

SUBCHAPTER A—INCOME TAX (CONTINUED)

PART 2—MARITIME CONSTRUCTION RESERVE FUND

Sec.

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AUTHORITY: Sec. 511(b), 49 Stat. 1985, as amended, sec. 7805, 68A Stat. 917; 26 U.S.C. 7805, 46 U.S.C. 1161(b).

SOURCE: T.D. 6820, 30 FR 6030, Apr. 29, 1965, unless otherwise noted.

EDITORIAL NOTE: The regulations contained in this part have been recodified in 46 CFR part 287.

§ 2.1 Statutory provisions; sections 511 and 905, Merchant Marine Act, 1936, and related statutes.

SEC. 511. [Merchant Marine Act, 1936] (a) When used in this section the term *new vessel* means any vessel (1) documented or agreed with the Commission to be documented under the laws of the United States; (2) constructed in the United States after December

31, 1939, or the construction of which has been financed under titles V or VII of this Act, as amended, or the construction of which has been aided by a mortgage insured under title XI of this Act as amended; and (3) either (A) of such type, size, and speed as the Commission shall determine to be suitable for use on the high seas or Great Lakes in carrying out the purposes of this Act, but not of less than 2,000 gross tons or of less speed than twelve knots, unless the Commission shall determine and certify in each case that a vessel of a specified lesser tonnage or speed is desirable for use by the United States in case of war or national emergency, or (B) constructed to replace a vessel or vessels requisitioned or purchased by the United States.

(b) For the purpose of promoting the construction, reconstruction, reconditioning, or acquisition of vessels, or for other purposes authorized in this section, necessary to carrying out the policy set forth in title I of this Act, any citizen of the United States who is operating a vessel or vessels in the foreign or domestic commerce of the United States or in the fisheries or owns in whole or in part a vessel or vessels being so operated, or who, at the time of purchase or requisition of the vessel by the Government, was operating a vessel or vessels so engaged or owned in whole or in part a vessel or vessels being so operated or had acquired or was having constructed a vessel or vessels for the purpose of operation in such commerce or in the fisheries, may establish a construction reserve fund, for the construction, reconstruction, reconditioning, or acquisition of new vessels, or for other purposes authorized in this section, to be composed of deposits of proceeds from sales of vessels, indemnities on account of losses of vessels, earnings from the operation of vessels documented under the laws of the United States and from services incident thereto, and receipts, in the form of interest or otherwise, with respect to amounts previously deposited. Such construction reserve fund shall be established, maintained, expended, and used in accordance with the provisions of this section and rules or regulations to be prescribed jointly by the Commission and the Secretary of the Treasury.

(c) In the case of the sale or actual or constructive total loss of a vessel, if the taxpayer deposits an amount equal to the net proceeds of the sale or to the net indemnity with respect to the loss in a construction reserve fund established under subsection (b), then—

(1) If the taxpayer so elects in his income-tax return for the taxable year in which the gain was realized, or

(2) In case a vessel is purchased or requisitioned by the United States, or is lost, in any taxable year beginning after December 31, 1939, and the taxpayer receives payment for the vessel so purchased or requisitioned, or receives from the United States indemnity on account of such loss, subsequent to the end of such taxable year, if the taxpayer so elects prior to the expiration of sixty days after the receipt of the payment or indemnity, and in accordance with a form of election to be prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury,

no gain shall be recognized to the taxpayer in respect of such sale or indemnification in the computation of net income for the purposes of Federal income or excess-profits taxes. If an election is made under subdivision (2) and if computation or recomputation in accordance with this subsection is otherwise allowable but is prevented, on the date of making such election or within six months thereafter, by any statute of limitation, such computation or recomputation nevertheless shall be made notwithstanding such statute if a claim therefor is filed within six months after the date of making such election.

For the purposes of this subsection no amount shall be considered as deposited in a construction reserve fund unless it is deposited within sixty days after it is received by the taxpayer.

As used in this subsection the term *net proceeds* and the term *net indemnity* mean the sum of (1) the adjusted basis of the vessel and (2) the amount of gain which would be recognized to the taxpayer without regard to this subsection.

