the D and E estates had no value as of the dates of their deaths.

In the D estate the tax was paid in 1925, by the Alien Property Custodian. In June, 1926, a claim for refund of the tax was filed by a representative of the decedent's beneficiaries, and in August, 1926, a claim for refund of the tax was filed by the Alien Property Custodian. As the tax is refundable and as the Alien Property Cus-

todian paid the tax, the claim filed by that officer should be allowed in its entirety and the other claim rejected in its entirety.

The Bureau has not as yet determined the liability of the estate of E. It may be stated that with reference to the seized property his estate is not subject to the tax.

3. At the time of her death in Rumania in 1918, G was entitled to a distributive share in the estate of her father, a resident of the United States, who died, intestate, in Ohio, on February 7, 1917. When G died, her father's estate was being administered on under the laws of Ohio, and her share therein was in the custody of the local court. Section 7(b) of the Act provides:

* * * No conveyance, transfer, delivery, payment, or loan of money or other property, in violation of section 3 hereof, made after the passage of this Act, and not under license as herein provided shall confer or create any right or remedy in respect thereof; * * *

The interest of G in the estate was not, during her lifetime, held by the court for delivery to her (on the final accounting of the Ohio administrator), but was held for delivery, under the Act, to the Alien Property Custodian, and that interest was not held by the court after the death of G for delivery (on the final accounting of her father's administrator) to her representatives or next of kin and legatees but was held for delivery, and was delivered, under the Act, to the Alien Property Custodian. In view of these facts, this office concludes that any property right which G had in the estate of her father at the time of her death was so contingent and uncertain as to have no value on the date of death. The said share was included in the gross estate in the return made for the estate of G. The tax shown on the return was paid in 1925. A claim has been filed for the refund of the tax so paid. That claim should be allowed in its entirety.

4. In December, 1923, H died in Germany. His property of the value of $17,460.42, which was situated in the United States, had been seized during his lifetime by the Alien Property Custodian. Of the property so seized, $9,900 was, under the amendment of March 4, 1923, returned on October 31, 1923, by the Alien Property Custodian to the said H. That part of the $9,900 (namely, $9,238.71) which was owned by the decedent and was in the United States at the time of death was included in the gross estate in the return filed for the estate. The tax resulting from the inclusion of the $9,238.71 in the gross estate has been paid. On the review of the return the balance ($7,560.42) of the seized property was not included by the Bureau in the gross estate, and no tax has been paid with respect to that balance.

Under the amendment of March 4, 1923, the decedent was not only entitled to the return of the property taken from him by the Alien Property Custodian in an amount not to exceed in value the sum of $10,000, but he was also entitled to the net income, dividends, interest, and other earnings accruing on the property so taken from him, in an amount not exceeding $10,000, in any one year. Pursuant to the amendment, payments of such net income and interest have been made since the date of death, by the Alien Property Custodian, to the decedent's representatives or next of kin or legatees.

As the net income and interest from the balance of the seized property could not exceed the sum of $10,000 in any one year, the

decedent had a transmissible right to all such net income and interest. Consequently, on the date of death he had the full transmissible enjoyment of the balance of the property taken from him. Obviously this right of enjoyment was not without some value, and the question of the amount to be included in the gross estate is one of fact depending upon all the circumstances of the case, the determination of which falls within the province of the administrative unit.

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

GROSS ESTATE—TRANSFERS BY DECEDENT IN HIS LIFETIME.

REGULATIONS 70, ARTICLE 15: Transfers during life. VI–34–3386
T. D. 4066

ESTATE TAX—TRANSFERS.

Articles 15, 16, and 17, Regulations 70, amended

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

To Collectors of Internal Revenue and Others Concerned:

Articles 15 * * * of Regulations 70 are hereby amended to read as follows:

ART. 15. *Transfers during life.*—Except bona fide sales for an adequate and full consideration in money or money's worth, all transfers made by the decedent subsequent to September 8, 1916, are taxable if made in contemplation of or intended to take effect in possession or enjoyment at or after his death. If the enjoyment of the property or the interest transferred (whether the property or the interest was transferred by the decedent before or after passage of the Revenue Act of 1916) was subject at the date of the decedent's death to change by the exercise of any power to alter, amend, or revoke, or if any such power was relinquished by the decedent subsequent to the effective date of Part I, Title III, of the Revenue Act of 1924, in contemplation of death, the entire value of the property, or the interest transferred, as of the date of decedent's death must be included in the gross estate unless the transfer constituted a bona fide sale for an adequate and full consideration in money or money's worth. To constitute a bona fide sale for an adequate and full consideration in money or money's worth it must have been made in good faith, and the price must have been an adequate and full equivalent, and reducible to a money value. Where the price was less than an adequate and full equivalent only the excess of the fair market value of the property, as of the date of the decedent's death, over the price received by the decedent should be included in the gross estate.

Where a transfer, by trust or otherwise, was made by written instrument, duplicate copies thereof should be filed with the return. If of public record, one of the copies should be certified: if not of record, one copy should be verified. Where the decedent was a nonresident, only one copy, certified or verified, need be filed.

REGULATIONS 70, ARTICLE 16: Nature of transfer. VI–34–3387
T. D. 4066

Articles * * * 16 * * * of Regulations 70 are hereby amended to read as follows:

TRANSFERS IN CONTEMPLATION OF DEATH.

ART. 16. *Nature of transfer.*—The words "in contemplation of death" do not mean, on the one hand, a general expectation of death such as all persons enter-

tain, nor, on the other, is the meaning limited to an expectation of immediate death. A transfer, however, is made in contemplation of death wherever the person making it is influenced to do so by such an expectation of death, arising from bodily or mental conditions, as prompts persons to dispose of their property to those whom they deem proper objects of their bounty. Such a transfer is taxable, although the decedent parts absolutely and immediately with his title to and possession and enjoyment of the property.

Transfers made by the decedent in his lifetime, other than transfers intended to take effect in possession or enjoyment at or after death (see art. 17), excepting bona fide sales for an adequate and full consideration in money or money's worth, must be returned for tax, or disclosed in the return, as follows (see also art. 20):

(1) *Transfers made in contemplation of death.*—The executor must return for tax the value, as of the date of the decedent's death, of all property transferred by the decedent subsequent to September 8, 1916, in contemplation of death.

(2) *Transfers not admitted to have been made in contemplation of death.*—

(*a*) The executor is required to disclose in the return all transfers made by the decedent subsequent to September 8, 1916, of an amount or value of $5,000 or more. Any such transfer made within two years of the decedent's death, but before the effective date of the Revenue Act of 1926, and constituting a material part of the decedent's property and in the nature of a final disposition or distribution thereof, is deemed to have been made in contemplation of death within the meaning of the statute. Where the executor contends that the transfer was not made in contemplation of death he must file with the return sworn statements, in duplicate, of all the material facts, including, among other things, the decedent's motive in making the transfers and his mental and physical condition at that time, and one copy of the death certificate.

(*b*) The executor is required to return for tax all transfers made by the decedent within two years prior to his death, but after the effective date of the Revenue Act of 1926, to the extent that the value thereof to any one person is in excess of $5,000, even though the transfer is not admitted to have been made in contemplation of death. The entire value of the transfers should be disclosed in the return. Example: The decedent died April 15, 1926, having transferred on March 1, 1926, a farm to his son, A, and certain shares of stock to his son, B, the values, as of date of death, being $20,000 and $30,000, respectively. Both transfers should be listed on the return and the entire value of the transfers disclosed but the taxable portion of the value of the transfers will be $15,000, and $25,000, respectively. This example is applicable only in case the transfer is not admitted or shown to have been made in contemplation of death.

The fact that a gift was made as an advancement, to be taken into account upon the final distribution of the decedent's estate, is not, in and of itself, determinative of its taxability.

REGULATIONS 70, ARTICLE 17: General. VI–34–3388
T. D. 4066

Articles * * * 17 of Regulations 70 are hereby amended to read as follows:

TRANSFERS INTENDED TO TAKE EFFECT IN POSSESSION OR ENJOYMENT AT OR AFTER DEATH.

ART. 17. *General.*—All transfers made by the decedent subsequent to September 8, 1916, other than bona fide sales for an adequate and full consideration in money or money's worth, which were intended to take effect in possession or enjoyment at or after his death, are taxable, and the value, as of the date of the decedent's death, of property or interest so transferred must be returned as a part of the gross estate.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 12, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

DEDUCTIONS—TRANSFERS FOR PUBLIC, CHARITABLE, RELIGIOUS, ETC., USES.

REGULATIONS 70, ARTICLE 45: Religious, charitable, scientific, and educational corporations. VI-34-3380 T. D. 4062

ESTATE TAX.

Deduction of value of property transferred by will, or by the decedent during his lifetime, to religious, charitable, scientific, and educational corporations.—Article 45, Regulations 70, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 45, Regulations 70, is hereby amended to read as follows:

ART. 45. *Religious, charitable, scientific, and educational corporations.*—A corporation or association to which such a transfer was made must meet three tests: (1) It must be organized and operated for one or more of the specified purposes; (2) it must be organized and operated exclusively for such purpose or purposes; and (3) no part of its net earnings shall inure to the benefit of private stockholders or individuals.

The estate is not deprived of the right to deduct the value of property so transferred by reason of the fact that private individuals are the recipients of the benefits which the corporation or association dispenses. Such right is, however, lost wherever any part of the net earnings of the corporation or association inures to the benefit of a private stockholder or individual.

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

Approved August 8, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

PAYMENTS OF AND RECEIPTS FOR TAXES.

REGULATIONS 70, ARTICLE 78: Payment of tax, general. VI-40-3457 T. D. 4091

Procedure for issuing certificates of overassessment covering overassessments of estate and gift taxes.

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

To Collectors of Internal Revenue, Officials of the Bureau of Internal Revenue, and Others Concerned:

1. Effective immediately, taxpayers will be notified by the Bureau of overassessments of estate taxes by means of certificates of overassessment, Form 7924. These certificates will be addressed to the executor or administrator of the estate, or such other person, or persons, as are authorized by law to receive notice of the Commissioner's determination, and will be prepared covering all overassessments disclosed by the audit or subsequent review, of estate tax returns in the Bureau, regardless of whether or not claims are filed, unless the issuance of the certificate of overassessment is barred by the statute of limitations or otherwise.

2. If the records of the collector of internal revenue show that there are no outstanding estate taxes against the estate, the amount of the overassessment will be certified for refund by the collector. Upon approval by the Commissioner, a Treasury check covering the amount allowed for refund will be drawn and will be forwarded through proper channels to the executor or administrator, or legally authorized representative, accompanied by the original copy of the certificate of overassessment, Form 7924.

3. The instructions contained herein apply with equal force to overassessments disclosed by the audit or subsequent review of any gift tax return.

4. All prior instructions inconsistent with the foregoing are hereby revoked and any conflicting instructions contained in Regulations 70 are modified accordingly.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 26, 1927.

A. W. MELLON,
Secretary of the Treasury.

TITLE III. PART I.—ESTATE TAX. (1924)

GROSS ESTATE—TRANSFERS BY DECEDENT IN HIS LIFETIME.

REGULATIONS 68, ARTICLE 15: Transfers during life. VI-34-3389
T. D. 4065

ESTATE TAX—TRANSFERS.

Articles 15, 16, and 17, Regulations 68, amended

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

To Collectors of Internal Revenue and others concerned:

Articles 15 * * * of Regulations 68 are hereby amended to read as follows:

ART. 15. *Transfers during life.*—Except bona fide sales for a fair consideration in money or money's worth, all transfers made by the decedent subsequent to September 8, 1916, are taxable if made in contemplation of or intended to take effect in possession or enjoyment at or after his death. If the enjoyment of the property or the interest transferred (whether the property or the interest was transferred by the decedent before or after passage of the Revenue Act of 1916) was subject at the date of the decedent's death to change by the exercise of any power to alter, amend, or revoke, or if any such power was relinquished by the decedent subsequent to the effective date of Part I, Title III, of the Revenue Act of 1924, in contemplation of death, the entire value of the property, or the interest transferred, as of the date of decedent's death must be included in the gross estate unless the transfer constituted a bona fide sale for a fair consideration in money or money's worth. To constitute a bona fide sale for a fair consideration in money or money's worth, it must have been made in good faith, and the price must have been a fair equivalent, and reducible to a money value.

Where a transfer, by trust or otherwise, was made by written instrument, duplicate copies thereof should be filed with the return. If of public record, one of the copies should be certified; if not of record, one copy should be verified. Where the decedent was a nonresident, only one copy, certified or verified, need be filed.

REGULATIONS 68, ARTICLE 16: Nature of transfer. VI-34-3390
T. D. 4065

Articles * * * 16 * * * of Regulations 68 are hereby amended to read as follows:

TRANSFERS IN CONTEMPLATION OF DEATH.

ART. 16. *Nature of transfer.*—The words "in contemplation of death" do not mean, on the one hand, a general expectation of death such as all persons entertain, nor, on the other, is the meaning limited to an expectation of immediate death. A transfer, however, is made in contemplation of death wherever the person making it is influenced to do so by such an expectation of death, arising from bodily or mental conditions, as prompts persons to dispose of their property to those whom they deem proper objects of their bounty. Such a transfer is taxable, although the decedent parts absolutely and immediately with his title to and possession and enjoyment of the property. Any transfer made by a decedent within two years prior to his death, without a fair consideration in money or money's worth, is deemed to have been made in contemplation of death if of a material part of his property and in the nature of a final disposition or distribution thereof. The executor must return the value, as of the date of decedent's death, of all property transferred by the decedent subsequent to September 8, 1916, in contemplation of death, where the transfer was not a bona fide sale for a fair consideration in money or money's worth, and must disclose in the return all transfers of a material part of decedent's property made subsequent to September 8, 1916, even though such transfer was made more than two years prior to death without such consideration. The executor is also required to report any transfer of an amount or value of $1,000 or more made by the decedent within two years of his death and not constituting a bona fide sale for a fair consideration in money or money's worth. The executor need not include in the gross estate the value of such transfers as he contends were not made in contemplation of death. Where the executor contends that any transfer of a material part of the decedent's property, made within two years of death, is not taxable he must file with the return sworn statements in duplicate of all the material facts, including, among other things, the decedent's motive in making the transfer and his mental and physical condition at that time; also one certified copy of the death certificate. (See also art. 20.)

The fact that a gift was made as an advancement, to be taken into account upon the final distribution of the decedent's estate, is not, in and of itself, determinative of its taxability.

REGULATIONS 68, ARTICLE 17: General. VI-34-3391
T. D. 4065

Articles * * * 17 of Regulations 68 are hereby amended to read as follows:

TRANSFERS INTENDED TO TAKE EFFECT IN POSSESSION OR ENJOYMENT AT OR AFTER DEATH.

ART. 17. *General.*—All transfers made by the decedent subsequent to September 8, 1916, other than bona fide sales for a fair consideration in money or money's worth, which were intended to take effect in possession or enjoyment at or after his death, are taxable, and the value, as of the date of the decedent's death, of property or interest so transferred must be returned as a part of the gross estate.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 12, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

TITLE III. PART II.—GIFT TAX. (1924)

DEDUCTIONS—TRANSFERS FOR PUBLIC, CHARITABLE, RELIGIOUS, ETC., USES.

REGULATIONS 67, ARTICLE 10: Religious, charitable, scientific, and educational corporations. VI-34-3381 T. D. 4061

GIFT TAX.

Deduction of gifts to religious, charitable, scientific, and educational corporations.—Article 10. Regulations 67, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 10, Regulations 67, is hereby amended to read as follows:

ART. 10. *Religious, charitable, scientific, and educational corporations.*—A corporation or association to which a gift is made must meet three tests to entitle the donor to deduct the amount thereof: (1) It must be organized and operated for one or more of the purposes specified in the statute; (2) it must be organized and operated exclusively for such purpose or purposes; and (3) no part of its net earnings shall inure to the benefit of private stockholders or individuals.

The donor is not deprived of the right to deduct an amount equal to the value of property so transferred by reason of the fact that private individuals are the recipients of the benefits which the corporation or association dispenses. Such right is, however, lost wherever any part of the net earnings of the corporation or association inures to the benefit of a private stockholder or individual.

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

Approved August 8, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

ASSESSMENT OF TAX.

REGULATIONS 67, ARTICLE 37: Payment of tax, general.

Certificates of overassessment to be issued. (See T. D. 4091, on page 339.)

TITLE IV.—ESTATE TAX. (1921)

GROSS ESTATE—GENERAL.

REGULATIONS 63, ARTICLE 12: Specific property to be included. VI-31-3348 T. D. 4049

ESTATE TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. GROSS ESTATE—REAL ESTATE.

The interest of a decedent at the time of death in real estate should be included in the gross estate under section 402(a) of the

Revenue Act of 1921, notwithstanding the fact that the State law does not specifically authorize the sale of such real estate for the payment of administration expenses.

2. CASE DISTINGUISHED.

United States v. *Field* (255 U. S., 257) [T. D. 3150] distinguished.

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 *Carrie Steedman et al.* v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved July 23, 1927.

CARL T. SCHUNEMAN,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

Carrie Howard Steedman and Eugenia Howard Edmunds v. *The United States.*

[February 28, 1927.]

OPINION.

GRAHAM, Judge, delivered the opinion of the court.

This case involves a claim for refund of estate taxes voluntarily paid, upon the ground that there was erroneously included in decedent's tax return as a part of her gross estate certain real estate located in the State of Missouri owned by her at the time of her death, for the alleged reason that under the statute of that State real estate could not be sold for the payment of expenses of administration and should, therefore, have been excluded from the gross estate under the terms of the taxing statute. Thus in effect plaintiffs are claiming an exemption by reason of the alleged failure of the State to pass a statute, and attempting to make the enforcement and effectiveness of the taxing act contingent and dependent upon the passage by the different States of statutes making real estate subject to sale for payment of administration expenses.

The question involved is whether the value of this real estate should have been included in the gross estate of the decedent under the provisions of section 402(a) of the Revenue Act of 1921 (42 Stat., 227, ch. 136), as follows:

"That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

"(a) To the extent of the interest therein of the decedent at the time of his death, which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate; * * *."

The mother of the petitioners, Kate M. Howard, died on the 23d of February, 1923. She owned at the time of her death certain real estate which she devised to the petitioners, one-half to each, by her last will and testament. Her executors, in making a return for Federal estate tax purposes, included the value of this real estate in her gross estate, and paid the taxes assessed. They thereafter filed a claim for refund upon the ground that said real estate should not have been included in the gross estate. The Commissioner of Internal

Revenue rejected the claim and thereupon this action was brought for the same reasons as those urged before the Commissioner.

The Supreme Court, in construing the above-quoted section of the Act of 1921, in the case of *United States* v. *Field* (255 U. S., 257, 262), held that the provisions of paragraph (a) of section 402 must be taken conjunctively. The court said:

"These conditions are expressed conjunctively; and it would be inadmissible, in construing a taxing Act, to read them as if prescribed disjunctively. Hence, unless the appointed interests (the property involved in this particular case) fulfilled all three conditions, it was not taxable under this clause."

It will be seen that section 402 provides, first, that the value of the gross estate shall include "all property" of the decedent at the time of death, wherever situated; second, "to the extent of the interest" therein of the decedent at the time of death; and third, said interest is such interest as after the decedent's death is "subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate."

The decision of the Supreme Court in the Field case, it is urged, requires that in order to subject to taxation an interest in real estate of which a decedent dies the owner, it must be "subject to" all three of the conditions named.

The plaintiff's contention is that under the statutes and rulings of the courts of Missouri the real estate of a decedent is not "subject to" the payment of "expenses of its administration," conceding that it is subject to the other conditions. The statutes of Missouri allow the sale of real property for the payment of debts and legacies, and section 149 of the Missouri Code provides:

"The proceeds of the sale of such real estate shall be first applied to the payment of such judgments and attachments, according to their priority of lien, and the residue of such proceeds, if any, shall become assets in the hands of the executor or administrator, to be administered according to law."

Section 402, supra, does not use the word "liable"; it uses the words "subject to." "Subject to" does not necessarily mean "liable for." It may be said that where land is liable for sale for the payment of debts, it is subject to the payment of debts, but the converse is not necessarily true. Real estate may be under certain conditions "subject to" the payment of expenses of administration and yet not liable to sale therefor; that is, it may be under the contingency of or exposed to payment of administrative expenses and thus "subject to" the payment.

Real estate may be sold under the Missouri statute for the payment of debts, and, having been sold, because the personal estate was not sufficient to pay the debts and the administration expenses, the latter could be paid, under the decision of the court of Missouri, out of the fund realized from the sale. (*Howell* v. *Jump*, 140 Mo., 441.) If the proceeds from the sale of real estate for payment of debts may be used under certain contingencies for the payment of administration expenses, it is in such a case "subject to" the payment of the expenses of administration.

The expression "expenses of administration" covers the whole field of administrative charges. It is difficult to see how real estate could be sold and the proceeds not be held liable for the expenses incident to the sale, which, in the case of a sale by an administrator under order of court, are part of the expenses of administration.

The plain purpose of Congress as disclosed by the first part of section 402 was to subject to taxation "all of the estate" of a decedent to the full extent of his interest therein at the time of his death, whether real or personal, tangible or intangible, and wherever situated.

What the qualification "which is subject to" was expected to exclude it is difficult to see. It is not reasonable to hold that Congress intended or had in mind the possibility of the exclusion from taxation of all real estate of a decedent where a statute of the State in which it was located did not specifically grant the right to sell it for the payment of the expenses of administration, or where a court of such State had held that under the existing statute it could not be subjected to sale for such purposes; that is to say, it is unreasonable to hold that Congress intended to exempt from taxation the real estate of a decedent in any of the States where the statute of the State did not specifically authorize the sale of it for the payment of expenses of administration. If each of the States had no such statute, all real estate would be exempt, and if

in one State there was such a statute, the real estate would be taxable, and in another, where there was none, it would not be taxable, thus creating an inequality in taxation and a discrimination in favor of the States that have not passed such a statute.

The case of *United States* v. *Field*, supra, under the facts, we do not think controlling here.

It is presumed that Congress knew that under the common law real estate could not be sold by a probate court for the payment of debts or administration expenses. To hold that it intended to exclude from taxation all real estate or interest therein which was not subject to the payment of charges against the estate or expenses of administration and subject to distribution, unless specially allowed and jurisdiction given to the courts by State statutes, would be to hold that Congress included all real estate as subject to taxation and then provided for the possibility of all of it being excluded and exempted.

It is an established rule of construction that an Act must be read as a whole with a view to ascertaining the real purpose of Congress, with the assumption of a reasonable and intelligent purpose on its part, and that no construction should be given to an Act or a limitation thereof which would do violence to the general purpose of the Act and render it futile or absurd. It is the duty of the court to so construe an Act as to accomplish its general purpose and to enforce it in conformity with that purpose and within the reason of the Act.

We are of opinion that the real estate of the decedent was properly assessed as part of her gross estate by the Commissioner of Internal Revenue under section 402 of the Revenue Act of 1921, and that plaintiffs are not entitled to the refund which was refused by the Commissioner.

GROSS ESTATE—TRANSFERS BY DECEDENT IN HIS LIFETIME.

REGULATIONS 63, ARTICLE 17: Nature and time of transfer. VI-34-3392 T. D. 4064

ESTATE TAX—TRANSFERS.

Articles 17, 18, and 19, Regulations 63, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Articles 17 * * * of Regulations 63 are hereby amended to read as follows:

ART. 17. *Transfers during life.*—Except bona fide sales for a fair consideration in money or money's worth, all transfers made by the decedent subsequent to September 8, 1916, are taxable if made in contemplation of or intended to take effect in possession or enjoyment at or after his death. (As to transfers made prior to September 9, 1916, which were intended to take effect in possession or enjoyment at or after decedent's death, and with respect to which the decedent reserved the power to alter, amend, or revoke, see article 19.) To constitute a bona fide sale for a fair consideration in money or money's worth, it must have been made in good faith, and the price must have been a fair equivalent and reducible to a money value.