(d) The basis for determining gain or loss and for depreciation, for the purposes of Federal income or excess profits taxes, of any new vessel constructed, reconstructed, reconditioned, or acquired by the taxpayer, or with respect to which purchase-money indebtedness is liquidated as provided in subsection (g), in whole or in part out of the construction reserve fund shall be reduced by that portion of the deposits in the fund expended in the construction, reconstruction, reconditioning, acquisition, or liquidation of purchase-money indebtedness of the new vessel which represents gain not recognized for tax purposes under subsection (c).

(e) For the purposes of this section, (1) if the net proceeds of a sale or the net indemnity in respect of a loss are deposited in more than one deposit, the amount consisting of the gain shall be considered as first deposited; (2) amounts expended, obligated, or otherwise withdrawn shall be applied against the amounts deposited in the fund in the order of deposit; and (3) if any deposit consists in part of gain not recognized under subsection (c), any expenditure, obligation, or withdrawal applied against such deposit

shall be considered to consist of gain in the proportion that the part of the deposit consisting of gain bears to the total amount of the deposit.

(f) With respect to any taxable year, amounts on deposit on the last day of such year in a construction reserve fund in accordance with this section and with respect to which all the requirements of subsection (g) have been satisfied, to the extent that such requirements are applicable as of the last day of said taxable year, shall not constitute an accumulation of earnings or profits within the meaning of section 102 of the Internal Revenue Code [Part I (section 531 and following), Subchapter A, Chapter 1 of the Internal Revenue Code of 1954].

(g) The provisions of subsections (c) and (f) shall apply to any deposit in the construction reserve fund only to the extent that such deposit is expended or obligated for expenditure, in accordance with rules and regulations to be prescribed jointly by the Commission and the Secretary of the Treasury—

(1) Under a contract for the construction or acquisition of a new vessel or vessels (or in the discretion of the Commission, for a part interest therein), or, with the approval of the Commission, for the reconstruction or reconditioning of a new vessel or vessels, entered into within (i) two years from the date of deposit or the date of any extension thereof which may be granted by the Commission pursuant to the provisions of section 511(h), in the case of deposits made prior to the date [July 17, 1952] on which these amendatory provisions become effective, or (ii) three years from the date of such deposit in the case of a deposit made after such effective date, only if under such rules and regulations—

(A) Within such period not less than 12½ per centum of the construction or contract price of the vessel or vessels is paid or irrevocably committed on account thereof and the plans and specifications therefor are approved by the Commission to the extent by it deemed necessary; and

(B) In case of a vessel or vessels not constructed under the provisions of this title or not purchased from the Commission, (i) said construction is completed, within six months from the date of the construction contract, to the extent of not less than 5 per centum thereof (or in case the contract covers more than one vessel, the construction of the first vessel so contracted for is so completed to the extent of not less than 5 per centum) as estimated by the Commission and certified by it to the Secretary of the Treasury, and (ii) all construction under such contract is completed with reasonable dispatch thereafter;

(2) For the liquidation of existing or subsequently incurred purchase-money indebtedness to persons other than a parent company of, or a company affiliated or associated

with, the mortgagor on a new vessel or vessels within (i) two years from the date of deposit or the date of any extension thereof which may be granted by the Commission pursuant to the provisions of section 511(h), in the case of deposits made prior to the date [July 17, 1952] on which these amendatory provisions become effective, or (ii) three years from the date of such deposit in the case of a deposit made after such effective date.

(h) The Commission is authorized under rules and regulations to be prescribed jointly by the Secretary of the Treasury and the Commission to grant extensions of the period within which the deposits shall be expended or obligated or within which construction shall have progressed to the extent of 5 per centum of completion as provided herein, but such extension shall not be for an aggregate additional period in excess of two years with respect to the expenditure or obligation of such deposits or more than one year with respect to the progress of such construction: *Provided*, That until January 1, 1965, in addition to the extensions hereinbefore permitted, further extensions may be granted ending not later than December 31, 1965.

(i) Any such deposited gain or portion thereof which is not so expended or obligated within the period provided, or which is otherwise withdrawn before the expiration of such period, or with respect to which the construction has not progressed to the extent of 5 per centum of completion within the period provided, or with respect to which the Commission finds and certifies to the Secretary of the Treasury that, for causes within the control of the taxpayer, the entire construction is not completed with reasonable dispatch, if otherwise taxable income under the law applicable to the taxable year in which such gain was realized, shall be included in the gross income for such taxable year, except for the purpose of the declared value excess-profits tax and the capital stock tax. If any such deposited gain or portion thereof with respect to a deposit made in any taxable year ending on or before June 30, 1945, is so included in gross income for such taxable year, there shall (in addition to any other deficiency) be assessed, collected, and paid in the same manner as if it were a deficiency, an amount equal to 1.1 per centum of the amount of gain so included, such amount being in lieu of any adjustment with respect to the declared value excess-profits tax for such taxable year.

(j) Notwithstanding any other provision of law, any deficiency in tax for any taxable year resulting from the inclusion of any amount in gross income as provided by subsection (i), and the amount to be treated as a deficiency under such subsection in lieu of any adjustment with respect to the declared value excess-profits tax, may be assessed or

a proceeding in court for the collection thereof may be begun without assessment, at any time: *Provided, however*, That interest on any such deficiency or amount to be treated as a deficiency shall not begin until the date the deposited gain or portion thereof in question is required under subsection (i) to be included in gross income.

(k) This section shall be applicable to a taxpayer only in respect of sales or indemnifications for losses occurring within a taxable year beginning after December 31, 1939, and only in respect of earnings derived during a taxable year beginning after December 31, 1939.

(l) For the purposes of this section a vessel shall be considered as constructed or acquired by the taxpayer if constructed or acquired by a corporation at a time when the taxpayer owns at least 95 per centum of the total number of shares of each class of stock of the corporation.

(m) The terms used in this section shall have the same meaning as in chapter 1 of the Internal Revenue Code.

(n) The terms *contract for the construction* and *construction contract*, as used in this section, shall include, in the case of a taxpayer who constructs a new vessel in a shipyard owned by such taxpayer, an agreement between such taxpayer and the Commission with respect to such construction and containing provisions deemed necessary or advisable by the Commission to carry out the purposes and policy of this section.

(o) The terms *reconstruction and reconditioning*, as used in this section, shall include the reconstruction, reconditioning, or modernization of a vessel for exclusive use on the Great Lakes, including the St. Lawrence River and Gulf, if the Commission determines that the objectives of this Act will be promoted by such reconstruction, reconditioning, or modernization, and, notwithstanding any other provisions of law, such vessel shall be deemed to be a "new vessel" within the meaning of this section for such reconstruction, reconditioning, or modernization.

[Sec. 511 as added by Act of October 10, 1940 (Pub. L. 840, 76th Cong., 54 Stat. 1106), as amended by Act of June 17, 1943 (Pub. L. 78, 78th Cong., 57 Stat. 157); Act of Dec. 23, 1944 (Pub. L. 552, 78th Cong., 58 Stat. 920); secs. 9-14, Act of July 17, 1952 (Pub. L. 586, 82d Cong., 66 Stat. 762); Act of Sept. 12, 1964 (Pub. L. 88-595, 78 Stat. 943)]

SEC. 905. [Merchant Marine Act, 1936.]
When used in this Act—

(a) The words *foreign commerce* or *foreign trade* mean commerce or trade between the United States, its Territories or possessions, or the District of Columbia, and a foreign country.

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(c) The words *citizen of the United States* include a corporation, partnership, or association only if it is a citizen of the United States within the meaning of section 2 of the Shipping Act, 1916, as amended (U.S.C., title 46, sec. 802), and with respect to a corporation under title VI of this Act, all directors of the corporation are citizens of the United States, and, in the case of a corporation, partnership, or association operating a vessel on the Great Lakes, or on bays, sounds, rivers, harbors, or inland lakes of the United States the amount of interest required to be owned by a citizen of the United States shall be not less than 75 per centum.

* * * * *

(e) The terms *United States Maritime Commission* and *Commission* shall mean the Secretary of Commerce, the Maritime Administrator, or the * * * [Maritime Subsidy Board] as the context may require * * *.