Where a transfer, by trust or otherwise, was made by written instrument, duplicate copies thereof should be filed with the return. If of public record, one of the copies should be certified; if not of record, one copy should be verified. Where the decedent was a nonresident, only one copy, certified or verified, need be filed.

REGULATIONS 63, ARTICLE 18: Nature of transfer. VI-34-3393
T. D. 4064

Articles * * * 18 * * * of Regulations 63 are hereby amended to read as follows:

TRANSFERS IN CONTEMPLATION OF DEATH.

ART. 18. *Nature of transfer.*—The words "in contemplation of death" do not mean, on the one hand, a general expectation of death such as all persons entertain, nor, on the other, is the meaning limited to an expectation of immediate death. A transfer, however, is made in contemplation of death wherever the person making it is influenced to do so by such an expectation of death, arising from bodily or mental conditions, as prompts persons to dispose of their property to those whom they deem proper objects of their bounty. Such a transfer is taxable, although the decedent parts absolutely and immediately with his title to and possession and enjoyment of the property. Any transfer made by a decedent subsequent to September 8, 1916, and within two years prior to his death, without a fair consideration in money or money's worth, is presumed to be taxable if of a material part of his property and in the nature of a final disposition or distribution thereof. The executor must return the value, as of the date of decedent's death, of all property transferred by the decedent subsequent to September 8, 1916, in contemplation of death, where the transfer was not a bona fide sale for a fair consideration in money or money's worth, and must disclose in the return all transfers of a material part of decedent's property made subsequent to September 8, 1916, without such consideration, but need not include in the gross estate the value of such thereof as he contends were not made in contemplation of death, in which event he may submit with the return evidence of all material facts tending to disclose the decedent's motive at the time, his then anticipation of death, and mental and physical condition.

The presumption of taxability of a transfer made within the two-year period may be rebutted by proof that it was not made under the conditions stated in the statute, and such proof must be filed with the return. Unless proof is submitted which is sufficient to rebut the presumption the transfer will be included in the gross estate in computing the tax.

The fact that a gift was made as an advancement, to be taken into account upon the final distribution of the decedent's estate, is not enough, standing alone, to establish taxability.

REGULATIONS 63, ARTICLE 19: General. VI-34-3394
T. D. 4064

Articles * * * 19 of Regulations 63 are hereby amended to read as follows:

TRANSFERS INTENDED TO TAKE EFFECT AT OR AFTER DEATH.

ART. 19. *General.*—All transfers made by the decedent subsequent to September 8, 1916, other than bona fide sales for a fair consideration in money or money's worth, which were intended to take effect in possession or enjoyment at or after his death, are taxable, and the value, as of the date of the decedent's death, of property or interest so transferred must be returned as part of the gross estate.

Where a transfer (whether made before or after the passage of the Revenue Act of 1916) was intended to take effect in possession or enjoyment at or after the decedent's death, and the enjoyment of the property or the interest transferred was subject at the date of the decedent's death to change by the exercise of any power to alter, amend, or revoke, the value, as of the date of the decedent's death, of the property or interest so transferred must be returned as a part of the gross estate.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 12, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

DEDUCTIONS.

REGULATIONS 63, ARTICLE 34: Funeral expenses. VI-31-3346
T. D. 4047

ESTATE TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. GROSS ESTATE—DEDUCTIONS—EXPENSES—MAUSOLEUM ERECTED BY TRUSTEE.

The amount expended by a trustee under the will of the deceased person for the erection of a mausoleum after the final settlement of the decedent's estate and the discharge of the executor is not deductible from the value of the gross estate in determining the value of the net estate under section 403 of the Revenue Act of 1921.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the District Court of the United States for the Eastern Division of the Eastern Judicial District of Missouri in the case of *Lemuel Ray Carter, Trustee under the will of Thomas W. Carter*, v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved July 21, 1927.
OGDEN L. MILLS,
Acting Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES IN AND FOR THE EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI.

Lemuel Ray Carter, Trustee under the will of Thomas W. Carter, plaintiff, v. *United States of America, defendant.*

[April 25, 1927.]

MEMORANDUM OF ORAL OPINION OF THE COURT.

FARIS, J.: This case was submitted to the court a few days ago on an agreed statement of facts (a jury having been waived), and upon briefs and argument filed with the statement of facts. The court has considered the matter, with such care as the meager authorities warrant.

The action is for the recovery of certain Federal estate taxes, alleged to have been erroneously and illegally assessed against the estate of Thomas W. Carter, deceased, of whom plaintiff is the trustee under the will.

The taxes, I assume, were paid under protest, although I do not recall that there is anything anywhere, either in the agreed statement of facts or in the briefs, showing the fact of protest; but no point is made about it, and I assume either that it is so stated or that the statute under which the action is brought no longer requires such protest to be made as a condition precedent to recovery.

The amount involved is twelve hundred and seventy dollars and fifty cents, the same being the tax assessable upon the sum of $21,175 actually expended by plaintiff herein, as trustee under the will of Thomas W. Carter, deceased, for the erection of a mausoleum for the deceased.

Decedent died in St. Louis, Mo. (being at the time a resident of that city), on the 4th day of March, 1922, leaving a will, as forecast, which will, so far as the provisions thereof are pertinent, read in the sixth section thereof, thus:

"I hereby direct the executors of my estate to erect a mausoleum in my lot in Bellefontaine Cemetery, in the city of St. Louis, if not already built previous

to my decease, in keeping with other mausoleums located near said lot, and it is my wish to have said mausoleum completed at least 24 months after my decease, but if the executors shall, for any reason, fail to erect and complete said mausoleum before the final settlement of my estate, I direct that the same shall be erected or completed by the trustee hereinafter provided for in the tenth section of this will."

The language of the tenth section, which is referred to, seems to provide merely for the appointment of a trustee.

The final settlement of plaintiff as executor of the decedent's estate was allowed on July 9, 1923, and thereupon an order was entered by the probate court of the city of St. Louis, requiring the executor to assign, pay, transfer, and deliver all of the assets of such estate to Lemuel Ray Carter, trustee under said will, said Carter being, as already indicated, both the executor and the trustee under the will. Thereupon the executor was finally discharged, the estate, as such having been, as the term is, finally wound up.

Thereafter, the plaintiff, as trustee, proceeded in compliance with the sixth section of the will (but as such trustee, and not as executor, for he had been then discharged) to construct a mausoleum at the total cost of $21.175. And so, as said in the beginning, as trustee plaintiff here seeks to recover back from the United States the amount of taxes which he paid on the sum of $21,175 expended as already said.

The question involved, and the single question, is whether plaintiff is entitled to recover. The statute of the United States, under which this tax was levied and laid, provides that there shall be deducted from the value of the gross estate, for taxable purposes "such amount for funeral expenses, administration expenses, claims against the estate * * * as are allowed by the laws of the jurisdiction * * * in which the estate is being administered."

It will be noted, therefore, that the Federal tax provision is what may be denominated a reference statute, in that it permits as a deduction from the gross amount, such amounts for funeral expenses as are allowed by the laws of the jurisdiction under which the estate is being administered, in this case, of course, Missouri. The Missouri law, urged as pertinent, provides that in all settlements of executors the probate court shall settle the same according to law, allow all disbursements and appropriations made by order of the court, and all reasonable charges for funeral expenses.

In dealing with demands against the estate of a deceased person, the statute provides that such demands shall be divided into certain classes. The second class provides for the expenses of the last sickness, wages for servants, and demands for medical attendance during the last sickness of decedent; also the reasonable cost for a tombstone, if allowed by the court.

Whether the mausoleum provided for by the sixth section of decedent's will shall be construed as a tombstone, within the purview of the statute I have just read, I think is wholly unimportant. We may assume that this mausoleum is included within the language of the Missouri statute, and also that the amount expended in this case (being for a mausoleum, and not for a tombstone) is, under the circumstances, and considering the great value of this estate, a reasonable sum.

The question is whether, under the facts here, the expenses incurred in the construction of this mausoleum bring the plaintiff within the statute and its exemptions, particularly the latter. It will be noted that plaintiff had fully wound up and settled the estate of decedent; that he had been finally discharged as executor, and that up to this time he had not erected the mausoleum provided for. After he had taken over, as trustee, this estate, and some one year or more after his final discharge and final settlement as executor, he proceeded to incur the expenses, taxes on which are here in question.

It is fairly well settled that in construing a tax law the statute providing for such taxes shall be strictly construed in favor of the taxpayer. It is true, there has been some doubt upon that question, and seemingly the cases contain some contradiction, but the latest case that I know of seems to lay down that rule rather clearly. This case is found at 245 U. S., 151. I take it that the weight of authority is in favor of the view announced; at least, the case cited bears out that doctrine. But this is not a case of the laying of a tax. Here the tax laid is fairly explicit. It is clear that it applies to this estate, generally speaking. The situation involved here is a question of an exemption to the operation of that statute. The provision that a deduction may be made for the erection of a tombstone or mausoleum, may be made if such deduction is permitted, or, rather, such expenses are allowed by the statute of the State wherein the administra-

tion is pending. The State statute permits a reasonable amount of money to be expended for a tombstone, or mausoleum, if you will, if the allowance therefor shall be made by the court. Here the allowance in question was not made by the probate court of the city of St. Louis and State of Missouri, nor was a mausoleum erected while the estate was being administered. The mausoleum was erected, as already said, more than a year after plaintiff had ceased to be executor, and when he had become a trustee under the terms of the will.

So I take it that the situation involved is one wherein a tax is rather clearly and specifically laid, and wherein, to the laying of that tax, there are exemptions. The matter here, I think, is one of exemption.

Touching an exemption, the rule is the other way about. The matter of exemptions is to be strictly construed in favor of the Government, and not in favor of the taxpayer. This rule seems to be rather clearly laid down, and to be usually followed. (See 117 U. S., 139; 210 Fed., 577; Holmes Federal Taxes, 1485.)

Applying this rule, it seems to me that the case is a very clear one, that plaintiff has not done such acts as bring him within the exemption of the Federal statute. He has neither erected this mausoleum as executor, while he was executor, nor has he had the allowance allowed by the probate court; but, on the contrary, he followed a clause of the will which permitted him to construct this mausoleum either as executor or as trustee. He saw fit to construct it as trustee, after he had ceased to be an executor, and without ever having had any allowance therefor made by the probate court in his favor.

The Federal statute provides that the collector shall fairly follow the State provisions in the matter of the allowance of items of this sort.

I conclude, therefore, that judgment should go for the defendant, with costs, and so it is ordered.

TITLE IV.—ESTATE TAX. (1918)

GROSS ESTATE—TRANSFER BY DECEDENT IN HIS LIFETIME.

REGULATIONS 37, ARTICLE 22: Nature of transfer. VI–35–3403
T. D. 4071

ESTATE TAX—REVENUE ACT OF 1918—DECISION OF SUPREME COURT.

1. GROSS ESTATE—TRANSFERS BY DECEDENT.

An immediate and absolute transfer by a decedent to another in trust vesting the interest of the beneficiaries as soon as the trust instrument is executed, the trust in its terms having no reference to his death, does not create a trust "intended to take effect in possession or enjoyment at or after his death" by reason of a provision for the accumulation of the income for the beneficiaries for 30 years, and, the grantor not having acted in contemplation of death, the value of the property so transferred is not required to be included in determining the value of the decedent's gross estate under section 402(c) 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 Supreme Court in the case of *Shukert et al., Executrices of Shukert*, v. *Allen, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 20, 1927.

S. LOWMAN,
Acting Secretary of the Treasury.

SUPREME COURT OF THE UNITED STATES.

Elizabeth F. Shukert and Isabel C. Shukert, Executrices of the Estate of Gustave E. Shukert, Deceased, petitioners, v. *Arthur B. Allen, Collector of Internal Revenue for the District of Nebraska.*

On writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[March 21, 1927.]

Mr. Justice HOLMES delivered the opinion of the court.

This is a suit to recover the amount of a Federal estate tax paid by the plaintiffs, petitioners, under duress. The district court directed a verdict for the defendant, the collector (300 Fed. Rep., 754 [T. D. 3614, C. B. III-2, 377]), the judgment upon which was affirmed by the circuit court of appeals. (6 F. (2d), 551 [T. D. 3729, C. B. IV-2, 262].) A writ of certiorari was granted by this court. (269 U. S., 543.)

The tax was levied under the Revenue Act of 1918, February 24, 1919 (ch. 18, sec. 402(c); 40 Stat., 1057, 1097), which provides that the value of the gross estate of the decedent shall be determined by including all property "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," etc. By section 401 the tax is laid upon the transfer of the net estate. The transfer taxed in this case was made by the testator on May 5, 1921, and was a conveyance to the United States Trust Co. of Omaha of notes and bonds valued at $225,000, par, in trust to accumulate the income (subject to certain small deductions in case of the extreme destitution of the testator's wife or of any of the beneficiaries named) until February 1, 1951, unless the last of the beneficiaries should have died more than 21 years before that date, etc., and then to divide the principal and undistributed income among his three children by name. The testator died on September 29, 1921, a few months after creating this trust, but it is not argued that he created it in contemplation of death as a device to escape taxes. The only question is whether the trust was one intended to take effect in possession or enjoyment after his death, as was ruled below.

The transfer was immediate and out and out, leaving no interest remaining in the testator. The trust in its terms has no reference to his death but is the same and unaffected whether he lives or dies. Although the circuit court of appeals seems to have thought otherwise, the interest of the children respectively was vested as soon as the instrument was executed, even though it might have been divested as to any one of them in favor of his issue if any, or of the surviving beneficiaries, if he died before the termination of the trust. See Gray, The Rule Against Perpetuities (sec. 108(3)). It seems plain from the little evidence that was put in that the testator was not acting in contemplation of death as a motive for his act, or otherwise, except in the sense that he was creating a fund intended to secure his children from want in their old age, whoever might dissipate the considerable property that he retained and left at his death; and that being 56 years old, if he thought about it, he would have contemplated the possibility or probability of his being dead before the emergency might arise. Of course, it was not argued that every vested interest that manifestly would take effect in actual enjoyment after the grantor's death was within the statute. There certainly is no transfer taking effect after his death to be taxed under section 401.

It is not necessary to consider whether the petitioner goes too far in contending that section 402(c) should be construed to refer only to transfers of property the possession or enjoyment of which does not pass from the grantor until his death. But it seems to us tolerably plain that when the grantor parts with all his interest in the property to other persons in trust, with no thought of avoiding taxes, the fact that the income vested in the beneficiaries was to be accumulated for them instead of being handed to them to spend, does not make the trust one intended to take effect in possession or enjoyment at or after the grantor's death.

Judgment reversed.

REGULATIONS 37, ARTICLE 22: Nature of transfer. VI–35–3406
T. D. 4072

ESTATE TAX—REVENUE ACT OF 1918—DECISION OF SUPREME COURT.

1. GROSS ESTATE—TRANSFER TO TAKE EFFECT AT OR AFTER DEATH.

Where a decedent conveys immediately an absolute and indefeasible title to property and contemporaneously the grantee leases the property to the grantor for one year at nominal rental with provision for annual renewals until notice to the contrary, the conveyance is not a transfer "intended to take effect in possession or enjoyment at or after his death" within the meaning of section 402(c) of the Revenue Act of 1918, though there is an understanding, without, however, a valid agreement, that the premises may be enjoyed by the grantor as long as he might desire to use them for residential purposes.

2. GROSS ESTATE—CONSTITUTIONALITY—RETROACTIVITY.

Section 402(c) of the Revenue Act of 1918, in so far as it requires that there shall be included in the gross estate the value of the property transferred irrevocably in trust by a decedent in 1907 merely because the conveyance was intended to take effect in possession or enjoyment at or after death, is unconstitutional.

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 *Nichols, Collector*, v. *Coolidge et al.* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 22, 1927.

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

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SUPREME COURT OF THE UNITED STATES.

Malcolm E. Nichols, Collector of Internal Revenue of the United States for the District of Massachusetts, plaintiff in error, v. *Harold J. Coolidge and Augustus P. Loring, Executors of the Will of Julia Coolidge.*

In error to the District Court of the United States for the District of Massachusetts.

[May 31, 1927.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

Defendants in error sued to recover additional Federal taxes exacted of the estate in their keeping. The cause was heard upon an agreed statement; judgment went for them on a directed verdict; and this writ of error, allowed April 3, 1925, brings the matter here. In a comprehensive charge the trial court interpreted the law, but gave no further opinion. (4 Fed. (2d), 112.)

Mrs. Julia Coolidge, of Massachusetts, survived her husband and died January 6, 1921. As required by the Revenue Act approved February 24, 1919 (ch. 18, 40 Stat., 1057, 1096), the executors returned a schedule to the collector. He estimated the gross estate at $180,184.73 and allowed $77,747.74 deductions. They paid the amount assessed upon the balance. Their return

did not include certain property transferred by the decedent through duly executed deeds and without valuable consideration, some to trustees and some directly to her children. The Commissioner of Internal Revenue held that under section 402(c) the value of all this property at her death must be included in the gross estate. He raised the assessment accordingly and demanded the additional tax—$34,662.65—here challenged.

July 29, 1907, Mrs. Coolidge and her husband owned certain real estate in Boston, also valuable personal property, which they transferred without consideration to trustees, who agreed to hold it and pay the income to the settlors, then to the survivor, and after his death to distribute the corpus among the settlors' five children or their representatives. The deed directed that the interest of any child predeceasing the survivor should pass as provided by the statute of distribution "in effect at the time of the death of such survivor." The trustees were authorized to sell the property, to make and change investments, etc. April 6, 1917, the settlors assigned to the children their entire interest in the property, especially any right to the income therefrom. At the death of Mrs. Coolidge the trustees held property worth $432,155.35, but through sales and changes much of what they originally received had passed from their possession.

May 18, 1917, by deeds purporting to convey the fee Mrs. Coolidge—her husband joining—gave their five children two parcels of land long used by her for residences. Contemporaneously the grantees leased these parcels to the conveyors for one year at nominal rental, with provision for annual renewals until notice to the contrary. All parties understood that renewals would be made if either lessee wished to occupy the premises. When Mrs. Coolidge died the value of this property was $274,300.

Plaintiff in error now maintains the above-described transfers by Mrs. Coolidge were intended to take effect in possession or enjoyment at or after death, within the ambit of section 402(c), Act February 24, 1919, and that the value at her death of the property held by the conveyees constituted part of her gross estate.

The court below held the transfer of the residences (1917) was absolute; the right to possess or enjoy them did not depend upon death; and their value constituted no part of the gross estate. Also, that under the statute the value of the property conveyed to trustees in 1907 or resulting therefrom must be included in the gross estate, but, thus construed, the Act went beyond the power of Congress.

Relevant portions of "Title IV—Estate Tax," Act February 24, 1919, are printed below. It undertakes to lay a charge equal to the sum of specified percentages—from 1 to 25—"of the value of the net estate * * * upon the transfer of the net estate of every decedent" dying thereafter. And it directs that the net estate shall be ascertained by deducting from the gross certain items and an exemption of $50,000. Also, "That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated"—

"(a) To the extent of his interest therein subject to the payment of charges against the estate, expenses of administration, and subject to distribution. (b) The dower or courtesy, etc., interest of the surviving spouse. (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. (d) Any interest held jointly with another and payable to the survivor. (e) Property passing under a general power of appointment. (f) The excess over $40,000 of insurance taken out by the decedent upon his own life."

Y. M. C. A. v. *Davis* (264 U. S., 47, 50) says of this tax: "What was being imposed here (Act February 24, 1919) was an excise upon the transfer of an estate upon death of the owner." *Edwards* v. *Slocum* (264 U. S., 61, 62 [T. D. 3584, C. B. III–1, 479]), "this is not a tax upon a residue, it is a tax upon a transfer of his net estate by a decedent, a distinction marked by the words that we have quoted from the statute, and previously commented upon at length in *Knowlton* v. *Moore* (178 U. S., 41, 49, 77). It comes into existence before and is independent of the receipt of the property by the legatee. It taxes, as

Hanson, Death Duties, puts it in a passage cited in 178 U. S., 49, 'not the interest to which some person succeeds on a death, but the interest which ceased by reason of the death.'"

Concerning transfer of the residences in 1917, the trial court charged—

"I do not have much difficulty in reaching a conclusion respecting the deeds of the Boston and Brookline real estate, and I will first consider the claim of the parties respecting those transfers.

"The deeds conveyed, with warranty covenants, absolute and indefeasible title to the real estate without any valid reservations, conditions, or restrictions whatsoever.

"The leases, executed the same day, were for one year or any renewal thereof, but were always subject to the right in the lessors to terminate the term during any year by giving the notice as therein provided. It is conceded that the parties contemplated that the premises would be enjoyed by the decedent and her husband so long as they might desire to use them for residential purposes, but the decedent had no valid agreement to that effect. Her rights must be held to be governed by the terms of the lease. If it could be said that the grantees did not come into full possession and enjoyment of the estate at the time of the conveyances—and I am inclined to the opinion that they did—their right to come into full possession did not depend in the slightest degree upon the death of the grantor. The effect of this transaction was to vest in the five sons named in the deed full and complete title to the property including the right of disposition. They had a right to sell the property subject to the lease, and had all rights incident to ownership. There was here a gift completed during the lifetime of the donor. The act of 1918 did not purport to tax such gifts.

"I have reached the conclusion, therefore, that respecting the property conveyed by the deed the facts of this case do not bring the property within the reach of the statute, and that the Commissioner of Internal Revenue was without authority to include the value of it as a part of the gross estate. I therefore give the following instructions, as requested by the plaintiffs: The real estate referred to in the second count of the declaration was not a part of the net estate of Julia Coolidge within the meaning of the Revenue Act of 1918."

We agree with this conclusion and accept as adequate the reasons advanced to support it.

Counsel for the United States argue that the challenged subsection only undertakes to tax the transfer from the dead and merely uses the gross estate to measure the charge. Taken together, sections 402, 408, and 409 disclose definite purpose to do much more than tax this transfer.

Section 402 directs that the gross estate shall be ascertained by including (among other things) the value at his death of all property "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." The language of this section inhibits the conclusion that only subsequent transfers are to be included. Under *Lewellyn* v. *Frick* (268 U. S., 238, 251 [T. D. 3715, C. B. IV-1, 322]), only such transfers come within section 402(f). *Shwab* v. *Doyle* (258 U. S., 529, 536 [T. D. 3339, C. B. I-2, 312]) confined section 202(b), Act September 8, 1916 (ch. 463, 39 Stat., 756, 777)—prototypes of section 402(c), Act 1919—to subsequent transfers. The emphatic words, "whether such transfer or trust is made or created before or after the passage of this Act," added by the latter Act, evidently were intended to exclude a like construction.

Section 408 authorizes an executor to recover from one who receives life insurance "such portion of the total tax paid as the proceeds, in excess of $40,000, of such policies bear to the net estate." Section 409 imposes a lien to secure the tax upon the gross estate; and provides: "If (*a*) the decedent makes a transfer of, or creates a trust with respect to, any property in contemplation of or intended to take effect in possession or enjoyment at or after his death (except in the case of a bona fide sale for a fair consideration in money or money's worth) or (*b*) if insurance passes under a contract executed by the decedent in favor of a specific beneficiary, and if in either case the tax in respect thereto is not paid when due, then the transferee, trustee, or beneficiary

shall be personally liable for such tax, and such property, to the extent of the decedent's interest therein at the time of such transfer, or to the extent of such beneficiary's interest under such contract of insurance, shall be subject to a like lien equal to the amount of such tax."

For the United States it is said that the imposition under consideration is an exercise of the Federal taxing power and is imposed upon a transmission of property by death. Also, that what Congress intended was to provide a measure for the tax which would operate equally upon all those who made testamentary dispositions of their property, whether this was by will or intestacy or only testamentary in effect; the immediate purpose was not to prevent evasions, for the statute applies to transactions completed when there was none to be evaded. And the conclusion is that the measure adopted is reasonable, since the specified transactions are testamentary in effect.

But the conveyance by Mrs. Coolidge to trustees was in no proper sense testamentary, and it bears no substantial relationship to the transfer by death. The mere desire to equalize taxation can not justify a burden on something not within congressional power. The language of the statute is not consistent with the idea that it utilizes the gross estate merely to measure a proper charge upon the transfer by death. See *Lewellyn* v. *Frick*, supra. *Frick* v. *Pennsylvania* (268 U. S., 473, 494) rejected a somewhat similar claim, and said:

"Of course, this was but the equivalent of saying that it was admissible to measure the tax by a standard which took no account of the distinction between what the State had power to tax and what it had no power to tax, and which necessarily operated to make the amount of the tax just what it would have been had the State's power included what was excluded by the Constitution. This ground, in our opinion, is not tenable. It would open the way for easily doing indirectly what is forbidden to be done directly, and would render important constitutional limitations of no avail."

The exaction is not a succession tax like the one sustained by *Scholey* v. *Rew* (23 Wall., 331). *Keeney* v. *New York* (222 U. S., 525.) The right to become beneficially entitled is not the occasion for it. There is no claim that the transfers were made in contemplation of death or with purpose to evade taxation. The provision applicable in such circumstances is not relied on and the extent of congressional power to prevent evasion or defeat of duly imposed exactions need not be discussed.

Certainly Congress may lay an excise upon the transfer of property by death reckoned upon the value of the interest which passes thereby. But under the mere guise of reaching something within its powers Congress may not lay a charge upon what is beyond them. Taxes are very real things and statutes imposing them are estimated by practical results.

As the executors paid the contested charge out of property which actually passed by death, only their rights are here involved. If the fund held by them had been insufficient and payment had been exacted from others, somewhat different questions might require consideration. *Lewellyn* v. *Frick*, supra.

The statute requires the executors to pay an excise ostensibly laid upon transfer of property by death from Mrs. Coolidge to them but reckoned upon its value plus the value of other property conveyed before the enactment in entire good faith and without contemplation of death. Is the statute, thus construed, within the power of Congress?

Undoubtedly Congress may require that property subsequently transferred in contemplation of death be treated as part of the estate for purposes of taxation. This is necessary to prevent evasion and give practical effect to the exercise of admitted power, but the right is limited by the necessity.

Under the theory advanced for the United States, the arbitrary, whimsical, and burdensome character of the challenged tax is plain enough. An excise is prescribed, but the amount of it is made to depend upon past lawful transactions, not testamentary in character and beyond recall. Property of small value transferred before death may have become immensely valuable, and the estate tax, swollen by this, may leave nothing for distribution. Real estate transferred years ago, when of small value, may be worth an enormous sum at the death. If the deceased leaves no estate there can be no tax; if, on the other hand, he leaves $10, both that and the real estate become liable. Different estates must bear disproportionate burdens determined by what the deceased did 1 or 20 years before he died. See *Frew* v. *Bowers, Collector* (12 Fed. (2d), 625 [T. D. 3789, C. B. IV-2, 258]).

This court has recognized that a statute purporting to tax may be so arbitrary and capricious as to amount to confiscation and offend the fifth amendment. (*Brushaber* v. *Union Pacific R. R.*, 240 U. S., 1, 24; *Barclay & Co.* v. *Edwards*, 267 U. S., 442, 450 [T. D. 3691, C. B. IV–1, 207].) See also *Knowlton* v. *Moore* (178 U. S., 41, 77). And we must conclude that section 402(c) of the statute here under consideration, in so far as it requires that there shall be included in the gross estate the value of property transferred by a decedent prior to its passage merely because the conveyance was intended to take effect in possession or enjoyment at or after his death, is arbitrary, capricious, and amounts to confiscation. Whether or how far the challenged provision is valid in respect of transfers made subsequent to the enactment we need not now consider.

The judgment of the court below is affirmed.

GROSS ESTATE—PROPERTY HELD JOINTLY.

REGULATIONS 37, ARTICLE 27: Property held jointly or as tenants by the entirety. VI–28–3307 T. D. 4032

ESTATE TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. GROSS ESTATE—COMMUNITY PROPERTY—CALIFORNIA.

In determining the gross estate of a deceased husband for the purposes of the Federal estate tax there should be included the entire value of the community property acquired under the laws of the State of California.

2. LIMITATIONS—MISTAKE.

There is no statutory limitation to the recovery by the Government of taxes refunded by mistake under an erroneous construction of the law.

3. CASE FOLLOWED.

United States v. *Robbins* (269 U. S., 315 (T. D. 3817 [C. B. V–1, 188])).

4. CASE SUPERSEDED.

Wardell v. *Blum* (276 Fed., 226).

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 California in the case of *Talcott* v. *United States* is published for the information of internal revenue officers and others concerned.

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

Approved July 2, 1927.

CARL T. SCHUNEMAN,
Acting Secretary of the Treasury.

UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF CALIFORNIA.

Talcott, Exctrx., v. *United States.*

[February 28, 1927.]

BOURQUIN, District Judge: Herein the court finds for defendant and against plaintiff, and that defendant is entitled to recover of and from plaintiff the amount of the former's counterclaim, interest and costs. Judgment accordingly.

Stewart v. *Stewart* (72 Cal. Dec., 244) and *U. S.* v. *Robbins* (269 U. S., 315) foreclose all argument, supersede *Wardell* v. *Blum* (276 Fed., 226), and require the conclusion herein.

In respect to limitations, the counterclaim is for money paid by mistake, to which the statutory limitations for collection of taxes have no application—to which is no limitation.

SECTION 402(e).—PROPERTY PASSING UNDER POWER OF APPOINTMENT.

REGULATIONS 37(1921), ARTICLE 30: General rules. VI–42–3475
T. D. 4095

ESTATE TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. GROSS ESTATE—POWER OF APPOINTMENT.

When the donee of a power may appoint without restriction as to the beneficiaries the power is general within the meaning of section 402(e) of the Revenue Act of 1918, although it is exercisable by will only.

2. DECISION AFFIRMED.

The decision of the district court (15 Fed. (2d), 591, T. D. 3960 [C. B. VI–1, 323] 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 Third Circuit in the case of *Elise Whitlock Rose, Executrix of Henry C. Whitlock, deceased, plaintiff in error,* v. *Blakely D. McCaughn, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved October 12, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

Elise Whitlock Rose, Executrix of Henry C. Whitlock, deceased, plaintiff in error, v. *Blakely D. McCaughn, Collector of Internal Revenue, defendant in error.*

In error to the District Court of the United States for the Eastern District of Pennsylvania.

[August 4, 1927.]

OPINION.

Before BUFFINGTON, WOOLLEY, and DAVIS, Circuit Judges.

DAVIS, Circuit Judge: This was an action brought against the collector of internal revenue to recover a Federal estate tax assessed and collected against the estate of Henry C. Whitlock, deceased, under the provisions of section 402 of the Revenue Act of 1918. (40 Stat., 1057.) A statement of claim was filed

by the plaintiff for $441.03, the amount of the tax, with interest, to which an affidavit of defense was filed raising questions of law in the nature of a demurrer. The court sustained the questions of law raised by the defendant and entered judgment for him and the plaintiff brought the case here on writ of error.

Friend Whitlock, father of Henry C. Whitlock, in his last will and testament devised to Henry the income from one-half of his residuary estate, during his natural life, and from and after his death he gave the principal or the one-half "for such uses and purposes, as my said son, Henry Cruskey Whitlock, by any last will and testament may direct, limit and appoint."

In his last will and testament, Henry C. Whitlock devised his residuary estate, which included the estate held in trust for him under the last will and testament of his father over which he had the power of appointment, to his niece, "Eliza Whitlock Rose, her heirs and assigns forever, in fee simple."

The executrix of the estate of Henry C. Whitlock, in making her return of the Federal estate tax to the collector of internal revenue, included the property over which Henry exercised the power of appointment under the will of his father. She thereafter concluded that this property should not have been included in her return because the power given to and exercised by Henry was not a "general power." She, therefore, demanded a return of the amount of the estate tax which she had paid on the property over which Henry had the power of appointment, and when this was refused, she brought this suit.

Section 402 of the Act provides:

"That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

"(e) To the extent of any property passing under a general power of appointment exercised by the decedent (1) by will, or (2) by deed executed in contemplation of, or intended to take effect in possession or enjoyment at or after, his death, except in case of a bona fide sale for a fair consideration in money or money's worth; * * *."

The question for determination is whether or not the property on which the tax was assessed and collected passed from Henry to Elise Whitlock-Rose under a "general power of appointment." The plaintiff contends that in order for a power to be general, it must not be limited either as to appointees or method of appointment. In other words, he says, the donee of the power must be able to convey the property to whomsoever he desires either by will or deed, and since Henry could convey only by last "will and testament" and not by deed, the power was special or particular and not general. Consequently, it is urged, the property did not pass under a "general power" of appointment and so does not come within the provisions of the statute.

What did Congress have in mind when it said that the gross estate of a decedent shall be determined by including the value at the time of his death of all property wheresoever situated, "to the extent of any property passing under a general power of appointment exercised by the decedent (1) by will, or (2) by deed executed in contemplation of, or intended to take effect in possession or enjoyment at or after his death"? The power which the Congress had in mind and which it called "general" was a power which could be exercised by either *will or deed* and did not have to include both. A decedent could select either method, by will or deed, by which a power could be exercised by a donee. Either method, if the donee of the power is not restricted as to appointees, complies with the statute and the power is general.

This use of the term "general power of appointment" is in harmony with general usage. A power is regarded as "general" when it is not restricted by the donor to particular objects or beneficiaries, though the method of exercising it may be restricted and limited to a testamentary paper. (*Tucker* v. *Alexander*, 15 Fed. (2d), 356; *Hume* v. *Randall*, 141 N. Y., 499, 503; *Greenway* v. *White*, 196 Ky., 745.) "A general power of appointment by will enables the donee to devise the property of (to) any person who may have the capacity to take." Underhill on the Law of Wills.

Property subject to a power of appointment under a will is a general power and is equivalent to a fee. (*Lane* v. *Lane*, 55 Atl. (Del.), 184; Bingham's Appeal, 64 Pa., 345; *Pennsylvania Co., etc.*, v. *Ledcrer*, 292 Fed., 629; *Bullen* v. *State of Wisconsin*, 240 U. S., 625.) The law of New Jersey controls this case and, under New Jersey law, property subject to power of appointment by will

is subject to donee's debts and is accordingly a general power. (*Crane* v. *Fidelity Union Trust Co. et al.*, 133 Atl., 205.)

The power created by the will of Friend Whitlock permitted Henry C. Whitlock to appoint "by any last will and testament" any person whomsoever he wished and it was, therefore, a general power and was subject to the tax.

The decree of the district court is affirmed.

PROPERTY PREVIOUSLY TAXED.

REGULATIONS 37 (1921), ARTICLE 52: Property acquired in exchange. VI–38–3440 T. D. 4088

ESTATE TAX—REVENUE ACT OF 1918—DECISION OF COURT.

DEDUCTION—TRANSFER PREVIOUSLY TAXED—PROPERTY ACQUIRED IN EXCHANGE.

Where securities received by a decedent as a share of the estate of a prior decedent are converted into cash and subsequently other securities of substantially the same value are purchased, the securities so purchased are not acquired in exchange for property so received within the meaning of section 403(a)2 of the Revenue Act of 1918, and therefore their value may not be deducted from the value of the gross estate of the decedent.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the District Court of the United States for the Eastern District of Pennsylvania in the case of *United States of America, plaintiff*, v. *Elmer E. Rodenbough, Executor of the Will of Elizabeth McCahan Rodenbough, defendant*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 10, 1927.

A. W. MELLON,
Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

United States of America, plaintiff, v. *Elmer E. Rodenbough, Executor of the Will of Elizabeth McCahan Rodenbough, defendant.*

[August 15, 1927.]

OPINION.

FINDINGS OF FACT.

The court finds the facts as stipulated and adopts the respective stipulations of fact filed by the parties of record as its findings of fact.

CONCLUSION OF LAW.

The property claimed by the executor of Mrs. Rodenbough as a basis for deduction is not property which can be identified as having been acquired by the decedent in exchange for property received by her as a share in the estate of any person who died within five years prior to her death.

OPINION OF THE COURT.

This is an action by the United States to recover the sum of $111,852.58, with interest, the balance of a deficiency assessment of estate tax in the estate of Elizabeth McCahan Rodenbough. The Commissioner of Internal Revenue determined a deficiency due of $113,649.70. On appeal from this determination, the Board of Tax Appeals entered an order determining the deficiency to be $1,797.12, which amount was paid by the defendant. This action was thereupon brought to recover the balance of the deficiency determined by the Commissioner but which had been disallowed by the Board of Tax Appeals.

Mrs. Rodenbough died October 15, 1921. She was a daughter of William J. McCahan, who died within five years prior to her death. The value of Mrs. Rodenbough's share in her father's estate was $3,831,506.22. In the distribution of her father's estate Mrs. Rodenbough received certain stocks and bonds which are set forth at large in the fourth stipulation of fact, together with certain other securities which remained in her possession until the time of her death. As to these latter, no question is raised and they were not included in the decedent's gross estate by the Commissioner of Internal Revenue.

All of the securities, particularly referred to in the fourth stipulation of fact, were converted into cash during the lifetime of Mrs. Rodenbough. Some of them were sold by her. Others matured and were paid off at their maturity dates, Mrs. Rodenbough receiving the cash. In the case of W. J. McCahan Sugar Refining Co. (the largest item in the list), this company sold its assets and distributed their proceeds in liquidation to the stockholders. Mrs. Rodenbough received as a result of this distribution $1,296,675 in cash in two installments.

Upon receipt of the proceeds of the sales, maturities, and liquidating distributions referred to, Mrs. Rodenbough deposited the money to her credit in a general banking account in the Philadelphia Trust Co., where the proceeds were mingled with funds derived from other and miscellaneous sources. From time to time, Mrs. Rodenbough invested in other securities, purchasing them by checks drawn against this account. Between the time of the receipt by Mrs. Rodenbough of the securities of her father's estate and the time of her death she deposited in her bank account from proceeds of sales, maturities, and distributions arising out of the same the sum of $1,716,834.93 and from other and miscellaneous sources the sum of $774,095.14. During that time she drew checks against her bank balance to purchase other securities referred to in the stipulation of facts in the amount of $1,444,382.20, and for other purposes the sum of $1,018,652.48. She also purchased a house for the sum of $100,000, drawing the funds by check from her general account in the Philadelphia Trust Co.

At the time of her death she was in possession of certain investments which had been purchased in the manner above indicated and paid for by checks drawn upon her general account.

The defendant, her executor, claims a deduction under section 403(a)2 of the Revenue Act of 1918, representing the greater part of the value of the securities so purchased. This deduction was disallowed by the Commissioner of Internal Revenue and the deficiency in tax arising from its disallowance is the subject of this suit.

Section 403(a)2 of the Revenue Act of 1918 (40 Stat., 1057) is as follows:

"SEC. 403. 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—

* * * * * * *

"(2) An amount equal to the value at the time of the decedent's death of any property, real, personal, or mixed, which can be identified as having been received by the decedent as a share in the estate of any person who died within five years prior to the death of the decedent, or which can be identified as having been acquired by the decedent in exchange for property so received, if an estate tax under the Revenue Act of 1917 or under this Act was collected from such estate, and if such property is included in the decedent's gross estate;"

The question involved is whether the securities claimed as a deduction constituted property "which can be identified as having been acquired by the

decedent in exchange for property so received"; that is, received from the estate of a person who died within five years prior to the death of the decedent.

The plaintiff's position is based upon the strict legal interpretation of the word "exchange." It is contended that property deductible must have been acquired by a transaction constituting an exchange at common law which is equivalent to barter and excludes all transfers of property for money, that the statute limits the deduction to cases where one such exchange only has taken place, that none of the transactions by which Mrs. Rodenbough acquired the property now claimed as a deduction was an exchange, and that therefore the entire question of the identification of these securities as having been purchased with the proceeds of those received from her father's estate is wholly immaterial. On the other hand, it is the position of the defendant that looking toward the substance of the transactions and not the form, Mrs. Rodenbough's purchase of new securities in substitution for those obtained from her father's estate and subsequently paid off, liquidated, or sold constituted acquiring property in exchange, and that by tracing the proceeds through her bank account, the securities claimed as a deduction can be identified as property so acquired.

There is no difficulty about the legal meaning of the word "exchange." It is a word of precise import and sharply distinguished from a sale. "'Exchange' means the giving of one thing for another. It excludes the idea of first measuring the respective things in money value and then settling or paying any difference." (*Chicago G. W. R. Co.* v. *Postal Tel. Cable Co.*, 249 Fed., 664.) "'Sale' means for money. 'Exchange' of property is a mere barter or trade. The very purpose of money is to have a medium of exchange so that borrowing or trading or bartering can be dispensed with." (*Ewers* v. *Weaver*, 182 Fed., 713.) "But 'exchange' is barter and carries with it no implication of reduction to money as a common denominator." (*Postal Tel. Cable Co.* v. *Tonopah R. R. Co.*, 248 U. S., 471.) Any transaction into which money enters, either as the consideration furnished by one party or as a basis for measuring the value of the things transferred, is excluded. To constitute an exchange in the legal sense, the mutual transfers must be in kind. So far the contention of the Government is correct, and is supported by ample authority.

But we are here concerned with the meaning not of a single word but of a phrase, viz, "acquired in exchange for." If the statute referred to property "exchanged," or if the words were "acquired by an exchange," or even "acquired by exchange," the conclusions drawn by the Government would undoubtedly follow. But the phrase under consideration has a broader meaning. Thus, in case of a sale, say, of a bond for $1,000 in cash, it is perfectly correct to say that the money was acquired or received in exchange for the bond, although the transaction is a sale and not an exchange at all in the legal sense. Courts have even made use of the phrase in question in defining a sale. "Sale means transfer of property in exchange for money or security for money." (*Brown* v. *Fitz*, 13 N. H., 283.) Whatever the strict legal intendment of the word "exchange" may be, the phrase "in exchange for," according to common usage, does not exclude the idea of money as a medium for carrying out the transaction.

On the other hand, it is obvious that in providing for the deduction in question, the Congress took care to place definite limits upon it. It carefully avoided allowing a general deduction to the amount of the property received from the prior decedent. The phrases adopted to define and limit the scope of the deduction were: "the value * * * of any property * * * which can be identified as having been received by the decedent as a share in the estate * * * or which can be identified as having been acquired by the decedent in exchange for property so received." In arriving at the intention of Congress in using the latter of these limiting phrases, we may consider the object which it sought to obtain by the section in question and the evil which it endeavored to remedy. In enacting the second subdivision of section 403(a) of the Revenue Act, providing for the deductions here claimed, Congress unquestionably had in mind the hardship arising from the double taxation of the same or substantially the same estate, which under the old law would arise from the accident of two successive deaths occurring within a comparatively short time. It was the subjection of the same property the second time to the taxing power that in the judgment of Congress called for a remedy. On this point the report of the Ways and Means Committee on the revenue bill of 1918, Sixty-fifth Congress, second session, Report 767, accompanying H. R. 12863, is illuminating. That report says:

"It has come to the attention of the committee that persons closely related have died within such a short space of time that the same estate passing within a short period of time has been subjected to the estate tax and thereby diminished unreasonably because of the short period within which the two levies have been made."

In introducing the bill in the House of Representatives, Mr. Kitchin said:

"We have another very just provision that if a person who receives a share of an estate dies within five years from the death of the person from whom he receives the estate, his share shall not pay another transfer tax within the five-year period."

It is quite true that the tax was not in theory a direct tax upon the property, but upon the right to transmit it; but the tax was as a practical matter usually borne by the property of the estate. It was the depletion of the same estate by the second imposition of a tax that Congress sought to avoid. Another consideration which may also have been present in the adoption of the phrases in question is the practical difficulty in applying the statute and the intricacies of proof involved in tracing funds where property had passed through a number of changes in form, or where money had been commingled with other funds. At any rate, it is clear that in allowing the deduction the Congress deemed the substantial identity of the property of the estate sought to be taxed with that received from the prior decedent to be the essential and controlling fact. With this as the paramount purpose in mind, it was entirely consistent and reasonable to extend the deduction to cases where, by reason of the mode of its acquisition, the new property was so closely related with that received as to be essentially the same property changed in form only, and this is clearly the intent underlying the second clause, providing for cases where property had been acquired in exchange for property of the prior decedent. If the language used by the Congress to express its purpose be carefully considered, it will be seen that it is nicely adapted to that object.

These considerations are overlooked by the defendant in his argument as to the meaning of the phrase in question. The result of his contention, so far as it applies to the facts in this case, is to make the language under consideration equivalent to "purchased with the proceeds of" or perhaps "acquired in substitution for" or "held in the place of," and thus broadened, it allows a general deduction to the amount received from the estate of the prior decedent subject only to the condition that the money or property so received be traced in some form into the hands of the executor claiming the deduction. Both the manifest purpose of Congress and the words used negative such a conclusion.

The phrase "acquired in exchange for" has a much more limited scope than those just mentioned. "Acquired in exchange for" means acquired by a transaction which is in substance though not necessarily in form an exchange. It carries the idea of a mutual substitution. The Century Dictionary gives as a definition of exchange, "4. Mutual substitution; return; used chiefly in the phrase *in exchange*." In order to acquire one thing in exchange for something else, there must be something given as well as something received. A thing which has ceased to exist can not thereafter be exchanged, and no other thing can be acquired in exchange for it. If a house is destroyed by fire and the owner purchases securities with the insurance money, he does not acquire the securities in exchange for the house. If a mortgagor pays off a mortgage and the mortgagee buys an automobile with the money so received, he does not acquire the automobile in exchange for the mortgage. In those cases, it might properly be said that the property acquired was purchased with the proceeds of the former property or that it is held in place of or in substitution for it, but not that it was acquired in exchange for it. There must also be some definite and reasonably close relation between the giving and the receiving. Where the only facts that can be shown are that property was sold and that some time subsequently other property of approximately the same value purchased, it can not be said that the property so purchased was acquired in exchange for the property sold, even though it could be shown that it was purchased with the proceeds of the property sold (an element which, as will appear, is lacking in this case so far as the sales and purchases are concerned).

But the defendant argued that unless his contention be accepted, the result will be that the deduction will be confined to instances of technical exchange or barter at common law. This does not follow, however. Transactions are common enough which may or may not be exchanges in form but are neverthe-

less substantial exchanges. For example, where corporate or other debts are refinanced by the giving and voluntary acceptance of new obligations in place of the old, where by reason of a merger or consolidation stockholders accept new securities in place of old, or even in cases of sale, through a broker or agent where the transaction results in a mutual substitution of property, there would be no difficulty in holding that a substantial exchange of property was accomplished.

When we come to examine the transactions by which Mrs. Rodenbough obtained the securities now claimed for the basis of a deduction, we find three general types or classes: (1) Certain corporation bonds matured, were paid off, and she received the cash; (2) the W. J. McCahan Sugar Refining Co. sold its assets, liquidated, and paid off its stockholders in cash; (3) she sold certain securities on the market, deposited the proceeds in her general bank account, and subsequently bought other securities. When the corporation bonds were paid off, the rights of Mrs. Rodenbough which were evidenced by them and which were the real subject of ownership were extinguished. The same thing occurred when the sugar company liquidated. It makes no difference whether or not the company was actually dissolved. So far as practical results are concerned, the stock ceased to have any value whatever. The fact (if it be a fact) that with the money so received she subsequently bought some of the securities now claimed does not bring those securities within the language of the deduction. They were not acquired in exchange for the matured bonds or for the stock of the sugar company. As to the sales made by her, there is no evidence whatever of any relation between them and the subsequent purchases, except, in certain cases, the equivalence of the sums of money involved.