[Sec. 905 (a), (c), and (e) (49 Stat. 2016), amended by sec. 39 (a) and (b), Act of June 23, 1938 (Pub. L. 705, 75th Cong., 52 Stat. 964); Act of July 17, 1952 (Pub. L. 586, 82d Cong., 66 Stat. 765); sec. 4, Act of Sept. 21, 1959 (Pub. L. 86-327, 73 Stat. 597)]

SEC. 2. [Shipping Act, 1916.] (a) That within the meaning of this Act no corporation, partnership, or association shall be deemed a citizen of the United States unless the controlling interest therein is owned by citizens of the United States, and, in the case of a corporation, unless its president or other chief executive officer and the chairman of its board of directors are citizens of the United States and unless no more of its directors than a minority of the number necessary to constitute a quorum are noncitizens and the corporation itself is organized under the laws of the United States or of a State, Territory, District, or possession thereof, but in the case of a corporation, association, or partnership operating any vessel in the coastwise trade the amount of interest required to be owned by citizens of the United States shall be 75 per centum.

(b) The controlling interest in a corporation shall not be deemed to be owned by citizens of the United States (a) if the title to a majority of the stock thereof is not vested in such citizens free from any trust or fiduciary obligation in favor of any person not a citizen of the United States; or (b) if the majority of the voting power in such corporation is not vested in citi-

zens of the United States; or (c) if through any contract or understanding it is so arranged that the majority of the voting power may be exercised, directly or indirectly, in behalf of any person who is not a citizen of the United States; or (d) if by any other means whatsoever control of the corporation is conferred upon or permitted to be exercised by any person who is not a citizen of the United States.

(c) Seventy-five per centum of the interest in a corporation shall not be deemed to be owned by citizens of the United States (a) if the title to 75 per centum of its stock is not vested in such citizens free from any trust or fiduciary obligation in favor of any person not a citizen of the United States; or (b) if 75 per centum of the voting power in such corporation is not vested in citizens of the United States; or (c) if, through any contract or understanding it is so arranged that more than 25 per centum of the voting power in such corporation may be exercised, directly or indirectly, in behalf of any person who is not a citizen of the United States; or (d) if by any other means whatsoever control of any interest in the corporation in excess of 25 per centum is conferred upon or permitted to be exercised by any person who is not a citizen of the United States.

(d) The provisions of this Act shall apply to receivers and trustees of all persons to whom the Act applies, and to the successors or assignees of such persons.

[Sec. 2 (39 Stat. 729) as amended by Act of July 15, 1918 (Pub. L. 198, 65th Cong., 40 Stat. 900); sec. 38, Merchant Marine Act, 1920 (41 Stat. 1008); sec. 3, Act of Sept. 21, 1959 (Pub. L. 86-327, 73 Stat. 597)]

§ 2.1-1 Definitions.

(a) As used in the regulations in this part, except as otherwise expressly provided—

(1) *Act* means the Merchant Marine Act, 1936, as amended (46 U.S.C. 27).

(2) *Section* means one of the sections of the regulations in this part.

(3) *Administration* means the Maritime Administration of the Department of Commerce as created by Reorganization Plan No. 21 of 1950 (46 U.S.C. 1111 note).

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(4) *Citizen* means a person who, if an individual, was born or naturalized as a citizen of the United States or, if other than an individual, meets the requirements of section 905(c) of the Act and section 2 of the Shipping Act, 1916, as amended (46 U.S.C. 802).

(5) *Taxpayer* means a citizen who has established or seeks to establish a construction reserve fund under the provisions of section 511 of the Act and the regulations in this part, and may include a partnership.

(6) *Corporation* includes associations, joint-stock companies and insurance companies.

(7) *Stock* includes the shares in an association, joint-stock company, or insurance company.

(8) *Affiliate* or *associate* means a person directly or indirectly controlling, controlled by, or under common control with, another person.

(9) *Control*, as used in subparagraph (8) of this paragraph, means the possession of the power to direct in any manner the management and policies of a person, and the terms “controlling” and “controlled” shall have the meanings correlative to the foregoing.

(10) *Person* means an individual, a corporation, a partnership, an association, an estate, a trust, or a company.

(11) *Partnership* includes a syndicate, group, pool, joint venture, or other unincorporated organization.

(12) *Construction*, if so determined by the Administration, shall include reconstruction and reconditioning.