The circumstance that these transactions were accomplished through the medium of money does not necessarily exclude them from the deduction. We agree with the argument of the defendant, based upon the rule in *U. S.* v. *Phellis* (257 U. S., 156 [T. D. 3270, C. B. 5, 37]) and other cases, to the effect that in determining whether a particular transaction is subject to the tax laws, the courts will consistently regard matters of substance and disregard forms. The difficulty with the defendant's position is that, even disregarding the forms of the transactions by which Mrs. Rodenbough obtained the securities now claimed, they were none of them exchanges in substance. The only way in which the statute can be made to cover such transactions is to give it a meaning which totally ignores the use of the word "exchange" and the purpose for which it was adopted.

There is, however, in the case of the sales and purchases, a further difficulty. Even under the defendant's theory, it would still be necessary to identify the property in question as having been acquired with the funds arising from the sale of the securities which she inherited. This would involve the necessity of tracing the proceeds of the sales, and when we turn to Mrs. Rodenbough's bank account, as set forth in full in the thirty-fifth stipulation of fact, we find that that is impossible. Mrs. Rodenbough sold and bought the securities in question during a period extending approximately from December 17, 1918, down to December 13, 1920. During that period she deposited from sales of the securities in question $520,159.93, and from other and independent sources (including the money which she had on deposit at the time of the first sale), $609,055.05. She purchased the securities now claimed as a deduction to the amount of $437,898.15, and she drew out for general expenses and other purposes not connected with the deduction claimed $501,560.48.

The defendant bases his claim that the proceeds are traceable upon the stipulation that between the dates of the deposits of money received from sales and the withdrawals in payment for subsequent purchases the balance in the account was at no time lower than the amount required to make the purchase, and invokes the rule of *Knatchbull* v. *Hallett* (13 Ch. D., 696) and the many trust fund cases that follow it. That rule, however, has no application to this case. It arises from the presumption that where there has been a tortuous commingling by a trustee of trust funds with other funds not subject to the trust, followed by withdrawals, the trustee in making withdrawals is presumed to have acted honestly and not wrongfully, and therefore the withdrawals will be presumed to have been of his own money and what remains will belong to the cestui que trust. Obviously, that presumption does not apply here. Without the benefit of it, however, the defendant can not trace the proceeds of the securities sold into the securities on hand at the time of Mrs. Rodenbough's death. The burden of showing that the estate is entitled to a deduction with respect to property which, under the general provisions of the

statute, forms part of the gross estate is upon the defendant, and in the absence of evidence to establish this fact there can be no deduction allowed.

The defendant further points out that since the Board of Tax Appeals decided this case the Revenue Act of 1926 was enacted, containing in section 303, subsection (a)2, the identical language construed by the Board of Tax Appeals, and argues that this amounts to an adoption of that construction by Congress. With this conclusion we do not agree. The cases cited by the defendant are all cases where the provisions of the statute reenacted had received construction by the Supreme Court of the United States. It is also true that there are decisions to the effect that when the meaning of the statute is doubtful great weight should be given to the construction placed upon it by the department charged with its execution, and also that reenactment by Congress, without change, of a statute which had previously received long-continued executive construction is an adoption by Congress of such construction. (*U. S.* v. *Hermanos y Compania*, 209 U. S., 337.) In *Iselin* v. *U. S.* (270 U. S., 245 [T. D. 3846, C. B. V–1, 365]) the Supreme Court declined to apply this rule to the case before it, saying:

"But the construction was neither uniform, general, nor long continued; neither is the statute ambiguous. Such departmental construction can not be given the force * * * of law."

In the case before us, the Board of Tax Appeals made its decision January 31, 1925. This decision was contrary to the construction which had been placed upon the provision by the Commissioner for a considerable time. The Commissioner never acquiesced in the view of the Board of Tax Appeals. On December 11, 1925, the statement of claim in this case was filed, based upon a construction contrary to that adopted by the Board. This was the position of affairs when the Revenue Act of 1926 was passed on February 26, 1926. Under these conditions it can not be said that the reenactment of the section in question without change was an adoption of the construction placed upon it by the Board of Tax Appeals.

One other matter remains to be disposed of. The defendant argued that under the limitation provision of section 407 of the Revenue Act of 1921 this action against the defendant is barred. The discharge from liability provided for by that statute, however, is a discharge from personal liability. This action is not against the executor personally, but against him in his respective capacity as executor of the estate. A judgment rendered in this action would not subject him directly to any personal liability. If for any reason as a result of the judgment in this case recourse against the executor in his personal capacity should be attempted, the question could then be raised. As the record stands at present it is not involved.

In accordance with the foregoing, judgment may be entered for the plaintiff in the amount of $111,852.58, with interest as claimed in the statement of claim.

DEDUCTIONS—CHARITABLE AND SIMILAR BEQUESTS.

REGULATIONS 37, ARTICLE 53: Public, charitable, and similar bequests. VI–32–3361 T. D. 4051

ESTATE TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. GROSS ESTATE—DEDUCTION—CHARITABLE BEQUEST UPON CONTINGENCY.

The amount of a bequest for charitable purposes contingent upon an event that may never happen is not deductible from the value of the gross estate in determining the value of the net estate under section 403 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 Court of Claims of the United States, in the case of *John J. Mitchell, Augustine L. Humes, and*

Illinois Merchants Trust Co., as Executors of the Last Will and Testament of Dellora R. Gates, deceased, v. *United States*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 1, 1927.
CARL T. SCHUNEMAN,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

John J. Mitchell, Augustine L. Humes, and Illinois Merchants Trust Co., as Executors of the Last Will and Testament of Dellora R. Gates, Deceased, v. *The United States.*

[June 6, 1927.]

MEMORANDUM BY CHIEF JUSTICE CAMPBELL.

The considerations upon which the court bases its judgment are as follows:

The question for decision is whether, under the undisputed facts, the executors of the will, in the ascertainment of the value of the net estate, may deduct from the value of the gross estate a bequest to trustees for charitable purposes where such bequest is upon a contingency that may never happen.

(1) The Revenue Act of 1918 (40 Stat., 1098, sec. 403), authorizing deductions from the gross estate of the amount of all bequests or gifts to a trustee, exclusively for religious or charitable purposes, contemplates bequests or gifts intended to take effect (1) upon the testator's death, or (2) upon the happening of an event that will certainly occur.

(2) If the contingency, upon which the bequest is to go to the charitable purpose, be such that the bequest or gift may never become effective in possession or enjoyment the statute does not authorize a deduction of the amount, or its ascertained value, from the gross estate.

(3) In the instant case any right to the supposed charitable bequest is liable to be defeated if and when the niece, made the principal beneficiary under the residuary clause of the will, attains 40 years of age. In other words, the supposed bequest to charity may never ripen into possession or enjoyment. It is, therefore, too remote, contingent, and uncertain to be taken into account in determining the value of the net estate for the purposes of the estate tax under the Revenue Act of 1918.

TITLE IV.—ESTATE TAX. (1916)

THE NET ESTATE.

REGULATIONS 37 (1917), ARTICLE XXI. VI-37-3430
T. D. 4084

ESTATE TAX—REVENUE ACT OF 1916—DECISION OF COURT.

1. GROSS ESTATE—DEDUCTIONS—ESTATE TAX.

The Federal estate tax imposed by the Revenue Act of 1916, as amended, is not a charge against the estate within the meaning of that phrase as used in section 203(a)1 of that Act and can not, therefore, be deducted from the value of the gross estate to determine the value of the net estate.

2. NET ESTATE—COMPUTATION—DEDUCTION OF ESTATE TAX.

The estate tax imposed by Title II of the Revenue Act of 1916, as amended, is a single estate tax, the amount of which is computed upon the basis of a single net estate, and not several taxes each based upon the part of the net estate within the several blocks provided for in section 201.

3. DECISION AFFIRMED.

The decision in the case of *Old Colony Trust Co. et al.* v. *Malley* (15 Fed. (2d), 105, T. D. 3962 [C. B. VI–1, 326]) is 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 First Circuit, in the case of *Old Colony Trust Co. et al., Executors, plaintiffs, plaintiffs in error*, v. *John F. Malley, Formerly Collector of Internal Revenue, et al.*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 30, 1927.
OGDEN L. MILLS,
Acting Secretary of the Treasury.

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UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

Old Colony Trust Co. et al., Executors, plaintiffs, plaintiffs in error, v. *John F. Malley, Formerly Collector of Internal Revenue, et al., defendants, defendants in error.*

Error to the District Court of the United States for the District of Massachusetts.

[May 17, 1927.]

OPINION.

ANDERSON, J.: The executors under the will of Sidney W. Winslow, who died on June 18, 1917, brought this suit at law to recover a portion ($58,238.12) of an inheritance tax claimed to have been illegally exacted from their estate. The tax was levied under the Act of September 8, 1916 (39 Stat., 777), as amended (by increasing the rates) by Act of March 3, 1917 (39 Stat., 1002). Sections 201 and 203, so far as they need now be stated, are as follows:

"SEC. 201. That a tax (hereinafter in this title referred to as the tax), equal to the following percentages of the value of the net estate to be determined as provided in section 203, 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:

"1½ per centum of the amount of such net estate not in excess of $50,000;

"3 per centum of the amount by which such net estate exceeds $50,000 and does not exceed $150,000;

"4½ per centum of the amount by which such net estate exceeds $150,000 and does not exceed $250,000. * * *

"13½ per centum of the amount by which such net estate exceeds $4,000,000 and does not exceed $5,000,000."

"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; and

"(2) An exemption of $50,000."

The applicable regulation promulgated by the Treasury Department under date of May, 1917, is as follows:

"ART. XXI. The Federal estate tax is not determined, does not attach, and can not be assessed or paid until the net estate upon which it is based has been exactly established. The estate tax, therefore, can not be deducted from the gross estate to determine the taxable net estate."

Plaintiffs attack this regulation as inconsistent with the statute; also as "unconstitutional"—a claim so obviously unsound as to call for no discussion.

The Commissioner determined the net value of the Winslow estate to be $4,837,860.63, and computed the tax at $489,613.61, by applying the appropriate percentages to the blocks as stated in section 201, but without deducting the tax in order to determine the amount of the tax. Plaintiffs' learned counsel, in an elaborate argument, urge that this method is erroneous; they contend that the Act imposes successive taxes, equal to percentages of the separate blocks of the net estate, each of which, exclusive of the tax, constitutes a separate unit of measure.

In the exact words of counsel for plaintiffs—

"The question presented involves the interpretation of that Act, to ascertain whether the amount of the tax itself, imposed by the Act, should be included in the 'measure of that tax.'"

We agree with plaintiffs' counsel that this problem of statutory construction must be determined under the familiar rule that, in taxing statutes, doubt about the construction must be resolved against the Government and in favor of the taxpayer. (*Gould* v. *Gould*, 245 U. S., 151, 153; *United States* v. *Merriam*, 263 U. S., 179, 187, 188 [T. D. 3535, C. B. II-2, 87].)

But we are not able to adopt the view that there is any reasonable doubt about the construction of this statute. Weight must be given to the contemporaneous construction of the department charged with the enforcement of the statute. (*Malley* v. *Walter Baker & Co.*, 281 Fed., 41, 46 [T. D. 3344, C. B. I-2, 300] and cases cited; *Baltzell* v. *Mitchell*, 3 Fed. (2d), 428, 430 [T. D. 3668, C. B. IV-1, 191] and cases cited.) We think that the Treasury Department put the obvious and the only natural interpretation upon the language used.

The Act contemplates a tax—i. e., a single tax; and upon a net estate, not upon various estates. The fact that the tax is "equal to the following percentages of the value of the net estate" does not transmute one tax into many taxes, and one net estate into several net estates. The words "equal to the following percentages of the value of the net estate" mean exactly the same as the words "equal to the sum of the following percentages of the value of the net estate" in section 401 of the Act of 1918 (40 Stat., 1096); not, as plaintiffs urge, a different basis for the tax. There is one tax on one net estate, under both Acts.

The gist of the plaintiff's contention is that, under section 203, the tax and no part thereof can be used as the measure or base of the tax; that "net estate" means the exact amount available for transfer to beneficiaries; from which it follows that there must be as many real "net estates" as there are separate blocks. But only by an algebraic formula—an intent to use which is "not lightly to be imputed to legislators" (*Edwards* v. *Slocum*, 264 U. S., 61, 63; 287 Fed., 651, 654 [T. D. 3584, C. B. III-1, 479])—can the tax thus grounded be computed.

The fallacy of the elaborate schedules and diagrams in plaintiffs' brief may most easily be demonstrated by assuming the simplest form of a taxable estate—one of $50,000 *net*—that is, after deducting the undisputed items covered by section 203—and a tax thereon of 1 per cent. Manifestly, the Commissioner would figure the tax as $500, 1 per cent of $50,000. But this would leave a "net estate," plaintiffs urge, of only $49,500; so that the tax of $500 is, *pro tanto*, measured by the tax. To meet their objection, a formula something like the illustration set forth in the margin is necessary, or at any rate convenient.

Plaintiffs compute the tax on the Winslow estate as follows:

Blocks of net estate.		Amount of tax.	Statutory language.	Rate of tax.	Transfer of net estate.
	$4,406,485.14	$431,375.49			$4,406,485.14
1st	50,000.00	750.00	Equal to	1½ per cent of	50,000.00
2d	100,000.00	3,000.00	Equal to	3 per cent of	100,000.00
3d	100,000.00	4,500.00	Equal to	4½ per cent of	100,000.00
4th	200,000.00	12,000.00	Equal to	6 per cent of	200,000.00
5th	550,000.00	41,250.00	Equal to	7½ per cent of	550,000.00
6th	1,000,000.00	90,000.00	Equal to	9 per cent of	1,000,000.00
7th	1,000,000.00	105,000.00	Equal to	10½ per cent of	1,000,000.00
8th	1,000,000.00	120,000.00	Equal to	12 per cent of	1,000,000.00
9th	406,485.14	54,875.49	Equal to	13½ per cent of	406,485.14

This method disregards the controlling principle of their argument—that the tax on each block should be deducted in computing the tax on that particular block. The tax, as they compute it, is reckoned, flat ($750), on the first block of $50,000; and thus includes the tax as part of the measure of the tax. So as to the other blocks. The deduction of the tax on earlier blocks, at lower rates, does not really apply plaintiffs' theory, as they argue it.

We have taken pains to compute the tax in real accordance with plaintiffs' theory. It follows:

Blocks of net estate.		Rate.	Tax.
		Per cent	
1st	$50,000.00	1½	$738.92
2d	100,000.00	3	2,912.62
3d	100,000.00	4½	4,306.22
4th	200,000.00	6	11,320.75
5th	550,000.00	7½	38,372.09
6th	1,000,000.00	9	82,568.81
7th	1,000,000.00	10½	95,022.62
8th	1,000,000.00	12	107,142.85
9th	837,860.63	13½	99,657.43
Net estate	4,837,860.63		

Let $X = \text{tax}$.
Then $X = 1$ per cent of ($50,000—X).

$$X = \frac{\$50{,}000 - X}{100}$$

$100\ X = \$50{,}000 - X.$
$101\ X = \$50{,}000.$
$X = \$495.49.$

This gives a total of $442,042.31, or $10,666.92 more than plaintiffs reckon it, by misapplying their own theory, and $47,571.30 less than the Commissioner computed it.

What plaintiffs in their computation really do is to subtract the tax on the first eight blocks, $376,500 (reckoned properly as the Commissioner computes it), thus reducing the ninth block from $837,860.63 to $406,485.14. On not one of the blocks do they reckon the tax in accordance with what they urge as the correct interpretation of the Act. They simply use the tax on the first eight blocks in the attempt to reduce the size of the last block—which is, of course, subject to the highest rate—13½ per cent.

Congress never intended anything of this sort. It intended the Act to be construed and applied as it has been for 10 years.

If the correct construction were otherwise in doubt, we think the legislative history of the corresponding provisions in the Act of September 3, 1918 (40 Stat., 1057), would resolve that doubt. The principle laid down by Marshall, C. J., in *Alexander* v. *Mayor, etc., of Alexandria* (5 Cranch, 1) is applicable:

"If a subsequent act on the same subject affords complete demonstration of the legislative sense of its own language, the rule which has been stated,

requiring that the subsequent should be incorporated into the foregoing Act, is a direction to courts in expounding the provisions of the law."

The same principle is stated in *United States* v. *Freeman* (3 How., 556, 564).

In the report of the committee dealing with the intended revision, we find the following concerning section 403:

"Section 403, which takes the place of section 203 of the original Act defining the deductions for the purpose of arriving at the net estate, inserts a provision that income taxes upon income received after the death of the decedent, and estate, succession, legacy, or inheritance taxes, are not to be deducted. Obviously, income taxes should not be deducted, for the reason that they are payable from and on account of income which is not included in the gross estate. Inheritance taxes payable to States are payable in respect to the benefits derived by individual legatees and beneficiaries. They are computed upon the basis of the amount which passes to such beneficiaries and are not known until estate taxes have been ascertained. These provisions are in conformity with existing rulings in the administration of the law, which rulings the committee thinks are in accordance with the statute, and are now included for the sake of clarification, as in the case of additions made to section 402 mentioned above."

Accordingly, section 403 of the Revenue Act of 1918 (ch. 18, 40 Stat., 1098) was made to read as follows:

"SEC. 403. 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, or from theft, when such losses are not compensated for by insurance or otherwise, and such amounts reasonably required and actually expended for the support during the settlement of the estate of those dependent upon the decedent, as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered, *but not including any income taxes upon income received after the death of the decedent, or any estate, succession, legacy or inheritance taxes.*"

We think the italicized words at the end are nothing but declaratory of the real meaning of the previous laws, as properly construed by the department charged with its enforcement. We can not adopt the view of plaintiff's counsel that this provision of the Act of 1918 "shows a decided change" in the method of computing this tax; it was, as the committee states, "included for the sake of clarification."

Certainly there is nothing in the decided cases lending any support to the plaintiff's fundamental contention. The decision of the Supreme Court in *Edwards* v. *Slocum* (264 U. S., 61) (s. c. 287 Fed., 651) falls little if anything short of being conclusive against the plaintiff. The court was there dealing with the provisions of the statute of February 24, 1919 (ch. 18, sec. 400, 40 Stat., 1057, 1096), which, for present purposes, are indistinguishable from those here involved. The court said (p. 63), by Mr. Justice Holmes, of this statute:

"It 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."

In *Irving Bank-Columbia Trust Co.* v. *United States* [T. D. 3961, C. B. VI–1, 328], United States Court of Claims, the plaintiff made exactly the same contention as is now before us. That court declined to adopt the plaintiff's theory, saying, *inter alia:*

"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."

In this case, *sub nominee, American Exchange-Irving Trust Co.* v. *United States*, certiorari was denied by the Supreme Court on February 28, 1927. (Sup. Ct. Rep.)

On principle and authority the judgment below must be affirmed.

The judgment of the district court is affirmed.

NET ESTATE—DEDUCTIONS.

REGULATIONS 37, ARTICLE 40: Funeral expenses. VI–36–3416
T. D. 4074

ESTATE TAX—REVENUE ACT OF 1916—DECISION OF COURT.

GROSS ESTATE—DEDUCTIONS—CHARGES—AGREEMENT AS A DISSENT FROM WILL.

An agreement between a widow and the executor of her husband by the terms of which she released all her rights as widow against the executor except her interest under his will is not such dissent from the will as is required by the law of Tennessee, and payments made to the widow as a result of such agreement are not deductible from the value of the gross estate under section 203(a)1 of the Revenue Act of 1916 as charges against the estate allowed by the laws of the jurisdiction under which the estate is being administered.

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 at Knoxville, Tenn., in the case of *Lucy G. Briscoe et al.* v. *E. B. Craig, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 26, 1927.

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

UNITED STATES DISTRICT COURT AT KNOXVILLE, TENN.

Lucy G. Briscoe et al. v. *E. B. Craig, Collector of Internal Revenue.*

[June 20, 1927.]

OPINION—REVENUE ACT OF 1916–1917.

MEMORANDUM.

This is a lawsuit, and by proper stipulation was tried to the court without a jury. The plaintiffs are the executors and trustees of the estate of Daniel Briscoe, deceased. Originally the defendant was E. B. Craig, collector of internal revenue for Tennessee. Upon his death the suit was revived against the executors of his will.

Daniel Briscoe died testate on February 7, 1918, leaving a widow, Lucy G. Briscoe, and seven children. The executors filed a return for estate tax

purposes, and paid the tax based thereon, to wit, $79,624.21. Afterwards the Commissioner of Internal Revenue directed a review and audit of the return, with the result that the value of the real estate was increased $154,275, and there was included in the gross estate $75,000 paid to the widow, Lucy G. Briscoe, as the result of a certain agreement between her and the executors and trustees. Upon this increased valuation an additional estate tax and interest thereon in the sum of $29,638.57 was assessed and paid on September 3, 1921, under protest. The claim for refund of this amount with interest was filed and rejected, and thereupon this suit brought to recover it.

The suit was originally commenced in the middle district of Tennessee. The declaration was filed, and thereupon the defendant filed a motion to dismiss upon five grounds. This was improper practice. The procedure should have been in accordance with the Conformity Act, United States Code, page 935, section 724. There is no such practice in Tennessee as a motion to dismiss upon the grounds indicated. This motion to dismiss was heard by Judge Gore, one of the judges of the middle district, and was properly treated by him as a demurrer and was overruled. Thereupon the defendant filed an answer denying liability. This was likewise improper, because the action is one at law, and under the Conformity Act and the Tennessee practice required a plea rather than an answer, but no objection was made, and the case having been heard without a jury, I treat the issues as properly made and the issues are, first, whether the real estate was properly assessed, and, second, whether the sum of $75,000 paid to the widow should have been excluded from the gross estate, or if included, should have been deducted therefrom in computing the net estate.

As to the real estate. * * * I have examined it carefully, and I have a feeling that the plaintiffs have suffered no injustice at the hands of the Commissioner in the assessment of the real estate, and I therefore dismiss the plaintiffs' case as to this feature.

As to the $75,000. The Federal estate tax is simply an excise due upon the transfer of an estate at the death of the owner, and is to be calculated upon the net estate. (Sec. 201, Act of September 8, 1916, 39 Stat., 756; *Y. M. C. A.* v. *Davis*, 264 U. S., 47; *Randolph* v. *Craig*, 267 Fed., 993.) The value of the net estate for tax purposes is to be determined by a deduction from the value of the gross estate of "claims against the estate" 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 was held by Judge (now Mr. Justice) Sanford, while district judge in this jurisdiction, that "in any event if her (the widow's) dower, homestead and year's support should be deemed a part of the decedent's gross estate within the meaning of the estate tax stafute, they would be deductible from the value of the gross estate under section 203 (cl. a(1)), being Compiled Statutes, section 6336½d, as charge against the estate allowed by the law of the jurisdiction under which the estate is being administered.

It is insisted by plaintiffs that of the $75,000 paid to the widow by the executors and trustees of the estate, $70,000 represented dower and that $5,000 represented a year's support. If this is true, assuming that property assigned to the widow as dower and year's support is a part of the gross estate contrary to the opinion in *Randolph* v. *Craig*, above cited, I conclude that dower and year's support would be deductible from the gross estate by virtue of that portion of section 203 of the Act providing that the value of the net estate shall be determined by deducting from the value of the gross estate "such other charges against the estate, as are allowed by the laws of the jurisdiction * * * under which the estate is being administered." So that the fundamental question here is whether the $75,000 is to be treated as the equivalent of dower and year's support. There is no provision in Tennessee for dower and year's support to the widow of one dying testate except section 4146 of Shannon's Code, and as to this case the only applicable provision is subsection 1 of said section 4146. This section, so far as material, is as follows:

"A widow may dissent from her husband's will (cl. 1) where a satisfactory provision in real and personal estate is not made for her; in which case *she shall signify her dissent in open court* within one year after the probate of the will * * *. And * * * she shall be endowed as if her husband had died intestate and shall be entitled to her distributive share as provided in section 4147."

In other words, upon a proper dissent from the will a widow is placed in the same situation as if her husband had died intestate, not only as to the dower, but as to her distributive share in personalty and as to the year's support provided for by statute. (*Turner* v. *Fisher*, 4 Sneed, 209; *Fry* v. *Watson*, 7 Heisk., 232; *Stewart* v. *Taylor*, 9 Lea, 352; *Rowlett* v. *Rowlett*, 8 Cates, 458; *Chammes* v. *Parrish*, 10 Cates, 745; *Gupton* v. *Gupton*, 3 Head, 489; *DeMos* v. *DeMos*, 7 Cole., 262; *Waterbury* v. *Netherlands*, 6 Heisk., 920; *Rhea* v. *Greer*, 2 Pick., 68.) To be more specific, if the widow does not dissent from the will, she of course takes under the will, whereas if she does properly dissent, she then takes under the law of intestate administration. It is with her a matter of election, and it is a choice personal to herself. (*Bowers* v. *McGavock*, 114 Tenn., 438.) It is not an informal or unimportant matter. In many cases it is a matter of grave consequence. The law throws around the proceeding many restrictions. Before she makes her choice the widow is entitled to have disclosed to her the state and condition of her husband's estate. (Shannon's Code, sec. 4148.) "*She shall signify her dissent in open court within one year after the probate of the will.*" (Shannon's Code, 4146, cl. 1.) She has this entire year within which to make a choice, and if she fails to dissent within the year, she is conclusively presumed to have elected to take under the will. *Waterbury* v. *Netherlands* (6 Heisk., 521) and cases there cited. Whether she takes under the will or under the law, she takes all together under one or the other. If she dissents from the will, she dissents from it as a whole. If she accepts under the will, she accepts the benefits of the will as a whole. In other words, she takes under either one or the other. She can not take under both. (*Calvert* v. *Wodd*, 93 Tenn., 453; *Williams* v. *Williams*, 15 Lea, 438; *Bible* v. *Marshall*, 103 Tenn., 324; *Parkey* v. *Ramsey*, 103 Tenn., 302; *Gusler* v. *Miller*, 10 Lea, 90.)

With these preliminary considerations, we shall now consider whether the widow Lucy G. Briscoe did either in law or in fact dissent from the will. That she was dissatisfied with the provisions made for her therein is not to be doubted. In this situation she employed counsel, and as a result of negotiations between counsel for both parties, the agreement filed herein as Exhibit 3 to the deposition of plaintiff's witness E. D. Ross was consummated. For the sake of clarity, I do not enter into a discussion of this agreement at length. By the terms of it she was to receive, and did receive, $70,000 in cash as her absolute property, except under a certain contingency not necessary here to set out, and she was also to receive $5,000 per annum for three years for the maintenance and upkeep of the Daniel Briscoe home. In consideration of said payment of her "said Lucy G. Briscoe does hereby release and relinquish all right, claim and interest of every nature whatsoever, whether by virtue of the laws in respect to her rights of dower, homestead, distributee, heir, surviving widow or otherwise, in, to or against the parties of the second part *except her interest in the estate of the said Daniel Briscoe, sr.*, as given her under his last will and three codicils thereto." It is further specifically provided in said agreement as follows:

"Fourth. Said parties of the second part further agree that this payment and agreement shall in no way, except as herein specifically provided, affect or change the interest of the party of the first part in the estate of said Daniel Briscoe, sr., nor prejudice her rights to receive, as provided in said will and three codicils, her full one-ninth share of the net income from the residue of the estate after the payment to her of said $70,000, and the amount paid to her as and for the maintenance of a home; but except as said payments shall reduce the amount of the general estate the same shall not be considered in determining or in any way affect her full one-ninth of the net annual income of said estate which shall be paid to her at such times as payments are made to the other beneficiaries of their several shares of said net income."

It is further provided by section 5 of said agreement that under certain contingencies "the said Lucy G. Briscoe shall be restored immediately to all her rights and privileges, as the surviving widow of Daniel Briscoe, including the right to dissent from said will and to have allotted to her as a dissenting widow proper distributive share of the personalty of said estate valued as the same now is, a year's support and dower and homestead, without regard to whether one year from the death of the said Briscoe has expired; and in such event the said Lucy G. Briscoe shall account for said sums hereinfore and in this instrument agreed to be paid her in settlement and compromise of the

differences between her and said estate represented by the said parties of the second part."

This agreement, of course, reflects the facts, and I conclude that it is not equivalent to such dissent from the will as the law requires. The agreement contains no specific dissent. The right to dissent is left determinative upon a certain contingency. It is expressly agreed that she does not relinquish, but that she specifically retains under the will certain large and beneficial interests therein, including her one-ninth share of the net income from the residue of the estate. There is nothing in the agreement indicating any specific allotment for a year's support or dower. This is left only to inference. There is no specific provision in this agreement which the court may seize upon as indicating that the $70,000 was intended in lieu thereof. There is a specific release and relinquishment upon the part of Lucy G. Briscoe not only of her dower rights but of her constitutional right to homestead and any and all other rights to which she might be entitled as a surviving widow except her interest under the will as herein elsewhere indicated. I apprehend that a reasonable construction of this agreement would be that the executors simply purchased, out of funds derived by and transferred from the will by way of a compromise settlement, any claim which she might assert against the estate by reason of any rights she might have as a widow.

The law upon the matter of dissent from a will was not complied with in any particular. The widow did not signify her dissent in open court. There is no pretense that any court record so declares. There was therefore no jurisdiction or authority in any Tennessee court to declare her "endowed as if her husband had died intestate" or declare her "entitled to her distributive share as provided in section 4147." No proceeding was ever instituted in the county court to set apart to her a year's support, as required by Shannon's Code, section 4020, or to set apart to her dower, as required by Shannon's Code, section 4154, et seq.

With much respect for the opinion of the learned district judge who overruled the demurrer in this case, I can not bring myself to agree with the proposition that the agreement between the parties herein was equivalent in law to an allotment of dower and year's support. Dower and year's support when allotted by the procedure required by law is binding upon all parties. The agreement is binding upon none other than those executing the same, to wit. the widow, upon the one hand, and the executors and trustees of the estate, upon the other. This agreement is not binding upon any of the legatees or distributees of the estate except perhaps J. Ernest Briscoe and Phil J. Briscoe, who are executors and trustees. It is certainly not binding upon the defendant, which has a right to a proper determination of the amount of taxes due it. If, upon a proper dissent from the will, dower and a year's support become a proper charge against the estate, as I apprehend they do, then such charges are only such "*as are allowed by the laws of the jurisdiction * * * under which the estate is being administered.*" They should not be made to depend upon the uncertainty of agreements to which the United States is not a party. To adopt such a precedent would place the taxing power of the Government largely at the mercy of the taxpayer.

Upon the whole I conclude that there has been no such dissent from Daniel Briscoe's will as the law requires. Neither has there been any such allotment of dower and year's support as required by law, nor any such application thereof as requires the defendant to be bound thereby, and as to this feature the suit is likewise dismissed.

I am not unmindful that the district judge took an opposite view when this case was before him upon the petition to dismiss which he considered as a demurrer. It is insisted that his action upon the demurrer is *res judicata.* In a determination of this point, one is controlled by the actual decision rather than by the opinion of the court, because the decision is the conclusion of the court. (Black on Judicial Precedents, p. 38.) The decision is reflected in the court order entered of record, which simply is that "the court is of opinion that the several grounds of demurrer assigned by the defendant are not well taken, and the same are accordingly overruled and disallowed." In other words, all that was adjudged was that the demurrer was overruled and disallowed. There was no adjudication that the plaintiffs were entitled to have any amount deducted from the gross estate of Daniel Briscoe by reason of the agreement between them and the widow. The demurrer was, I think, very properly overruled, because some of the grounds thereof were general, and because the demurrer sought the dismissal of the whole case upon grounds attacking only

that portion of it relating to the matter of dower and year's support. The point is in substance ruled against the plaintiff in the case of *Rogers* v. *Dibrell* (6 Lea, 69) and *Clark* v. *Pence* (3 Cates, 26).

This memorandum is filed only as a basis for or explanation of the responses to findings of fact and law requested by both parties. Of course the direct answer to these requests must control under the rule rather than the memorandum opinion. These responses to requests for findings of fact and law immediately follow, to wit, * * *.

The suit will be dismissed, and the plaintiffs will pay the costs thereof, and opposing counsel will agree upon an order for the record in accordance herewith.

CAPITAL STOCK TAX RULINGS.

TITLE VII.—SPECIAL TAXES. (1924)

REGULATIONS 64 (1924), ARTICLE 11: Basis of the tax: "Carrying on or doing business." VI-40-3454 T. D. 4090

CAPITAL STOCK TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. CORPORATIONS—HOLDING COMPANY—DOING BUSINESS.

A corporation, organized to hold for profitable sale the assets of a deceased person, to invest funds and to liquidate the assets whenever that could be done advantageously, and which pursues the purposes for which organized, even though not actively engaged in business in the ordinary sense, is subject to the capital stock tax imposed by section 700 of the Revenue Act of 1924.

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, District of Minnesota, Third Division, in the case of *Conhaim Holding Co., a Corporation*, v. *Levi M. Willcuts, Collector of Internal Revenue*, is published for the information of internal revenue officers and others concerned.

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

Approved September 21, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES DISTRICT COURT, DISTRICT OF MINNESOTA, THIRD DIVISION.

Conhaim Holding Co., a Corporation, plaintiff, v. *Levi M. Willcuts, Collector of Internal Revenue, defendant.*

[August 10, 1927.]

OPINION.

This cause came on to be tried before the court on the 14th day of April, 1927, in the city of St. Paul, Minn. Mr. Benjamin H. Flesher, of Minneapolis, Minn., appeared for the plaintiff; and Mr. Leland W. Scott, assistant United States attorney, and Mr. Ralph S. Scott, special assistant United States attorney, for the defendant.

In December, 1920, the plaintiff, Conhaim Holding Co., was incorporated under the laws of Minnesota. Its main object was to hold and conserve the assets belonging to the estate of Louis Conhaim, deceased, to liquidate them when that could be done advantageously, and to distribute their avails among the stockholders of the corporation. The estate consisted of stocks, leaseholds, timberland, and life insurance renewal commissions. The corporation has maintained an office, but has no employees. It has never dealt in securities. It has never sold the timberland because no opportunity has arisen to sell it. No income is received from it. The secretary of the corporation receives a salary of $100 a year for his services and is an auditor and accountant. The income of the corporation consists of dividends upon the stocks, renewal commissions upon life insurance written by Louis Conhaim in his lifetime, and rentals from the leaseholds. Numerous loans have been made by the corpora-

tion to its stockholders, who—with the exception of a son-in-law and the secretary, who hold qualifying shares—are the heirs of Louis Conhaim. One loan was made to the American Security Co. at the request of the son-in-law. The loans were apparently made for the accommodation and benefit of the stockholders, but interest was paid and collected. In some cases the company has loaned its credit to the stockholders, and in other cases, when in funds, has permitted them to have the use of funds, paying the current rate of interest therefor. No distribution of assets or income has been made, and the carrying charges of the property require most of the income.

The Revenue Act of 1924, section 700(a)1, provides that "every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000 of so much of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of $5,000." The plaintiff paid this excise tax for 1921, 1922, and 1923, amounting in all to $156, and then decided that it was not doing business within the meaning of the Revenue Act, and has brought this suit to recover what it has paid to the Government.

The question is whether the corporation was required to pay the tax.

The powers of the corporation, as enumerated in its articles, are as follows:

"To hold, own, acquire, use, manage, develop, improve, lease, buy, sell, transfer, convey, deal in, encumber, pledge, mortgage, assign, exchange, and otherwise dispose of any and all kinds of property, real, personal, and mixed, and wheresoever situated, including lands, and any interest therein, chattels, bonds, stocks, and other securities and evidences of indebtedness, whether corporate or not; loan and borrow money, either with or without security, but not to engage in a banking business; to purchase or otherwise acquire, hold, and reissue, subject to the provisions of law, the shares of its own capital stock; to acquire, undertake, carry on, and dispose of all or any part of the business, assets, liabilities, and securities of any person, partnership, association, or corporation, and to become surety or guarantor for the debts and obligations of the same, and to do any and all things essential, necessary or convenient or advisable in the conduct of such business."

It has been held that, in determining whether a corporation is obliged to pay the tax, the question is what the corporation is doing, and not what it could do. (*United States* v. *Emery, Bird, Thayer Realty Co.*, 237 U. S., 28, 32.)

In *Von Baumbach* v. *Sargent Land Co.* (242 U. S., 503, 516) the Supreme Court said:

"It is evident, from what this court has said in dealing with the former cases, that the decision in each instance must depend upon the particular facts before the court. The fair test to be derived from a consideration of all of them is between a corporation which has reduced its activities to the owning and holding of property and the distribution of its avails and doing only the acts necessary to continue that status, and one which is still active and is maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes."

In the case of *Flint* v. *Stone-Tracy Co.* (220 U. S., 107, 171) the court said:

"'Business' is a very comprehensive term and embraces everything about which a person can be employed. Black's Law Dict., 158, citing *People* v. *Commissioners of Taxes* (23 N. Y., 242, 244). 'That which occupies the time, attention and labor of men for the purpose of a livelihood or profit.' Bouvier's Law Dictionary, Vol. I, p. 273."

In *Zonne* v. *Minneapolis Syndicate* (220 U. S., 187) it was held that a corporation, the sole purpose of which was to hold title to a single parcel of real estate subject to a long lease and, for the convenience of the stockholders, to receive and distribute the rentals arising from the lease and proceeds of disposition of the land, and which had disqualified itself from doing any other business, was not a corporation doing business within the meaning of the corporation tax provisions of the Act of August 5, 1909 (ch. 6, 36 Stat., 11, 112), and was not subject to the tax.

In the case of *Nunnally Inv. Co.* v. *Rose* (D. C.) (14 Fed. (2d), 189), it appeared that the company, prior to June 30, 1921, had been doing business in a sense which required it to pay the tax. After that date it intended to do no business which would render it liable to the tax. It had no separate office, and kept its books in the office of another corporation, whose officers were also

officers of the investment company. There were but four stockholders, all belonging to the same family. The investment company held the proceeds of the sale of its corporate assets to the Nunnally Co. of Delaware. On July 1, 1921, the investment company's property consisted of a large amount of stocks, bonds, and case [cash]. It had loaned some money to employees and to its stockholders for their accommodation. It collected income on the stocks and bonds held by it, and declared dividends. The court concluded that it was not doing business within the meaning of the Act.

The Nunnally case seems to be almost identical with this one, since the making of the one loan to the American Security Co., which was not a stockholder and apparently not interested in the estate of Louis Conhaim, would scarcely be enough to distinguish it; but there is in my mind considerable doubt as to the correctness of that decision.

In *Edwards* v. *Chile Copper Co.* (270 U. S., 452, 455 [T. D. 3857, C. B. V-1, 410]), Mr. Justice Holmes said of the corporation there involved:

"It was organized for profit and was doing what it principally was organized to do in order to realize profit. The cases must be exceptional when such activities of such corporations do not amount to doing business in the sense of the statutes. The exemption 'when not engaged in business' ordinarily would seem pretty nearly equivalent to when not pursuing the ends for which the corporation was organized, in the cases where the end is profit."

It is true that the Conhaim Holding Co. was not engaged actively in business, but its purpose was to hold the assets of the estate until they could be disposed of advantageously and profitably, and then to distribute the avails. In the meantime it was to handle the stocks, leaseholds, lands, and other assets in such a way as would be to the best advantage of the corporation and those interested in it and so as to produce the largest amount for ultimate distribution, and that is what has been done. No distribution has been made because the time has not been reached when that can be done profitably.

To my mind, the question is a very close one, and my first impression was that the company was not subject to the tax and should not have paid it; but I can not escape the conclusion that the company is something more than a mere intermediary or agency for the stockholders. They chose the advantages of corporate organization as the best solution of the problem with which they were confronted, and the best and most profitable means of disposing of the assets of Louis Conhaim and their ultimate distribution. Concededly the corporation was organized to get a better price for these assets than was obtainable when it was organized, and the stockholders are receiving and will receive whatever gains may accrue by reason of its corporate activities in connection with the holding of the property for a better price and the investment of the funds in the meantime. While it has these assets, it does and must necessarily do what any other corporation would do which owned such property and was holding it for sale at a profit.

In *Flint* v. *Stone Tracy Co.*, supra, it was held that the tax is upon the doing of business with the advantages which inhere in the peculiarities of corporate or joint stock organization of the character described in the Act. See also *McCoach* v. *Minehill & S. H. R. Co.* (228 U. S., 295), *Maxwell* v. *Abrast Realty Co.* (218 Fed., 457), *Wilkes-Barre & W. V. Traction Co.* v. *Davis* (214 Fed., 511), *Cambria Steel Co.* v. *McCoach* (225 Fed., 278), *Lewellyn* v. *Pittsburgh &c. R. Co.* (222 Fed., 177), *Miller* v. *Snake River Valley R. Co.* (223 Fed., 946), *New York Central & H. R. R. Co.* v. *Gill* (219 Fed., 184), *Waterbury Gas Light Co.* v. *Walsh* (228 Fed., 54), *State Line & S. R. Co.* v. *Davis* (228 Fed., 246), *Public Service Ry. Co.* v. *Herold* (229 Fed., 902).

Finding the facts to be as hereinbefore stated, I reach the conclusion that the defendant is entitled to judgment that the plaintiff take nothing herein and that its complaint be dismissed, and for costs and disbursements as provided by law.

Let judgment be entered accordingly.

TITLE X.—SPECIAL TAXES. (1918)

REGULATIONS 50 (REVISED), ARTICLE 3: Associations and joint-stock companies.

Interindemnity insurance exchange is held subject to capital stock tax. (See T. D. 4096, page 314.)

MISCELLANEOUS TAX RULINGS.

TITLE VIII.—STAMP TAXES. (1926)

SCHEDULE A–5. PASSAGE TICKETS.

REGULATIONS 71: Exemption from stamp tax. VI–28–3304
T. D. 4030

EXEMPTION FROM STAMP TAX ON PASSAGE TICKETS.

Amending Treasury Decision 4014 [C. B. VI–1, 330].—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:

Treasury Decision 4014, approved April 11, 1927, is hereby amended to read as follows:

The Act of February 24, 1927, provides:

"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 or coupon of identical serial number, such steamship ticket or coupon to be 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.

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

Approved July 1, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

TOBACCO.

REGULATIONS 8, SECTION 99: Sizes of packages of cigars and cigarettes. VI–52–3556 T. D. 4110

DISPLAY BOXES OF CIGARS.

Regulations No. 8, section 99, amended relative to packing large cigars in special boxes for display purposes only.

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

To Collectors of Internal Revenue and Others Concerned:

Section 99 of Regulations No. 8 as amended by Treasury Decision 3655 [C. B. III–2, 400] is hereby further amended by adding at the end of the third sentence a new sentence, as follows:

Cigars weighing more than 3 pounds per 1,000 may be packed, for display purposes only, in wooden boxes having the outward appearance of containing 50 cigars but which have the bottoms raised so as to contain only a single layer of 12 or 13 cigars, provided, that each such box bears proper caution notice, factory brand, and classification label, and is sealed by internal revenue stamp of the proper denomination and class and the stamp canceled.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 19, 1927.

A. W. MELLON,
Secretary of the Treasury.

PEDDLERS OF TOBACCO.

REGULATIONS 8, SECTION 202: Definition. VI–40–3455 T. 1

An operator of an airplane making sales of tax-paid tobacco products from the plane at an airport is not liable as a peddler of tobacco under sections 3381, 3382, and 3383, Revised Statutes.

Sales of tobacco products made from an airplane after landing at an airport are not regarded as made while traveling from one public gathering to another and without having any particular place at which sales are made, within the purview of the definition of a ped-

dler of tobacco. (Reference T. D. 969, dated January 24, 1906.) Rather, it appears that the plane after landing at various airports establishes fixed places of business where sales are made after the manner of a dealer in tobacco as defined in subsection 8 of section 3244 of the Revised Statutes.

It is considered that sales made from airplanes are similar to those sales made by persons who put up booths or stands at public gatherings, such as farm vendues, fairs, bazaars, political meetings, etc., and at such fixed places of business sell tobacco products as dealers in tobacco.

OLEOMARGARINE.

REGULATIONS 9, SECTION 40: Substances taxable as oleomargarine. VI-29-8320 T. D. 4037

OLEOMARGARINE—DECISION OF COURT.

1. IMITATION OF BUTTER—CONCLUSIVENESS OF COMMISSIONER'S FINDING.

The determination of the Commissioner under section 14 of the Act of August 2, 1886 (24 Stat., 209), that a compound of vegetable oil, beef fat, and skim milk manufactured and sold by the plaintiff was made "in imitation or semblance of butter" and therefore subject to tax under section 8 of that Act as amended by section 3 of the Act of May 9, 1902 (32 Stat., 193), was amply justified by the facts, and in the absence of proof that his action was arbitrary or capricious such ruling is final.

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 F. Jelke Co.* v. *United States* is published for the information of internal revenue officers and others concerned.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

Approved July 8, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

John F. Jelke Co. v. *The United States.*

[April 4, 1927.]

OPINION.

MOSS, Judge, delivered the opinion of the court.

The plaintiff, John F. Jelke Co., during the years 1920 to 1924, inclusive, and for many years theretofore, manufactured and sold to bakers a cooking compound designated and known to the trade as "Bakers' Select," upon which

product plaintiff has continuously paid a tax of one-fourth cent per pound under what is called the Oleomargarine Act of August 2, 1886.

In 1924 plaintiff filed claims for the refund of taxes aggregating $16,162.50 on the ground that its product did not come within the provisions of the Oleomargarine Act and was therefore exempt from taxation. These claims were rejected by the Commissioner of Internal Revenue, and this action is for the recovery of said sum.

Section 2 of the Act of August 2, 1886, known as the Oleomargarine Act (24 Stat., 209), provides as follows:

"That for the purposes of this Act certain manufactured substances, certain extracts, and certain mixtures and compounds, including such mixtures and compounds with butter, shall be known and designated as 'oleomargarine,' namely: All substances heretofore known as oleomargarine, oleo, oleomargarine-oil, butterine, lardine, suine, and neutral; all mixtures and compounds of oleomargarine, oleo, oleomargarine-oil, butterine, lardine, suine, and neutral; all lard extracts and tallow extracts; and all mixtures and compounds of tallow, beef-fat, suet, lard, lard-oil, vegetable-oil annotto, and other coloring matter, intestinal fat, and offal fat made in imitation or semblance of butter, or when so made, calculated or intended to be sold as butter or for butter."

Section 8 of said Act, as amended by section 3 of the Act of May 9, 1902 (32 Stat., 193), is the provision of law under which the tax in this case was collected. It is as follows:

"That upon oleomargarine which shall be manufactured and sold, or removed for consumption or use, there shall be assessed and collected a tax of 10 cents per pound, to be paid by the manufacturer thereof; and any fractional part of a pound in a package shall be taxed as a pound: *Provided*, When oleomargarine is free from artificial coloration that causes it to look like butter of any shade of yellow said tax shall be one-fourth of 1 cent per pound. The tax levied by this section shall be represented by coupon stamps; and the provisions of existing laws governing the engraving, issue, sale, accountability, effacement, and destruction of stamps relating to tobacco and snuff, as far as applicable, are hereby made to apply to stamps provided for by this section."