(13) *Reconstruction and reconditioning* shall include the reconstruction, reconditioning, or modernization of a vessel for exclusive use on the Great Lakes, including the Saint Lawrence River and Gulf, if the Administration determines that the objectives of the Act will be promoted by such reconstruction, reconditioning, or modernization, and, notwithstanding any other provisions of law, such vessel shall be deemed to be a “new vessel” within the meaning of section 511 of the Act for such reconstruction, reconditioning, or modernization.

(14) *Purchase-money indebtedness* means any indebtedness, or evidence thereof, created as the result of the purchase of a vessel by the taxpayer.

(15) *Contract, contract for the construction, and construction contract* shall include, if so determined by the Administration, a contract for reconstruction or reconditioning and shall include, in the case of a taxpayer who constructs a new vessel in a shipyard owned by such taxpayer, an agreement, between such taxpayer and the Administration with respect to such construction, and containing provisions deemed necessary or advisable by the Administration to carry out the purposes and policy of section 511 of the Act.

(b) Insofar as the computation and collection of taxes are concerned, other terms used in the regulations in this part, except as otherwise provided, have the same meaning as in the Internal Revenue Code and the regulations thereunder.

§ 2.1-2 Scope of section 511 of the Act and the regulations in this part.

(a) *Applicability of regulations.* (1) The regulations prescribed in this part—

(i) Apply to gain realized from the sale or loss of vessels, earnings from the operation of vessels, and interest (or otherwise) with respect to amounts previously deposited in the construction reserve fund, for a taxable year beginning after December 31, 1964, and

(ii) Apply to the expenditure, obligation, or withdrawal, during a taxable year beginning after December 31, 1964, of any deposits of gain, earnings, and interest (or otherwise) of the character referred to in subdivision (i) of this subparagraph without regard to the taxable year in which the deposits were made.

(2) As to gain, earnings, or interest (or otherwise) described in subparagraph (1)(i) of this paragraph and as to an expenditure, obligation, or withdrawal described in subparagraph (1)(ii) of this paragraph, the regulations in this part supersede Treasury Decision 5330, as amended (26 CFR (1939) part 32).

(b) *Nonrecognition and accumulation.* Section 511 of the Act provides, under conditions specified, for the nonrecognition, for income and excess-profits tax purposes, of the gain realized from the sale or indemnification for loss of certain vessels including certain vessels in the course of construction, or shares therein. It also permits

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the accumulation of the proceeds of such sales or indemnification and of certain earnings without liability under Part I (section 531 and following), Subchapter G, Chapter I of the Internal Revenue Code of 1954, and the regulations thereunder (§§1.531-1 through 1.537-3 of this chapter (Income Tax Regulations)).

(c) *Availability of benefits.* The benefits of section 511 of the Act are available to any citizen as defined in paragraph (a)(4) of §2.1-1, who, during any taxable year owns, in whole or in part, a vessel or vessels within the scope of §2.1-3. A citizen operating such a vessel or vessels owned by any other person or persons can derive no benefit from the provisions relating to the nonrecognition of gain from the sale or loss of such vessel or vessels so owned, but may establish a construction reserve fund in which he may deposit earnings from the operation of such vessel or vessels.

(d) *Applicability of section 511.* Section 511 of the Act applies only with respect to sales or losses of vessels within the scope of §2.1-3 or in respect of earnings derived from the operation of such vessels. A loss to be within section 511 of the Act must be an actual or constructive total loss. Whether there is a total loss, actual or constructive, will be determined by the Administration.

§ 2.1-3 Requirements as to vessel operations.

Section 511 of the Act applies with respect to vessels operated in the foreign or domestic commerce of the United States or in the fisheries of the United States and vessels acquired or being constructed for the purpose of such operation. The foreign commerce of the United States includes commerce or trade between the United States (including the District of Columbia), the territories and possessions which are embraced within the coastwise laws, and a foreign country or other territories and possessions of the United States. The domestic commerce of the United States includes commerce or trade between ports of the United States and its territories and possessions, embraced within the coastwise laws and on inland rivers. The fisheries include the fisheries of

the United States and its territories and possessions. Section 511 of the Act does not apply to vessels operated in the foreign commerce or fisheries of any country other than the United States.

§ 2.1-4 Application to establish fund.