It is the contention of the Government that the determination by the Commissioner of the question involved herein is final and conclusive under section 14 of the Act of August, 1886, above mentioned. That section is as follows:

"That there shall be in the office of the Commissioner of Internal Revenue an analytical chemist and a microscopist, who shall each be appointed by the Secretary of the Treasury, and shall each receive a salary of $2,500 per annum; and the Commissioner of Internal Revenue may, whenever in his judgment the necessities of the service so require, employ chemists and microscopists, to be paid such compensation as he may deem proper, not exceeding in the aggregate any appropriation made for that purpose. And such Commissioner is authorized to decide what substances, extracts, mixtures, or compounds which may be submitted for his inspection in contested cases are to be taxed under this Act; and his decision in matters of taxation under this Act shall be final. The Commissioner may also decide whether any substance made in imitation or semblance of butter, and intended for human consumption, contains ingredients deleterious to the public health; but in case of doubt or contest his decisions in this class of cases may be appealed from to a board hereby constituted for the purpose, and composed of the Surgeon General of the Army, the Surgeon General of the Navy, and the Commissioner (now Secretary) of Agriculture; and the decisions of this board shall be final in the premises."

The ingredients used in the manufacture of plaintiff's product are cottonseed oil, 40 per cent; oleo stearin, 23 per cent; and the remainder skim milk. A small per cent of salt is added after the above ingredients are mixed.

The manufacture of plaintiff's product is accomplished by mixing cottonseed oil, oleo stearin, and skim milk in the proportions named above, and in large quantities, in a container in which the materials are churned until the ingredients are thoroughly mixed. As it flows out of the container it strikes cold water, which causes it to congeal. It is then drained and placed in a cool storage room for about 24 hours. A certain quantity of salt is then added to the mixture as it passes through several sets of rollers. This manipulation works out the water as it works in the salt. It is then ready for packing and preparation for market. The finished product has a lactic-acid flavor and

aroma. The same flavor and aroma are found in butter, although it is not the dominant or distinguishing characteristic of butter.

It will be noted that cottonseed oil (vegetable oil) and oleo stearin (beef fat) are specifically mentioned in section 2 of the Oleomargarine Act.

Plaintiff's product is taxable if (*a*) "made in imitation or semblance of butter," or (*b*) "when so made, calculated or intended to be sold as butter or for butter." It is not necessary that both conditions be present. If "made in imitation or semblance of butter" it is subject to tax under the Oleomargarine Act, and that seems to be the sole question for determination.

Obviously the purpose of the Oleomargarine Act is to impose a tax on all fat mixtures and compounds composed of the ingredients specified in section 2 of said Act if made in imitation or semblance of butter. Water may be used instead of skim milk, and the product would, for all practical purposes, be identical with that produced by the use of skim milk. What, then, could be the purpose of using the more expensive mixing medium, except to obtain the slight butter semblance resulting from the use of skim milk. Plaintiff's product was subjected to a chemical analysis by the Commissioner of Internal Revenue, who held that it had a semblance of butter and was therefore taxable. Congress definitely specified in unmistakable terms the powers of the Commissioner in this regard. The "Commissioner is authorized to decide what substances, extracts, mixtures, or compounds which may be submitted for his inspection in contested cases are to be taxed under this Act (sec. 14 of the Oleomargarine Act); and his decision in matters of taxation under this Act shall be final." Undoubtedly Congress must have realized the difficulty which the Commissioner might experience in the administration of the Oleomargarine Act, and it therefore provided for an analysis of mixtures and compounds mentioned in the Act by a specific agency to determine the taxability of same within the meaning of the Act.

Without determining whether or not the ruling of the Commissioner under this Act would in all cases be final, certainly the conclusion reached by him in the instant case is amply justified by the facts, and in the absence of any suggestion that his action herein was arbitrary or capricious his ruling should be regarded as final.

It is therefore the judgment of the court that plaintiff's petition should be, and the same is hereby, dismissed. And it is so ordered.

REGULATIONS 9, SECTION 40: Substances taxable as oleomargarine. VI-37-3432 T. D. 4085

OLEOMARGARINE—COOKING COMPOUNDS.

Effective date of Treasury Decision 4006 [C. B. VI-1, 333], amending paragraph (b) of section 40, Regulations 9 (revised August, 1925), relative to oleomargarine, etc., extended.

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

To Collectors of Internal Revenue and Others Concerned:

In order to extend for a period of three months the effective date of the amendment to paragraph (b) of section 40 of Regulations 9 (revised August, 1925), relative to the tax on oleomargarine and other substances, the last paragraph of Treasury Decision 4006 is amended to read as follows:

The provisions of this Treasury decision will take effect on January 1, 1928.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 31, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

FILLED CHEESE.

REGULATIONS 22, ARTICLE 2: Filled cheese defined. VI-36-3417
T. D. 4079

FILLED CHEESE—DECISION OF COURT.

FILLED CHEESE—DEFINITION.

A substance made of casein, commonly known as skimmed milk curd, with the admixture of cocoanut oil as a substitute for the butter fats which have previously been extracted from the whole milk and made in imitation of soft or cream cheese, is "filled cheese" as defined by section 2 of the Act of June 6, 1896 (29 Stat., 253, ch. 337).

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 *Chicago Cheese & Farm Products Co., a Corporation*, v. *The United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 27, 1927.

S. LOWMAN,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

Chicago Cheese & Farm Products Co., a Corporation, v. *The United States.*

[June 6, 1927.]

OPINION.

BOOTH, Judge, delivered the opinion of the court.

The plaintiff is an Illinois corporation engaged in manufacturing what it designates as a food product. The Commissioner of Internal Revenue levied and collected a manufacturer's and a sales tax upon plaintiff's business under the Act of June 6, 1896. The manufacturer's tax amounted to $400 per annum and the sales tax amounted to $490.73, extending over a period from March 1, 1925, to March 14, 1925, a total tax exaction of $890.73, and it is for the recovery of this amount, with interest thereon from date of payment, that this suit is brought. No jurisdictional question is involved.

The Act of June 6, 1896 (29 Stat., 253, ch. 337), is in terms as follows:

"*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.* That for the purposes of this Act, the word 'cheese' shall be understood to mean the food product known as cheese, and which is made from milk or cream and without the addition of butter, or any animal, vegetable, or other oils or fats foreign to such milk or cream, with or without additional coloring matter.

"SEC. 2. That for the purposes of this Act certain substances and compounds shall be known and designated as 'filled cheese,' namely: All substances made of milk or skimmed milk, with the admixture of butter, animal oils or fats, vegetable or any other oils, or compounds foreign to such milk, and made in imitation or semblance of cheese.

"SEC. 3. That special taxes are imposed as follows:

"Manufacturers of filled cheese shall pay $400 for each and every factory per annum. Every person, firm, or corporation who manufactures filled cheese for sale shall be deemed a manufacturer of filled cheese. * * *

* * * * * * *

"SEC. 6. That filled cheese shall be packed by the manufacturers in wooden packages only, not before used for that purpose, and marked, stamped, and branded with the words 'filled cheese' in black-faced letters not less than 2 inches in length, in a circle in the center of the top and bottom of the cheese; and in black-faced letters of not less than 2 inches in length in line from the top to the bottom of the cheese, on the side in four places equidistant from each other; and the package containing such cheese shall be marked in the same manner, and in the same number of places, and in the same description of letters as above provided for the marking of the cheese; and all sales or consignments made by manufacturers of filled cheese to wholesale dealers in filled cheese or to exporters of filled cheese shall be in original stamped packages. Retail dealers in filled cheese shall sell only from original stamped packages, and shall pack the filled cheese when sold in suitable wooden or paper packages, which shall be marked and branded in accordance with rules and regulations to be prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury. Every person who knowingly sells or offers to sell, or delivers or offers to deliver, filled cheese in any other form than in new wooden or paper packages, marked and branded as hereinbefore provided and as above described, or who packs in any package or packages filled cheese in any manner contrary to law, or who falsely brands any package or affixes a stamp on any package denoting a less amount of tax than that required by law, shall upon conviction thereof be fined for each and every offense not less than $50 and not more than $500 or be imprisoned not less than 30 days nor more than 1 year.

* * * * * * *

"SEC. 9. That upon all filled cheese which shall be manufactured there shall be assessed and collected a tax of 1 cent per pound, to be paid by the manufacturer thereof; and any fractional part of a pound in a package shall be taxed as a pound. The tax levied by this section shall be represented by coupon stamps; and the provisions of existing laws governing the engraving, issue, sale, accountability, effacement, and destruction of stamps relating to tobacco and snuff, as far as applicable, are hereby made to apply to stamps provided for by this section.

* * * * * * *

"SEC. 11. That all filled cheese as herein defined imported from foreign countries shall, in addition to any import duty imposed on the same, pay an internal-revenue tax of 8 cents per pound, such tax to be represented by coupon stamps; and such imported filled cheese and the packages containing the same shall be stamped, marked, and branded, as in the case of filled cheese manufactured in the United States.

* * * * * * *

"SEC. 15. That the Commissioner of Internal Revenue is authorized to have applied scientific tests and to decide whether any substances used in the manufacture of filled cheese contain ingredients deleterious to health. But in case of doubt or contest his decision in this class of cases may be appealed from to a board hereby constituted for the purpose, and composed of the Surgeon General of the Army, the Surgeon General of the Navy, and the Secretary of Agriculture, and the decision of this board shall be final in the premises.

* * * * * * *

"SEC. 18. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall make all needful regulations for the carrying into effect the provisions of this Act."

The Commissioner collected the taxes above mentioned by classifying plaintiff's product as "filled cheese" under section 2 of the statute. Plaintiff is now insisting that in this respect the Commissioner was in error and asserts that its product is not within the meaning and intent of the statute in any event.

The statute defines cheese first by designating it as "the food product known as cheese" and then by its ingredients, viz, "Made from milk or cream and without the addition of butter, or any animal, vegetable, or other oils or fats foreign to such milk or cream, with or without additional coloring matter." Obviously Congress by this procedure was referring to a known food product made by a process which utilized the natural ingredients of milk and cream, and eliminated the introduction of foreign ingredients in its composition. Section 2 manifestly takes up the identical subject and seeks to handicap its manufacture when the same resultant product is obtained by the use of foreign ingredients and the latter imitates the former. Clearly there can be little doubt that the

mischief to be corrected by the statute was a growing and expanding attempt to utilize skimmed milk or milk from which the animal fats had been extracted and replace them by foreign fats or oils and produce a product capable of being marketed as cheese. Congress was attempting to preserve the pure-cheese industry and maintain its marketable stability by imposing a tax burden upon the cheaper commodity made by the employment of foreign substances, and which in competition with the natural product would materially supplant it in the trade. Much expert testimony has been adduced, and a record of rather great proportions has been built up; but in reconciling conflicts and giving effect to its weight there is no doubt that the plaintiff's product is made from casein, a by-product of skimmed milk with which cocoanut oil is mixed for the express purpose of supplying the animal fats absent in skimmed milk. This, in our opinion, is the very thing the statute was seeking to tax. The language used could not make it plainer—"all substances made of milk or skimmed milk, with the admixture of butter * * * or compounds foreign to such milk, and made in imitation or semblance of cheese." Plaintiff's product has the outward appearance and texture of soft cheese, and the fact is conceded that it is not made from the natural ingredients of milk or cream.

Plaintiff seeks to escape the tax upon the theory that casein is not milk or skimmed milk. This contention we regard as untenable. The vital ingredient, aside from animal fats, in whole milk or cream to cheese making is casein. If allowed to remain in the milk, as in pure-cheese making, it surrounds the globules of butterfat, and when clotted furnishes the combined mass which is subsequently worked into the consistency of cheese. Milk from which the cream and casein have been extracted would be utterly worthless in cheese making. Therefore, plaintiff utilizes the cheese-making qualities of skimmed milk in so far as they are available and supplies the deficiencies by the introduction of unnatural and foreign substances, creating a product of the texture and appearance of soft cheese. If the plaintiff purchased skimmed milk and produced its own casein, the result would be exactly the same. Plaintiff could not make its product from skimmed milk alone. It is the casein in the milk, to which is added the foreign fats or oils, that brings forth what plaintiff sells at present as a food product. Obviously this is doing indirectly what the statute intends to reach. Casein is nothing more nor less than skimmed-milk curd. It is true that plaintiff purchased casein from outside parties and did not extract it from its own skimmed milk; but clearly the distinction is one of form and not of substance. The only ingredient of skimmed milk available to plaintiff in its manufacturing process was casein, and it might just as well have purchased its own skimmed milk directly and precipitated the casein therefrom. One may not escape a statutory provision by resorting to an outside source for the convenient and economical supply of an ingredient which, of itself, is the basic factor in a manufacturing process which the statute regulates and defines. Plaintiff uses skimmed milk to the very same extent it would have used the same if it had been impossible to purchase casein from others. Resort to purchasing casein was a mere convenience and doubtless cheaper than producing its own from skimmed milk.

Stress is put upon the contemporaneous condition of the cheese industry in 1896 when the statute was passed, and from the record a contention is made that the statute was intended to reach only imitations of hard or Cheddar cheese; that soft or cream cheese was practically unknown in 1896 and imitations of Cheddar cheese were influencing the foreign market and making serious inroads upon the domestic trade. The statute is not ambiguous. Its provisions are plain and the intent apparent. Section 2 defines "filled cheese." If plaintiff's product falls within the definition the tax attaches, notwithstanding the fact that in 1896 similar products may not have been manufactured.

While we have given the plaintiff the benefit of Finding V, in our opinion the scope and plain intent of the Act were to prevent imitations of natural cheese and save the public from purchasing imitations thereof, unless duly informed to that effect by proper brands and marking. To restrict the application of legislation of this character, legislation affecting the food supply to the narrow limits of form and technical names applied to the industry in 1896 is, we believe, without warrant of law. Congress was striking at the perversion of the usual and natural processes of making pure cheese. Substitutes for the natural ingredients of milk and cream in the industry were the primary factors of its concern, both the practices then extant, or those which the future might develop.

The petition will be dismissed. It is so ordered.

DISTILLED SPIRITS.

OCCUPATIONAL TAXES.

SECTION 3244, REVISED STATUTES: Wholesale and retail liquor dealers. VI-47-3516 T. D. 4101

Occupational tax on the sale of alcohol.—Section 3244, Revised Statutes, and section 9, Title III, National Prohibition Act.

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

To Collectors of Internal Revenue and Others Concerned:

Under authority conferred upon the undersigned with respect to internal-revenue taxes arising out of the manufacture, transportation, and sale of distilled spirits, where no violation of a law relating to the enforcement of the eighteenth amendment to the Constitution is involved, the following decision is promulgated for the information and guidance of all concerned, viz:

The fourth subdivision of section 3244, Revised Statutes, as amended, imposes an occupational tax on wholesale and retail liquor dealers. Proprietors of industrial alcohol plants (excepting those specifically exempt under section 3244) and proprietors of bonded warehouses established under the provisions of Title III, National Prohibition Act, who, under permits issued by the Prohibition Bureau, are authorized to sell alcohol, or to offer it for sale, would be subject to the occupational tax so imposed if it were not for the provisions of section 9, Title III, National Prohibition Act. This section provides that industrial alcohol plants and bonded warehouses established under the provisions of Title III of said Act shall be exempt from the provisions of certain sections of the Revised Statutes, including section 3244, imposing the occupational tax on wholesale and retail liquor dealers.

Under the terms of the exemption so granted proprietors of industrial alcohol plants and bonded warehouses established under the provisions of Title III, National Prohibition Act, who are authorized to sell alcohol, as defined in section 1 of Title III, National Prohibition Act, or to offer the same for sale, will not be required to pay the tax as wholesale or retail liquor dealers imposed by section 3244, provided their sales are made from industrial alcohol plants or bonded warehouses established under the provisions of Title III, National Prohibition Act. If alcohol, as so defined, is sold elsewhere, the persons engaging in the traffic will not be entitled to the exemption granted in section 9, Title III, National Prohibition Act, but will be held subject to the tax imposed by section 3244, Revised Statutes.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved November 15, 1927.

A. W. MELLON,
Secretary of the Treasury.

MISCELLANEOUS RULINGS.

OLEOMARGARINE.

VI–28–3305
MS. 68

Schedule of oleomargarine produced and materials used during the month of May, 1927, as compared with May, 1926.

	May, 1927.	May, 1926.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	19,637,034	16,713,444
Ingredient schedule for uncolored oleomargarine:		
Butter	199,038	292,432
Cocoanut oil	8,365,532	6,426,464
Corn oil	1,400	19,745
Cottonseed oil	1,853,691	1,563,508
Edible tallow	1,600	2,710
Milk	5,433,252	4,738,916
Mustard oil	5,489	2,765
Neutral lard	1,893,124	1,630,574
Oleo oil	3,735,439	3,396,708
Oleo stearine	407,706	443,043
Oleo stock	151,557	200,563
Palm oil	27,413	43,156
Palm-kernel oil	1,118	1,750
Peanut oil	258,930	294,563
Salt	1,681,608	1,432,043
Sesame oil	4,200	42,436
Soda	6,071	3,813
Soya-bean oil		15
Vanila extract	19	22
Total	24,027,187	20,535,226
Total production colored oleomargarine	1,279,734	1,006,028
Ingredient schedule for colored oleomargarine:		
Butter	2,615	5,105
Cocoanut oil	368,816	287,024
Color	1,709	1,499
Cottonseed oil	119,963	136,646
Edible tallow	8,050	
Milk	480,105	394,603
Mustard oil	55	
Neutral lard	153,165	141,485
Oleo oil	353,600	287,928
Oleo stearine	34,250	18,100
Oleo stock	16,643	23,338
Palm oil	11,973	14,308
Peanut oil	22,067	22,314
Salt	103,551	87,121
Sesame oil		20,837
Soda	110	103
Total	1,676,672	1,440,411

VI–32–3358
MS. 69

Schedule of oleomargarine produced and materials used during the month of June, 1927, as compared with June, 1926.

	June, 1927.	June, 1926.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	19,451,096	16,915,736
Ingredient schedule for uncolored oleomargarine:		
Butter	174,016	282,785
Cocoanut oil	7,794,078	6,474,197
Corn oil	800	39,090
Cottonseed oil	1,812,857	1,438,306
Edible tallow	8,608	2,915
Milk	5,276,943	4,852,279
Mustard oil	5,235	2,915
Neutral lard	1,800,987	1,655,746
Oleo oil	4,018,798	3,529,100
Oleo stearine	397,981	429,549
Oleo stock	146,177	234,040
Palm oil	40,789	50,237
Palm-kernel oil		5,476
Peanut oil	255,781	324,255
Salt	1,635,143	1,441,611
Sesame oil	2,250	35,660
Soda	6,067	4,560
Soya-bean oil		669
Vanilla extract	22	23
Total	23,376,532	20,803,413
Total production colored oleomargarine	1,193,674	1,006,603
Ingredient schedule for colored oleomargarine:		
Butter	1,550	537
Cocoanut oil	250,135	261,719
Color	1,670	1,672
Cottonseed oil	96,102	142,732
Milk	412,142	397,570
Neutral lard	137,213	142,566
Oleo oil	338,260	318,673
Oleo stearine	31,685	18,512
Oleo stock	26,287	35,589
Palm oil	13,040	11,780
Peanut oil	19,585	18,220
Salt	95,843	83,985
Sesame oil		6,144
Soda	101	73
Total	1,523,603	1,439,772

VI–37–3433
MS. 70

Schedule of oleomargarine produced and materials used during the month of July, 1927, as compared with July, 1926.

	July, 1927.	July, 1926.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	16,229,041	15,614,837
Ingredient schedule for uncolored oleomargarine:		
Butter	134,597	116,526
Cocoanut oil	6,942,665	5,878,686
Corn oil		34,890
Cottonseed oil	1,474,487	1,276,521
Edible tallow	2,656	2,030
Milk	4,476,246	4,351,433
Mustard oil	3,810	2,595
Neutral lard	1,450,958	1,450,068
Oleo oil	3,101,052	3,142,210
Oleo stearine	372,403	344,324
Oleo stock	135,542	211,846
Palm oil	38,340	41,550
Palm-kernel oil		7,148
Peanut oil	238,747	319,523
Salt	1,397,781	1,275,074
Sesame oil	1,200	18,307
Soda	7,613	3,889
Soya-bean oil		3,523
Sunflower oil		4,400
Vanilla extract	14	16
Total	19,778,111	18,484,559
Total production colored oleomargarine	984,824	829,683
Ingredient schedule for colored oleomargarine:		
Butter	1,730	14
Cocoanut oil	305,066	259,122
Color	1,501	1,100
Corn oil		2,800
Cottonseed oil	84,023	96,337
Milk	341,041	338,080
Neutral lard	117,972	121,045
Oleo oil	263,368	238,224
Oleo stearine	25,065	14,262
Oleo stock	20,588	15,846
Palm oil	14,830	12,261
Palm-kernel oil		1,500
Peanut oil	17,959	18,328
Salt	78,720	77,400
Sesame oil		500
Soda	70	80
Soya-bean oil		6,676
Total	1,272,933	1,203,575

VI–42–3473
MS. 71

Schedule of oleomargarine produced and materials used during the month of August, 1927, as compared with August, 1926.

	August, 1927.	August, 1926.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	18,767,885	14,385,635
Ingredient schedule for uncolored oleomargarine:		
Butter	170,480	96,948
Cocoanut oil	8,212,041	5,594,210
Corn oil		22,600
Cottonseed oil	1,528,765	1,294,541
Edible tallow	2,400	2,597
Milk	5,187,726	4,161,649
Mustard oil	5,310	2,310
Neutral lard	1,712,809	1,397,592
Oleo oil	3,403,464	2,994,107
Oleo stearine	427,405	364,240
Oleo stock	156,575	208,868
Palm oil	42,968	40,850
Palm-kernel oil		5,387
Peanut oil	305,961	326,114
Salt	1,799,346	1,248,184
Sesame oil	3,300	24,850
Soda	6,318	4,054
Soya-bean oil		3,442
Sunflower oil		40,630
Vanilla extract	24	22
Total	22,964,892	17,832,195
Total production colored oleomargarine	1,903,845	1,249,802
Ingredient schedule for colored oleomargarine:		
Butter	6,552	507
Cocoanut oil	627,744	595,866
Color	1,527	938
Corn oil		2,050
Cottonseed oil	215,947	110,936
Milk	378,036	488,955
Neutral lard	134,755	128,262
Oleo oil	555,781	257,391
Oleo stearine	24,158	16,754
Oleo stock	22,293	24,568
Palm oil	10,440	12,096
Peanut oil	18,438	16,863
Salt	159,358	95,689
Sesame oil		900
Soda	84	67
Soya-bean oil		4,386
Sunflower oil		406
Total	2,155,113	1,756,634

VI–46–3504
MS. 72

Schedule of oleomargarine produced and materials used during the month of September, 1927, as compared with September, 1926.

	September, 1927.	September, 1926.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	22,284,014	19,157,510
Ingredient schedule for uncolored oleomargarine:		
Butter	202,242	145,871
Cocoanut oil	10,062,387	7,814,458
Corn oil		30,638
Cottonseed oil	2,004,824	1,632,988
Edible tallow	4,200	3,200
Milk	5,998,978	5,544,341
Mustard oil	6,720	3,409
Neutral lard	1,802,689	1,836,984
Oleo oil	4,934,285	3,781,823
Oleo stearine	499,453	458,359
Oleo stock	167,097	248,570
Palm oil	45,422	52,761
Palm-kernel oil		10,940
Peanut oil	340,308	380,638
Salt	1,907,341	1,610,774
Sesame oil	4,200	29,600
Soda	7,365	5,194
Soya-bean oil		3,957
Sunflower oil		23,290
Vanilla extract	19	19
Total	27,987,530	23,617,814
Total production colored oleomargarine	1,210,989	1,074,109
Ingredient schedule for colored oleomargarine:		
Butter	1,650	365
Cocoanut oil	373,508	312,656
Color	1,786	1,248
Corn oil		2,820
Cottonseed oil	107,948	141,971
Milk	410,661	446,738
Neutral lard	147,952	154,619
Oleo oil	348,448	318,983
Oleo stearine	28,942	21,380
Oleo stock	23,087	36,837
Palm oil	6,989	15,228
Palm-kernel oil		1,268
Peanut oil	25,371	22,173
Salt	99,852	92,390
Sesame oil		5,395
Soda	100	71
Soya-bean oil		10,286
Sunflower oil		30
Total	1,576,294	1,584,458

VI-50-3536
MS. 73

Schedule of oleomargarine produced and materials used during the month of October, 1927 as compared with October, 1926.