Any person claiming to be entitled to the benefits of section 511 of the Act may make application, in writing, to the Administration for permission to establish a construction reserve fund. The application shall be in such form and substance as the Administration may prescribe and shall designate, among other things, the depository or depositories with which the taxpayer proposes to establish the said fund. The original application shall be executed and verified by the taxpayer, or if the taxpayer is a corporation, by one of its principal officers, in triplicate, and shall be accompanied by eight conformed copies when filed with the Administration.

§ 2.1-5 Tentative authorization to establish fund.

Where the time between the receipt by the Administration of the application for permission to establish a construction reserve fund and the date prior to which an amount received from the sale or loss of a vessel must be deposited to come within the scope of section 511 of the Act is insufficient to permit a determination of the eligibility of the applicant, the Administration may tentatively authorize the establishment of a construction reserve fund and the deposit of such amount therein. Such tentative authorization shall be subject to rescission by the Administration if subsequently it is determined that the applicant is not entitled to the benefits of section 511 of the Act, or has not complied with the statutory requirements. For example, a tentative authorization will be rescinded if the Administration ascertains that the applicant is not a citizen. Upon such determination, the fund shall be closed and all amounts on deposit therein shall be withdrawn.

§ 2.1-6 Establishment of fund.

(a) *Authorization by the Administration.* If the application is approved by

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the Administration, the Administration will adopt Orders authorizing the establishment of a construction reserve fund with the depository or depositories designated by the taxpayer and approved by the Administration. The Orders will provide for joint control by the Administration and the taxpayer over such fund, will set forth the conditions governing the establishment and maintenance of the fund and the making of deposits therein and withdrawals therefrom, and will designate the representatives authorized to execute instruments of withdrawal on behalf of the Administration.

(b) *Resolution or agreement of the taxpayer.* A certified copy of the Orders of the Administration will be furnished the taxpayer. If the taxpayer is a corporation, it shall promptly adopt, through its board of directors, a resolution satisfactory in form and substance to the Administration, authorizing the establishment and maintenance of the fund in conformity with the action of the Administration. If the taxpayer is not a corporation, it shall promptly execute an agreement with the depository satisfactory in form and substance to the Administration to conform to the action of the Administration as set forth in the Orders. Certified copies of the Orders of the Administration and of the resolution of the taxpayer (if it is a corporation) will be furnished to the depository by the Administration and the taxpayer, respectively, for its guidance in maintaining the fund and honoring instruments of withdrawal. The taxpayer, if a corporation, shall also furnish the Administration with a certified copy of its resolution, or if not a corporation, a duplicate original of its agreement with the depository.

(c) *Constructive action not recognized.* Constructive deposits, substitutions or withdrawals will not be recognized by the Administration in the establishment and maintenance of the fund.

(d) *Failure to make deposits as basis for termination of fund.* In the event no deposit is made into the fund for more than five years, any amounts remaining in the fund shall be removed from the fund at the discretion of the Administration and, if so removed, the fund shall be terminated. In the event

of such termination, see § 2.1-23 for recognition of gain.

§ 2.1-7 Circumstances permitting reimbursement from a construction reserve fund.

(a) *Payments prior to establishment of fund.* If, prior to the establishment of a construction reserve fund under the regulations in this part, a taxpayer has made necessary payments under a contract which satisfies the provisions of the regulations in this part and section 511 of the Act for the construction or acquisition of a new vessel, such taxpayer may, if subsequently authorized to establish a construction reserve fund under the regulations in this part, draw against such fund as reimbursement for the amount, if any, of other funds which, with the approval or ratification of the Administration, the taxpayer used for making such necessary payments prior to the establishment of the fund.

(b) *Payments subsequent to establishment of fund.* If, subsequent to the establishment of a construction reserve fund under the regulations in this part, the taxpayer has made necessary payments under a contract which satisfies the provisions of the regulations in this part and section 511 of the Act for the construction or acquisition of a new vessel, such taxpayer may draw against such fund as reimbursement for the amount, if any, of other funds which, with the approval or ratification of the Administration, the taxpayer had used for the purpose of making such necessary payments.

§ 2.1-8 Investment of funds in securities.

(a) *Obligations of or guaranteed by the United States.* Interest-bearing direct obligations of the United States, or obligations fully guaranteed as to principal and interest by the United States, may be deposited in the construction reserve fund in lieu of cash, may be purchased with cash on deposit in the fund, or may be substituted for securities or commitment to finance in the fund, subject to the provisions of paragraph (b) of this section.