	October, 1927.	October, 1926.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	24,800,782	20,618,642
Ingredient schedule for uncolored oleomargarine:		
Butter	203,382	151,787
Cocoanut oil	11,883,692	8,541,604
Corn oil	7,100	20,300
Cottonseed oil	2,108,714	1,890,924
Edible tallow	4,200	3,105
Milk	6,913,896	5,991,567
Mustard oil	6,635	1,445
Neutral lard	2,040,745	1,963,181
Oleo oil	3,800,697	3,810,656
Oleo stearine	507,498	470,323
Oleo stock	161,852	222,926
Palm oil	52,807	43,053
Palm-kernel oil	3,138	8,243
Peanut oil	411,141	449,939
Salt	2,107,116	1,726,220
Sesame oil	5,950	20,010
Soda	8,324	13,537
Soya-bean oil	----	20
Vanilla extract	24	24
Total	30,226,911	25,328,861
Total production colored oleomargarine	1,239,929	1,201,610
Ingredient schedule for colored oleomargarine:		
Butter	1,390	364
Cocoanut oil	401,960	353,093
Color	1,692	1,357
Corn oil	----	700
Cottonseed oil	118,996	200,372
Milk	418,426	512,357
Neutral lard	150,770	177,254
Oleo oil	305,089	361,149
Oleo stearine	23,087	25,750
Oleo stock	11,397	33,466
Palm oil	20,299	5,836
Palm-kernel oil	1,343	796
Peanut oil	27,794	23,858
Salt	101,343	104,478
Sesame oil	----	2,196
Soda	110	151
Soya-bean oil	----	30
Total	1,583,696	1,803,207

MISCELLANEOUS.

VI–27–3299
D. C. 230 (Revised)

LAWS AND REGULATIONS GOVERNING THE RECOGNITION OF ATTORNEYS, AGENTS, AND OTHER PERSONS REPRESENTING CLAIMANTS AND OTHERS BEFORE THE TREASURY DEPARTMENT AND OFFICES THEREOF.

[1927. Department Circular No. 230 (Revised).[1] Committee on Enrollment and Disbarment.]

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, July 1, 1927.

The statutes regulating the recognition of attorneys and agents and their practice before the Treasury Department appear at the end of these regulations.

Pursuant to statutory provisions, the following rules and regulations are prescribed:

1. *Committee on Enrollment and Disbarment.*—A Committee on Enrollment and Disbarment is hereby created, consisting of six members, who shall be appointed by the Secretary of the Treasury, of whom two shall be detailed from the office of the Secretary, two from the office of the Commissioner of Internal Revenue, one from the Bureau of Customs, and one from the Bureau of Prohibition. The Secretary of the Treasury shall designate a chairman and vice chairman of the committee. The chairman shall be designated from the members detailed from the Secretary's office. The committee shall make such rules for its own government as it considers advisable. The committee shall meet regularly on Tuesday and Friday of each week if a business day, and shall meet on other days at the call of the chairman. Three members shall constitute a quorum.

The committee shall receive and consider applications to be recognized as attorney, agent, or other representative before the Treasury Department or offices thereof; receive complaints against those enrolled; conduct hearings; make inquiries; perform other duties as prescribed herein, and do all things necessary in the matter of proceedings for enrollment, suspension, or disbarment of such attorneys, agents, or other representatives, pursuant to these regulations; and submit its recommendations thereon to the Secretary of the Treasury for approval.

The Secretary of the Treasury shall appoint a secretary of the committee who shall not be a member thereof. The secretary of the committee shall keep and maintain its records and shall have the custody of all of its papers, records, rolls, etc.

The Secretary of the Treasury shall also appoint an attorney for the committee who shall not be a member of the committee. Such attorney shall be the legal adviser of the committee, present all formal complaints against enrolled attorneys or agents, and represent the Government in all proceedings before the committee.

2. *Practice.*—(*a*) No attorney or agent shall be permitted to represent a client in the matter of a claim, taxes, or permit relative to intoxicating liquors before the Treasury Department unless such attorney or agent is enrolled to represent clients before the Treasury Department in accordance with these and prior regulations. Any individual claimant, taxpayer, or applicant for a permit under the laws relative to intoxicating liquors, or member of a firm, or officer or authorized regular employee of an individual, firm, or corporation, may appear for himself or such individual, firm, or corporation solely upon adequate identification to the officials of the Treasury Department, except that a former employee of the Treasury Department shall not be permitted to appear as an officer or employee of an individual, firm, or corporation in connection with any

[1] Effective July 1, 1927. This circular supersedes Treasury Department Circular No. 230, dated Feb. 15, 1921, and its several revisions and supplements.

matter to which he gave personal consideration or as to the facts of which he gained actual personal knowledge while in the service of the Treasury Department.

(*b*) Preparation and filing of necessary written documents, representing clients at hearings and doing all other things necessary to present properly matters to officials of the Treasury Department when representing clients shall be deemed practice before the Treasury Department.

(*c*) It shall be the duty of enrolled attorneys to advise clients to comply with the law, and in the event an attorney knows that a client has not complied with the law or has made errors or omissions in any return or other report required by law to be made by such client, it shall be his duty to advise such client to correct such errors and omissions.

(*d*) The practice and duty of an enrolled agent before the Treasury Department shall be the same as that of an enrolled attorney, except that an enrolled agent shall not draft or prepare written instruments by which title to real or personal property may be conveyed or transferred for the purpose of affecting Federal taxes, nor shall such enrolled agent advise clients as to the sufficiency of, or legal effect of, any such instrument on the Federal taxes of such taxpayer under the Federal laws.

(*e*) An agent, who is enrolled to practice before the Bureau of Prohibition only, may do all things proper and necessary to handle the business of his client before the Prohibition Bureau.

(*f*) Every affidavit, argument, brief, or statement of facts prepared or filed by an attorney or agent as argument or evidence in the matter of a claim or tax matter pending before the Treasury Department shall have thereon a statement signed by such attorney or agent showing whether or not he prepared such document and whether or not the attorney or agent knows of his own knowledge that the facts contained therein are true.

(*g*) No attorney or agent as notary public shall take acknowledgments, administer oaths, certify papers, or perform any official act in connection with matters pending before the Treasury Department in which he is employed as counsel, attorney, or agent, or in which he may be in any way interested. (Act of June 29, 1906, 34 Stat., 622.)

3. *Necessary qualifications for enrollment.*—Applicants for enrollment must "show that they are of good character and in good repute, possessed of the necessary qualifications to enable them to render * * * claimants valuable service, and otherwise competent to advise and assist such claimants (or taxpayers) in the presentation of their cases." (Act of July 7, 1884, 23 Stat., 258.) In order better to protect the taxpayer's interests and to expedite practice before the Treasury Department, applicants should clearly establish their right to enrollment by showing that they possess (1) a good character and reputation, (2) a sound education, and (3) a familiarity with the laws and regulations covering taxes or other subjects which they will present to the Department: *Provided, however*, That no former employee of the Bureau of Internal Revenue who violated his agreement to stay at least a year in the Bureau shall be admitted to practice until after two years from his severance of connection with the Bureau. Practice before the Treasury Department is not restricted to duly licensed attorneys at law and certified public accountants, but an agent who is not an attorney or accountant must show satisfactory educational qualifications and evidence of ability to understand tax questions or such other matters as will be presented to the Treasury Department by the applicant. An applicant's character and reputation can only be established by inquiry among those who have had the opportunity of knowing the applicant in the community in which he has lived or where such applicant has practiced his profession.

A bad reputation as to integrity or any previous conduct of the applicant which is unethical as viewed by the standards of the American Bar Association, or conduct which is cause for suspension or disbarment as set forth in paragraph 9 of these regulations, or conduct which would be unfair in commercial transactions, may be regarded as sufficient cause to justify the rejection of the applicant. References as to the applicant's character should be given, and in addition the applicant should furnish the names of those with whom he has come in contact in his business and of whom inquiry may be made. The Committee on Enrollment and Disbarment will endeavor to ascertain all facts deemed necessary by it to pass on any application without expense or undue inconvenience to the applicant, but the committee may require, where it is not satisfied with the information received, that the applicant appear in person

before the committee or its duly authorized representative. The committee will hear an applicant on his application at his request. A person who is not qualified to render service to clients generally in matters before the Treasury Department, but who is qualified to render a special service to a client in matters before the Bureau of Prohibition, may, on showing that he possesses such qualifications, be enrolled to practice before the Bureau of Prohibition only.

4. *Applications for enrollment.*—Applicants for enrollment shall submit to the Secretary of the Treasury an application in duplicate, properly executed on Form 23, forming a part of these regulations. Application in any other form will not be considered, and all statements contained in the application must be verified by the applicant. The applicant must also take the oath of allegiance, and to support the Constitution of the United States as required by section 3478, Revised Statutes. A person who can not take the oath of allegiance, and to support the Constitution of the United States, can not be enrolled. Members of the bar of a court of record will apply for enrollment as attorneys; all other applicants will apply for enrollment as agents. Applicants will be notified of the approval or disapproval of their applications. All applications for enrollment must be individual, and individuals who practice as partners should apply for enrollment as individuals and not in the partnership name. An individual who has been enrolled may, however, represent claimants and others before the Treasury Department in the name of a partnership of which he is a member or with which he is otherwise regularly connected. In case all of the members of a partnership are not enrolled, then the enrolled attorney or agent of any such partnership shall be responsible for the unprofessional conduct of his unenrolled partner or partners, as set forth in paragraph 9 of these regulations. Except as hereinafter provided in paragraph 5, a corporation can not be enrolled, and attorneys or agents will not be permitted to practice before the Treasury Department for account of a corporation which represents claimants and others in the prosecution of business before the Treasury Department. Persons applying for enrollment who propose to act for such a corporation in the prosecution of claims and other business before the Treasury Department will be subject to rejection, and enrolled attorneys or agents who act for a corporation in representing claimants and others in the prosecution of claims and other business before the Treasury Department will be subject to disbarment or suspension from practice.

5. *Customhouse brokers.*—The Act of June 10, 1910 (36 Stat., 464, T. D. 30789), provides in part that persons, copartnerships, associations, joint-stock associations, and corporations may be licensed as customhouse brokers by the collector or chief officer of customs at any port of entry or delivery to transact business as such customhouse broker in the collection district in which such license is issued. Customhouse brokers so licensed require no further enrollment under these regulations for the transaction of business within their respective collection districts, but for the representation of a claimant before the Treasury Department in the city of Washington application for enrollment as attorney or agent must be made in conformity with the requirements of paragraph 4, and otherwise in accordance with these regulations, except that if a customhouse broker so licensed in a collection district is a copartnership, association, joint-stock association, or corporation its claims or other business may be prosecuted in its name before the Department in the city of Washington by an accredited member or representative, who must, however, be first duly enrolled in accordance herewith.

6. *List of attorneys and agents, and enrollment cards.*—(*a*) A list of all attorneys and agents who make application for enrollment or who are enrolled, or whose applications have been rejected, or who have been suspended or disbarred, will be kept in the office of the secretary of the committee, and a copy of such list will be furnished the bureaus, offices, and divisions of the Treasury Department. Information as to whether or not any person is enrolled as an attorney or agent may be had by application to the secretary of the committee. All bureaus, offices, and divisions of the Treasury Department are prohibited from recognizing or dealing with any attorney or agent unless enrolled: *Provided,* That the Committee on Enrollment and Disbarment may in its discretion grant temporary recognition to an attorney or agent pending action upon his application for enrollment: *And provided further,* That on written or telegraphic request and recommendation of the internal revenue agent in charge the committee may grant permission to an attorney to appear before the internal revenue agent in charge in a particular estate tax case when it appears that the person desiring such recognition is the attorney for the estate as shown

by the estate tax return, or as shown by the records of the local probate court. Such permission will not authorize the attorney to appear before the Treasury Department in Washington, D. C., without being regularly enrolled in accordance with these regulations.

(*b*) An enrollment card shall be issued to every attorney or agent upon his enrollment by the secretary of the Committee on Enrollment and Disbarment, and such card shall be sufficient evidence to any officer of the Treasury Department that such attorney or agent has been enrolled.

7. *Knowledge through connection with the Treasury Department.*—(*a*) No attorney or agent shall be permitted to appear before the Treasury Department in connection with any matter to which such attorney or agent gave personal consideration or as to the facts of which he gained actual personal knowledge while in the service of the Treasury Department, and likewise no such attorney or agent shall aid or assist another in any such matter, and no attorney or agent shall receive assistance from one formerly in the service of the Treasury Department and having such personal knowledge.

(*b*) No former officer, clerk, or employee of the Treasury Department shall act as attorney or agent in any matter or controversy pending in such Department during his employment therein within two years after he has ceased to be such officer, clerk, or employee without first having obtained the consent thereto of the Secretary of the Treasury or his duly authorized representative; and no enrolled attorney or agent shall, without first having obtained the consent of the Secretary of the Treasury or his duly authorized representative, employ or retain any such former officer, clerk, or employee directly or indirectly in any such matter or controversy within such two-year period. Such consent may only be granted when it appears (1) that such employment is not prohibited by law or the regulations of the Treasury Department; (2) that the applicant was not, during the period of two years immediately preceding the date of application, employed in the particular section (departmental or field) in which was pending the matter or controversy, to handle which such consent is sought; or if the applicant formerly held an administrative position such as head of a unit, division, or section or was employed as a reviewer or conferee or in an advisory capacity, such applicant will be required to file an affidavit to the effect that he has no knowledge of the facts and issues involved which was gained by him while employed in the Department. The statements made in said affidavit will be corroborated by an examination of the files and records pertaining to the case. Applications for consent should be directed to the secretary of the committee, stating the former connection of the employee and the matter or controversy in which the applicant desires to appear. The applicant shall thereupon be promptly advised as to his right to appear in the particular matter or controversy, and a copy of such advice shall be filed in the record of the case.

8. *Suspension and disbarment proceedings.*—(*a*) If an officer or employee of the Treasury Department, either in the city of Washington or elsewhere, has reason to believe, or if a complaint is made to him, that an enrolled attorney or agent has violated any provision of the laws and regulations governing practice before the Treasury Department, or otherwise engaged in improper or disreputable practice, he shall promptly make written report thereof through the proper channels to the Committee on Enrollment and Disbarment. And if any other person has information of such violations or such improper or disreputable conduct, he may also make written report thereof to the Committee on Enrollment and Disbarment.

(*b*) The committee may, on the basis of such complaint, upon its own motion or otherwise upon reasonable cause, institute proceedings for suspension or disbarment against any enrolled attorney or agent. Notice thereof, signed by the Secretary or Undersecretary of the Treasury shall be sent by mail to such attorney or agent at the address under which he is enrolled or at his last known address, and such notice shall state the charge or charges made and give the place and time within which the respondent shall file in duplicate his verified answer, which time shall not be less than 20 days from the date of mailing the notice. The respondent in his answer shall specifically aver which allegations in the complaint against him are true and which allegations in such complaint are not true. Such answer shall further aver specifically every defense relied upon by the respondent to answer the charge or charges against him in the complaint. Answer in general denial shall not be sufficient answer to such complaint. The committee may, in its discretion, extend the time for filing such answer. The complainant may, in the discretion of the committee, be

furnished with a duplicate copy of such answer. If the respondent fails to file such answer within such time, he shall be declared to be in default, and the charges against him may be deemed to be true without further proof by the complainant. When the answer has been filed, the committee shall pass upon the sufficiency of the same, and in case an issue of fact is raised by said answer then the committee shall set a time and place for the hearing of such case. Notice of the time and place of such hearing, signed by the chairman of the committee, shall be sent by mail to the respondent, which hearing shall not be less than 20 days from the date of mailing such notice. The committee may, in its discretion, postpone the date of hearing, or adjourn any hearing from time to time as may be necessary. An enrolled attorney or agent against whom proceedings for suspension or disbarment have been instituted as herein provided may, pending the conclusion of the proceedings, subject to the approval of the Secretary of the Treasury, be suspended for the time being from practice before the Treasury Department.

(*c*) The committee shall conduct hearings according to such rules of procedure as it shall determine and may receive evidence in such form as it may deem proper. The respondent may be represented by counsel. The testimony of witnesses may, in the discretion of the committee, be required to be under oath and may be stenographically reported and transcribed. Depositions for use at a hearing may, with the approval of the committee, be taken by either party upon oral or written interrogatories before any officer duly authorized to administer an oath for general purposes or an officer of the Internal Revenue Bureau authorized to administer an oath in internal revenue matters if the complaint is based upon violation of these regulations by the respondent in internal revenue matters upon not less than 10 days' written notice, if the deposition is to be taken within the District of Columbia, and upon not less than 20 days' written notice if it is to be taken elsewhere. Such notice shall state the names of the witnesses, the officer before whom, and the time when and place where, such depositions are to be taken: *Provided*, That when depositions are taken as aforesaid, if both parties are present or represented at the time and place specified for the taking of the depositions, either party may, after the examination of the witnesses produced under the order of the committee, be entitled to produce and examine other witnesses; but in such case one day's notice must be given to the adverse party or his counsel there present, unless such notice is waived: *And provided further*, That the complainant and respondent, or by their attorneys, may agree in writing upon a time when, place at which, and an officer before whom such depositions are to be taken, without formal notice. When a deposition is taken upon written interrogatories, any cross-examination shall be upon written interrogatories. Copies of such written interrogatories shall be served with the notice, and copies of any written cross-interrogatories shall be mailed or delivered to the opposing party or his counsel at least five days before the time of taking the deposition.

(*d*) The committee shall, promptly after the conclusion of any hearing, or, if the respondent does not appear in person for the hearing, promptly after the date set therefor, submit to the Secretary of the Treasury a copy of the notice of hearing, the complaint, answer (if any), the record of the hearing (if any), and any written findings of fact by a majority of the committee, together with a recommendation either that the charges be dismissed or that the respondent be reprimanded, suspended for a given period of time, or disbarred. The findings and recommendation shall be signed by all members of the committee agreeing thereto. Members of the committee dissenting therefrom shall submit statements of their reasons therefor. If any members of the committee were not present at the hearing, the fact shall be stated.

(*e*) Upon the approval of such finding and recommendation by the Secretary of the Treasury and his order of suspension or disbarment of an attorney or agent, notice thereof shall be given by the committee to the heads of all bureaus, offices, and divisions of the Treasury Department and to other branches of the Government. Unless duly reinstated, such person will not thereafter be recognized during the period of suspension or disbarment as an attorney or agent in any claim or other matter before the Treasury Department or any office thereof. Notice of such suspension shall be published in the Internal Revenue Bulletin during the period such attorney or agent is under suspension, and notice of disbarment of any such attorney or agent shall be published in the same publication for a period of one year. Notice of reprimand of any attorney or agent shall not be published, but notice of such

reprimand shall be given to all officers and employees of the bureau before which such attorney or agent so reprimanded most frequently appears.

9. *Causes for reprimand, suspension, or disbarment.*—In general, any conduct which would preclude an applicant from enrollment will be sufficient to justify suspension or disbarment. Specifically, the following conduct, in addition to conduct held to be disreputable by the courts in disbarment proceedings against attorneys, shall be a violation of these regulations and will be considered cause for disbarment or suspension of attorneys or agents:

(*a*) Violation of the statutes or rules governing practice before the Treasury Department.

(*b*) Conduct contrary to the canons of ethics as adopted by the American Bar Association.

(*c*) Making false statements of facts to a claimant or taxpayer or false statements of facts to the officers of the Treasury Department in matters pending before said Department in which such attorney or agent represents a claimant or taxpayer.

(*d*) The publication, in connection with his own Federal tax practice, of a so-called "tax service," containing all or part of the decisions or rules of the Treasury Department, United States Board of Tax Appeals, or the courts on Federal tax matters and procedure, rendered from time to time, with comment or discussion thereon, which tax service is subscribed for by Federal tax practitioners or Federal taxpayers.

(*e*) Direct or implied solicitation of employment in matters before the Treasury Department by circulars, letters, pamphlets, or interviews, or by an employed solicitor, not warranted by previous business or personal association. The mailing of circulars, letters, pamphlets, or other printed or written matter to a taxpayer who is not the client of such practitioner which contain no direct solicitation of such employment, but which contain a description of the practice, name, and address of such practitioner, is hereby defined as implied solicitation of such employment.

(*f*) Advertising in the following manner: (1) Printed matter appearing on letterheads, cards, or other advertising matter indicating previous connection with the Treasury Department. (2) Representation, orally, in printing or writing, of acquaintance with the officials or employees of the Treasury Department. (3) The use of any title or name of the practitioner or practice which might imply connection with the Treasury Department, such as "Federal tax expert," "Federal tax counsellor," "Federal tax counsel," "Federal tax bureau," "United States income tax expert," "United States income tax consultant," or "United States income tax bureau." (4) For an enrolled practitioner who has not been regularly admitted to practice as an attorney by a court of record, or who is not the holder of an unrevoked certificate of certified public accountant issued by a legally constituted board authorized by law to issue such certificates, to hold himself out orally, by card, stationery, or otherwise advertise that he is an attorney at law or a certified public accountant, or by title that implies he is an attorney at law or a certified public accountant. (5) By mailing or delivering bulletins, circulars, or pamphlets containing decisions or rulings of the Treasury Department, United States Board of Tax Appeals, or courts on Federal tax matters, and comment thereon by the practitioner, and which contain an advertisement or card of the practice of such practitioner or the name of such practitioner as a distributor of such bulletins, circulars, pamphlets, or other printed matter to Federal taxpayers who are not the clients of such practitioner. (6) By mailing or delivering to Federal taxpayers who are not clients of such practitioner a circular or pamphlet advertising any business, educational or social institution, or organization, which circular or pamphlet contains a card of advertisement of the Federal tax practice of such practitioner.

(*g*) Representing or assisting a client in any matter pending before the Treasury Department to which such attorney or agent gave personal consideration, or as to the facts or issues involved in such matter such attorney or agent gained actual personal knowledge while in the service of the Treasury Department.

(*h*) (1) Assisting a person who has been employed by a client in a matter pending before the Treasury Department, to which matter such person gave personal consideration or gained actual personal knowledge of the facts or issues involved in such matter while in the service of the Treasury Department, or (2) knowingly being assisted in a matter pending before the Treasury Department by a person who gave personal consideration or gained actual per-

sonal knowledge of the facts or issues involved in such matter while in the service of the Treasury Department, or (3) sharing the fees in such matter with such person.

(*i*) Knowingly accepting employment as correspondent or subagent in any matter pending before the Treasury Department of or from any person who has been denied enrollment because of unprofessional or disreputable conduct, or who has been disbarred or is under suspension from practice, or of any person who has procured employment in such matters by unprofessional solicitation.

(*j*) Knowingly assisting in any way or being assisted in a matter pending before the Treasury Department by any person who has been denied enrollment because of unprofessional or disreputable conduct, or who has been disbarred or is under suspension from practice.

(*k*) Sharing fees in any matter pending before the Treasury Department with an unenrolled person who is neither an attorney nor accountant engaged in the practice of law or accountancy.

(*l*) Directly or indirectly representing a client of a corporation in any matter before the Treasury Department, as set forth in paragraph 4.

(*m*) Incompetency or negligence in handling a matter pending before the Treasury Department, or conduct or use of any means whereby final settlement of the matter is unjustifiably delayed.

(*n*) Making false answers to questions in the application for enrollment, the falsity of which answers was not discovered until after the enrollment of such attorney or agent.

(*o*) Conviction of a crime involving moral turpitude.

(*p*) Disbarment of an attorney by a court of record.

(*q*) Disbarment or cancellation of certificate of an accountant by a legally constituted board.

(*r*) Making a false financial statement for any person, firm, or corporation and certifying that such statement is correct or true.

10. *Kind of advertising permitted.*—(*a*) Letterheads, professional cards, and the customary professional insertions in directories and newspapers, trade journals, or other publications should set forth only the name and address of the attorney or agent and a brief description of the nature of his practice—that is to say, whether he practices as an attorney, accountant, or agent, and, if desired, any special field of service or practice covered. An enrolled attorney or agent may use on his letterheads or cards, or professional cards carried in newspapers or directories, the words "enrolled to practice before the Treasury Department," or words of similar import.

(*b*) Employees of the Treasury Department, on severing their connection with the Department, may send out announcement cards briefly stating their former official status and announcing their new association: *Provided*, The cards are addressed only to personal or business acquaintances: *And provided further*, That such cards are distributed only at the time of severance of official connection with the Government.

11. *Employment as associate, correspondent, or subagent.*—An enrolled attorney or agent may accept employment as associate, correspondent, or subagent in any matter pending before the Treasury Department from an attorney or accountant engaged in the practice of law or accountancy who maintains an office for such practice, whether enrolled or not to practice before the Treasury Department, provided he is not under suspension, has not been disbarred or has not been rejected because of disreputable conduct, and from an enrolled agent who is neither an attorney nor accountant but is engaged in the Federal tax practice as a tax expert and who maintains an office for such practice; and with such attorney, accountant, or tax expert an enrolled attorney or agent as associate, correspondent, or subagent in any such matters may share the fees received.

12. *Contingent fees.*—While contingent fees may be proper in some cases before the Department, they are not generally looked upon with favor and may be made the ground of suspension or disbarment. Both their reasonableness in view of the services rendered and all the attendant circumstances are a proper subject of inquiry by the Department. The Commissioner of Internal Revenue or the head of any other Treasury bureau or division of the Secretary's office may, at any stage of a pending proceeding, require an attorney or agent to make full disclosure as to what inducements, if any, were held out by him to procure his employment, and whether the business is being handled on a contingent basis, and if so, the arrangement regarding compensation. The Treasury De-

partment will also make such independent inquiry in regard to the circumstances connected with the employment of attorneys or agents on a contingent basis as it deems advisable.

13. *Authority to prosecute claims.*—A power of attorney from the principal in proper form may be required of attorneys or agents by heads of bureaus, offices, and divisions in any case. *In the prosecution of claims involving payments to be made by the United States, proper powers of attorney shall always be filed before an attorney or agent is recognized.*

14. *Substitution of attorneys or agents and revocation of authority.*—(*a*) Where the power of attorney under which an attorney or agent of record is acting expressly confers the power of substitution, such attorney or agent, if in good standing before the Department, may, by a duly executed instrument, substitute another in his stead, such other, however, to be recognized as the attorney or agent only with the assent of the head of the bureau, office, or division concerned.

(*b*) If a firm dissolve, or those associated as attorneys or agents by virtue of a power of attorney contest the right of either to receive a draft, warrant, or check, the principal only shall thereafter be recognized, unless the members or survivors of such firm, or the associates in such power of attorney, file a proper agreement showing which of such members, survivors, or associates may continue to prosecute the matter and may receive a draft, warrant, or check, and in no case shall a final warrant or check to the principal be delayed more than 60 days by reason of the failure to file such agreement.

(*c*) The revocation by a principal or his legal representatives of authority to prosecute a matter will not be effective, so far as the Treasury Department is concerned, without the assent of the head of the bureau, office, or division before which the matter is pending. Where a matter has been suspended pending the furnishing of evidence for which a call has been made on an attorney or agent, failure to take action thereon within three months from the date of suspension may be deemed by the administrative officer before whom the case is pending cause for revocation of the authority of such attorney or agent without further notice to him.

15. *Application and effective date of circular.*—This circular supersedes the regulations promulgated by Treasury Department Circular No. 230 of August 15, 1923 [C. B. II–2, 372], as heretofore amended and supplemented, relating to the recognition of attorneys, agents, and others. The regulations contained in this circular shall apply to attorneys, agents, and others representing claimants and others before the Treasury Department in the city of Washington or elsewhere with the exception as to customhouse brokers as set forth in paragraph 5, and shall be effective from and after the 1st day of July, 1927. This circular shall apply to all unsettled matters then pending in this Department or which may hereafter be presented or referred to the Department or offices thereof for adjudication, and shall be applicable to all those now enrolled to practice before the Treasury Department as attorney or agent: *Provided*, That nothing herein contained shall be construed to require those now enrolled to apply again to be enrolled: *And provided further*, That the violation of the regulations of Department Circular No. 230 promulgated August 15, 1923, and all amendments amendatory thereof and supplementary thereto, committed prior to July 1, 1927, shall be punished under the provisions of said Department Circular No. 230 promulgated August 15, 1923, and the amendments thereof and supplements thereto, and the disbarment proceedings pending on July 1, 1927, before said committee shall not be affected by these regulations and such proceedings shall be concluded under the provisions of said Circular No. 230 of August 15, 1923, and amendments thereof and the supplements thereto. The persons now detailed or appointed members, secretary, and attorney of the committee under the provisions of Circular No. 230, dated August 15, 1923, shall continue to serve or hold their positions, respectively, under these regulations, subject to the terms of their detail or appointment.

16. *Circular may be withdrawn or amended.*—The Secretary of the Treasury may withdraw or amend at any time or from time to time all or any of the foregoing rules and regulations, with or without previous notice, and may make such special orders as he may deem proper in any case.

A. W. MELLON,
Secretary of the Treasury.

STATUTES.

The following statutes relate to the recognition of attorneys, agents, and other persons representing claimants and others before the Treasury Department and offices thereof:

That the Secretary of the Treasury may prescribe rules and regulations governing the recognition of agents, attorneys, or other persons representing claimants before his Department, and may require of such persons, agents, and attorneys, before being recognized as representatives of claimants, that they shall show that they are of good character and in good repute, possessed of the necessary qualifications to enable them to render such claimants valuable service, and otherwise competent to advise and assist such claimants in the presentation of their cases. And such Secretary may after due notice and opportunity for hearing suspend and disbar from further practice before his Department any such person, agent, or attorney shown to be incompetent, disreputable, or who refuses to comply with the said rules and regulations, or who shall with intent to defraud, in any manner willfully and knowingly deceive, mislead, or threaten any claimant or prospective claimant, by word, circular, letter, or by advertisement. (Act of July 7, 1884, 23 Stat., 258.)

Whoever, being an officer of the United States, or a person holding any place of trust or profit, or discharging any official function under, or in connection with, any executive department of the Government of the United States, or under the Senate or House of Representatives of the United States, shall act as an agent or attorney for prosecuting any claim against the United States, or in any manner, or by any means, otherwise than in discharge of his proper official duties, shall aid or assist in the prosecution or support of any such claim, or receive any gratuity, or any share of or interest in any claim from any claimant against the United States, with intent to aid or assist, or in consideration of having aided or assisted, in the prosecution of such claim, shall be fined not more than $5,000, or imprisoned not more than one year, or both. (Act of Mar. 4, 1909, sec. 109, 35 Stat., 1107.)

It shall not be lawful for any person appointed after the 1st day of June, 1872, as an officer, clerk, or employee in any of the departments, to act as counsel, attorney, or agent for prosecuting any claim against the United States which was pending in either of said departments while he was such officer, clerk, or employee, nor in any manner, nor by any means, to aid in the prosecution of any such claim, within two years next after he shall have ceased to be such officer, clerk, or employee. (Sec. 190, Revised Statutes.)

Any person who willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under, the internal-revenue laws, of a false or fraudulent return, affidavit, claim, or document, shall (whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document) be guilty of a felony, and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution. (Revenue Act of 1926, 44 Stat., 116.)

That section 558 of the Code of Law for the District of Columbia, relating to notaries public, be amended by adding at the end of said section the following: "*Provided*, That the appointment of any person as such notary public, or the acceptance of his commission as such, or the performance of the duties thereunder, shall not disqualify or prevent such person from representing clients before any of the departments of the United States Government in the District of Columbia or elsewhere, provided such person so appointed as a notary public who appears to practice or represent clients before any such department is not otherwise engaged in Government employ, and shall be admitted by the heads of such departments to practice therein in accordance with the rules and regulations prescribed for other persons or attorneys who are admitted to practice therein: *And provided further*, That no notary public shall be authorized to take acknowledgments, administer oaths, certify papers, or perform any official acts in connection with matters in which he is employed as counsel, attorney, or agent or in which he may be in any way interested before any of the departments aforesaid." (Act of June 29, 1906, 34 Stat., 622. Held by 26 Opinions of Attorney General, 236, to apply to all notaries who may practice before the departments.)

The head of each department is authorized to prescribe regulations, not inconsistent with law, for the government of his department, the conduct of its officers

and clerks, the distribution and performance of its business, and the custody, use, and preservation of the records, papers, and property appertaining to it. (Sec. 161, Revised Statutes.)

[In Duplicate.]

TREASURY DEPARTMENT,
COMMITTEE ON ENROLLMENT AND DISBARMENT.
Form 23. (Revised July 1, 1927.)

APPLICATION FOR ADMISSION TO PRACTICE BEFORE THE TREASURY DEPARTMENT.

The honorable THE SECRETARY OF THE TREASURY.
SIR:
I, _____
residing at _____
with my office at _____
hereby apply for admission to practice as _____
(Attorney or agent)[1]
to represent others before the Treasury Department, and submit the following information for the purpose of determining my eligibility and fitness for such practice, in compliance with Treasury regulations as set forth in Department Circular No. 230, revised July 1, 1927:

1. (*a*) Are you a citizen of the United States?_____ (*b*) Natural born?_____ (*c*) Naturalized?_____ (*d*) Where and when naturalized?
_____
(*e*) Date of birth_____
2. (*a*) Are you a member of the bar?_____ (*b*) If so, of what court?
_____
(*c*) Are you now in good standing at said bar?_____
3. (*a*) Do you hold a certificate as a certified public accountant?_____
(*b*) From what State?_____ (*c*) Are you now in good standing under said certificate?_____
4. What is the nature of your business or profession?_____
5. Are you engaged in your business or profession on your individual account?_____; or as a member of a firm?_____; or as an employee of an individual, firm, or corporation?_____
6. If an employee, give name and address of your employer and the nature of your employment_____
7. If a member of a firm, give the firm name and the names of the members of the firm_____
8. If connected with a corporation: (*a*) State the nature of the business in which the corporation is engaged and your connection with it_____
_____
(*b*) Is it your purpose to represent clients of the corporation?_____
(*c*) Will the corporation be benefited directly or indirectly as the result of your representing clients?_____
9. Are you familiar with the laws, rules, and regulations of the Treasury Department and particularly with Department Circular No. 230, revised July 1, 1927?_____
10. What classes of cases do you expect to handle before the Treasury Department?_____

If you are not a member of the bar or a certified public accountant, answer fully 11(*a*), 11(*b*), and 11(*c*).

11. (*a*) Where and when did you receive your education and of what did it consist?_____
_____
_____
_____
(*b*) What personal or business experience have you had, in what lines and with whom?_____
_____
_____
_____

[1] Members of the bar of a court of record will apply as attorneys; all others as agents.

(*c*) What are your particular qualifications rendering you competent to advise and assist claimants in presentation of their cases before the Treasury Department?_____

12. Submit the names and addresses of three business references_____

13. (*a*) Have you ever been rejected, suspended, or disbarred from appearing as attorney or agent, or in any other representative capacity before any branch of the Federal Government, or of any State government, or of any municipality, or any court, or have you ever been rejected, suspended, or disbarred from practicing as a certified public accountant?_____
(*b*) If so, state details of such rejection, suspension, or disbarment_____

14. (*a*) Have you ever been defendant in a criminal case in court?_____
(*b*) If so, state the circumstances and the result_____

15. (*a*) Have you ever been an officer or employee of the United States?_____
(*b*) If so, state the office or employment, with dates of appointment to and separation from the service_____

16. (*a*) Have you made previous application to be recognized as attorney or agent before the Treasury Department?_____
(*b*) If so, state details of such previous application and why you are now making another application_____

I,[2]_____, do solemnly swear (or affirm) that the statements contained in the foregoing application are true and correct; that I will support and defend the Constitution of the United States against all enemies, foreign and domestic; that I will bear true faith and allegiance to the same; that I take this obligation freely without any mental reservation or purpose of evasion; that, if authorized to represent others before the Treasury Department, I will at all times conduct myself strictly in compliance with the laws and regulations governing practice before the Department; that I will maintain the respect due to the Treasury Department and the officials thereof and will abstain from all offensive personalities; that I will not counsel or maintain any application or proceeding which shall appear to me to be unjust, nor will I take any action except such as I believe to be honestly debatable under the law; and that I will employ for the purpose of maintaining the causes confided to me such means only as are consistent with truth and honor; so help me God.

(Name)_____
(Address)_____

Subscribed and sworn to before me this _____ day of _____ 19__.

(Signature of officer)_____
(Official title)_____

[Impress seal here.]

INDORSEMENT.

WASHINGTON, _____, 19__.

The attached application of _____ for enrollment to be recognized as _____ to represent others before the Treas-

[2] NOTE.—This oath may be taken before any justice of the peace, notary public, or other person who is legally authorized to administer an oath in the State, Territory, or District where the application is executed. The seal of the officer administering the oath must be affixed, or if he has no seal, his official character must be duly certified under seal.

ury Department has been examined, and after consideration it is recommended that the application be_____

_____

_____, *Chairman.*
_____
_____
_____
_____
_____

Committee on Enrollment and Disbarment, Treasury Department.

Approved by the Secretary.
(See Schedule No. _____.)

VI–29–3322
Mim. 3554

Signed statement of attorney or agent to be placed on documents filed as evidence before the Treasury Department.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., July 8, 1927.

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

Attention is invited to paragraph (f) on page 2 of Department Circular 230 (revised July 1, 1927) [see page 392], which is quoted below:

Every affidavit, argument, brief, or statement of facts prepared or filed by an attorney or agent as argument or evidence in the matter of a claim or tax matter pending before the Treasury Department shall have thereon a statement signed by such attorney or agent showing whether or not he prepared such document and whether or not the attorney or agent knows of his own knowledge that the facts contained therein are true.

All officers and other employees concerned will carefully examine all documents of the above character filed by attorneys or agents to insure that this provision of the circular is complied with.

It is especially important that the matter have careful attention, since the provision is new to the practice requirements.

Correspondence in regard to the procedure outlined herein should be addressed to the Commissioner and refer to the symbols IT:E:CBA.

H. F. MIRES,
Acting Commissioner.

VI–32–3357
Mim. 3558

Special advisory committee.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., July 28, 1927.

To Collectors of Internal Revenue, Internal Revenue Agents in Charge, Officials and Employees of the Bureau of Internal Revenue, and Others Concerned:

Effective as of August 1, 1927, there is established in the office of the Commissioner a committee, designated Special Advisory Committee, consisting of a chairman, members, and a required personnel to perform the duties incident thereto.

The general purpose of this body shall be to examine into the reasons underlying the accumulation of pending income tax cases in the Bureau.

In connection with such general purpose, it will consider and act upon, subject to the approval of the Commissioner, the following classes of cases:

(*a*) Cases pending in the Bureau on which the advice of the Commissioner is desired as to questions of Bureau policy;

(*b*) Cases arising out of the mailing of deficiency letters as prescribed by the Revenue Act of 1926;

(*c*) Cases, not falling in (*a*) and (*b*) above, submitted to it by the office of the Commissioner.

The functions heretofore performed by the *sixty-day conference units* of the corporation audit division and the personal audit division, with such modifications as may be deemed necessary, will become a part of the functions of the committee.

Complete records shall be maintained by the committee of its action on cases.

D. H. BLAIR,
Commissioner of Internal Revenue.

VI–34–3382

Chairman Littleton, of the United States Board of Tax Appeals, announces the following amendment to rule 46(h) of the Board's rules of practice, revised April 1, 1927, this amendment to be effective immediately:

(h) *Return of.*—The officer must inclose the original depositions and exhibits, together with two copies of the depositions, in a sealed packet, with postage or charges prepaid, and direct and mail or express the same to the United States Board of Tax Appeals, Washington, D. C. In each case the original of the depositions must be directed and mailed or expressed to the Board. The officer may, upon written request, deliver a copy of the depositions to either or to both of the parties, or to their representatives, in lieu of sending such copies to the Board as above provided. If one or both of the required copies are delivered by the officer taking the depositions he shall attach to his return the written request of the party or parties, or of their counsel to whom such copy or copies were delivered, and shall state in his certificate of return the fact of delivery by him of such copy or copies. If copies of the depositions are delivered by the officer taking the same no service of copies of such depositions upon the party or his counsel of record will be made by the Board.

VI–34–3383

JULY 2, 1927.

Chairman Littleton, of the United States Board of Tax Appeals, announces the adoption by the Board of the following rule, effective immediately:

RULE 51. COSTS—PREPARATION OF RECORD ON REVIEW.

It shall be the duty of the clerk, immediately after the contents of a record on review have been settled or agreed to, to notify the petitioner of the costs and charges for the preparation, comparison, and certification of said record; such charges to be determined in accordance with the provisions of an Act of Congress entitled "An Act to provide fees to be charged by clerks of the district courts of the United States," approved February 11, 1925 (43 Stat., 857–858).

No transcript will be certified and transmitted to the appellate court until the costs and charges therefor have been paid to the Board.

VI–52–3552

DECEMBER 6, 1927.

Chairman Littleton, of the United States Board of Tax Appeals, announces the adoption by the Board of the following rule, effective immediately:

RULE 52. COSTS—PRINTING OF RECORD ON REVIEW.

In each proceeding for review of a decision of the Board by the United States Circuit Court of Appeals for the Second Circuit when review is sought by the Commissioner of Internal Revenue, the clerk of the Board shall, immediately after the contents of the record on review, as required by rule 35 of the court, have been settled or agreed upon, make available to the Commissioner, or his counsel, the record of the Board in the proceeding. The Commissioner shall cause the record to be printed. Sixteen copies of the printed record shall be delivered to the clerk of this Board for certification and filing with the clerk of the circuit court of appeals. The clerk of the Board shall serve five copies of the printed record upon counsel for the taxpayer by registered mail.

VI–42–3470

Announcement is made of the appointment of Clarence M. Charest as General Counsel for the Bureau of Internal Revenue, effective October 11, 1927, vice Alexander W. Gregg, resigned.

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[1]VI–52–3554

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.
Berkley, John O.	Washington, D. C.	Dec. 6, 1927	Charged with making a false financial statement of the assets and liabilities of a corporation, showing that such corporation possessed assets of large value, and certifying that said statement was true and correct, when in fact such corporation had practically no assets; that such financial statement was used to induce persons to purchase stock in such corporation, to the loss of such persons. Charges found proven by the committee.

[1] This ruling (No. 3554) includes also rulings Nos. 3298, 3302, 3323, 3333, 3349, 3359, 3374, 3385, 3404, 3418, 3434, 3441, 3448, 3456, 3467, 3474, 3483, 3492, 3498, 3505, 3511, 3522, 3528, 3537, and 3545. 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 January 1–December 31, 1927, inclusive, and all suspensions in effect during the 6-month period July 1–December 31, 1927, inclusive; also cancellations of the right to practice before the Treasury Department and resignations from the enrollment list occurring during the latter period. It does not include those barred from practice by reason of disapproval of their applications for enrollment.

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.
Cohn, Harry A.	Formerly New York.	Nov. 5, 1927	Charged with having been convicted of grand larceny, defaulted for failure to file answer, and charges found proven by the 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.
Fath, Edward J.	New York, N. Y.	Nov. 7, 1927	Charged with bribery of a revenue agent, and charges found proven by committee.
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.
Hackney, James H.	St. Petersburg, Fla.	Oct. 24, 1927	Charged with preparing false income-tax return for a corporation and publishing an advertisement soliciting employment in Federal tax matters, and charges found proven by the 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.
Hebrank, Harry M.	Philadelphia, Pa.	Sept. 30, 1927	Charged with having been indicted and convicted for embezzling funds in a court of the State of Pennsylvania. 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.
Houlihan James Francis.	Watertown, S. Dak.	Oct. 14, 1927	Charged with receiving money in payment of taxes from a taxpayer while employed as deputy collector of internal revenue and failing to account for such money, and charges found proven by committee.
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.
Marshall, L. H.	Omaha, Nebr.	Nov. 5, 1927	Charged with conspiracy to defraud the United States out of money due as taxes from a taxpayer, and making a false income tax return, 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.

Name.	Address.	Date of disbarment.	Cause.
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.
Schwartzman, Theodore I.	Brooklyn, N. Y.	Sept. 16, 1927	Charged with misconduct in connection with a matter pending before the Prohibition Unit. Charges found proven by committee.
Weinhandler, Joseph Jamison.	New York, N. Y.	July 11, 1927	Charged with having been indicted for and having plead guilty of grand larceny in the Court of General Sessions of the Peace in and for the County of New York, State of New York; and charged with having been indicted for violation of section 47, United States Criminal Code, upon which indictment he was later convicted and sentenced to a term of 6 months in jail and a fine of $2,000 in the District Court of the United States of America for the Northern District of New York, 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.

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.
Box, George G	Formerly Washington, D. C., now Miami, Fla.	30 days, from Aug. 24, 1927.	Charged with advertising his previous employment as an internal revenue agent, and charges found proven by committee.
Buchanan, Henry M.	Milwaukee, Wis	60 days, from Sept. 23, 1927.	Charged with making and filing a false income-tax return. Charge found proven by committee.
Miller, Grant L	Seattle, Wash	60 days, from Nov. 25, 1927.	Charged with having gained knowledge of the facts and issues involved in a tax case as an employee of the Internal Revenue Bureau, and that after severing his connection with said Bureau, accepted employment from the taxpayer, prepared protest and brief used in support of claims for abatement and refund in said tax case; and charges found proven by the committee.

DISBARMENT TERMINATED.

The Secretary of the Treasury has ordered that the order of disbarment entered against the following person be terminated as of the date indicated and that his name be restored to the roll of attorneys and agents eligible to practice before the Treasury Department:

Name.	Address.	Remarks.
Schwartz, Geo. W	Chicago, Ill	Disbarment ordered Apr. 15, 1924; disbarment terminated and good standing restored Nov. 15, 1927.

Resignations from enrollment to practice before the Treasury Department.

The following persons have tendered their resignations from enrollment to practice before the Treasury Department and, upon recommendation of the Committee on Enrollment and Disbarment after examination of their cases, the Secretary of the Treasury has approved the resignations, and they are therefore no longer entitled to practice before the Treasury Department:

Name.	Address.	Designation.	Date of acceptance.	Remarks.
Barry, John J	Boston, Mass	Attorney	July 1, 1927	Without prejudice.
Beaman, Reuben John.	Cincinnati, Ohio	Agent	Nov. 17, 1927	Do.
Mitchell, Joseph J	New York, N. Y.	do	Aug. 31, 1927	Do.
Peck, W. J	Caruthersville, Mo.	do	Aug. 5, 1927	Do.
True, Wallace W	Formerly of Milwaukee, Wis., now Irvington, N. J.	do	July 11, 1927	Do.

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