(b) *Other securities.* In cases where the taxpayer desires to deposit any securities in the fund in lieu of cash other

than those of or guarantees by the United States or to purchase such other securities with cash on deposit in the fund, or to substitute such other securities for securities or commitment to finance in the fund, the taxpayer shall make written application to the Administration and shall not consummate the transaction until the written consent of the Administration shall have been received. The application shall describe the securities fully. Every approval by the Administration of such application shall be conditioned upon agreement by the taxpayer forthwith to dispose of such securities upon subsequent request by the Administration. Immediately upon the purchase of any securities for deposit in the fund, the taxpayer shall advise the Administration, giving the date of purchase, a description of the securities, and the price paid therefor (net, brokerage and other charges, and gross). Ordinarily, the Administration will not approve the deposit in the fund in lieu of cash, or the purchase with cash on deposit in the fund or the substitution for securities in the fund of securities not actively traded in on exchanges registered under the Securities Exchange Act of 1934 (15 U.S.C. ch. 2B), or securities which are not legal for investment of trust funds. Whenever the Administration approves the substitution of other securities for securities in the fund, such substitution shall be effected only upon or after the deposit of the substituted securities into the fund.

(c) *Cash*. Cash may be substituted for amounts which are on deposit in the fund in any other form.

(d) *Devalued securities*. In the event the Administration determines that the market value at any date of any securities in the fund has decreased to a figure which is less than 90 percent of the market value at the time of deposit into the fund, then within 60 days after the taxpayer receives notice of such determination the taxpayer shall (except as otherwise provided in this paragraph) deposit into the fund cash or securities in an amount equal to the difference between the current market value of the devalued securities and the market value of such securities at the time of their original deposit. However

if any securities in the fund are valued at the time of their deposit at less than the market value of such securities at the time of their deposit the taxpayer shall be required to deposit only an amount equal to that portion of the difference between the current market value of the devalued securities and the market value of such securities at the time of their original deposit which bears the same ratio to such total difference as the amount at which the securities were valued at the time of their deposit bears to the market value at the time of such deposit.

§ 2.1-9 Valuation of securities in fund.

(a) *Equivalent values*. In cases where securities are deposited in the fund in lieu of cash, or are purchased with cash on deposit in the fund, or are substituted for securities in the fund, the value of such securities must not be less than the amount of cash in lieu of which they are so deposited or with which they are so purchased, or the value at the time of deposit of the securities for which they were so substituted. If the securities on deposit in the fund are replaced by cash from the general funds of the taxpayer, the amount of cash to be deposited in the fund in lieu thereof shall be not less than the amount at which such securities were valued at the time of their deposit in the fund.

(b) *Determination of value*. (1) For the purpose of determining the amount in the fund, the value of securities shall be their "market value" (which shall be the basis for determining value, unless otherwise agreed to by the administration) and shall be determined in the following manner:

(i) In instances where no actual purchase is involved, such as the initial deposit of securities in the fund in lieu of cash, the last sales price thereof on the principal exchange on the day the deposit was made shall be deemed to be the "market value" thereof, or, if no such sales were made, the "market value" thereof will be determined by the Administration on such basis as it may deem to be fair and reasonable in each case.

(ii) In instances where the purchase of securities with cash on deposit in the fund is involved, "market value"

shall be the gross price paid (adjusted for accrued interest): *Provided*, That if such securities are purchased otherwise than upon a registered exchange the price shall be within the range of transactions on the exchange on the date of such purchase, or, if there were no such transactions, then the "market value" thereof will be determined by the Administration on such basis as it may deem to be fair and reasonable in each case.

(2) Purchase-money obligations secured by mortgages on vessels sold or irrevocable commitments to finance the construction or acquisition of new vessels which are deposited in the construction reserve fund as provided in §2.1-13 ordinarily will be considered as equivalent to their face value.

§2.1-10 Withdrawals from fund.

(a) *Withdrawals for obligations or liquidation.* (1) Checks, drafts, or other instruments of withdrawal to meet obligations under a contract for the construction or acquisition of a new vessel or vessels or for the liquidation of existing or subsequently incurred purchase-money indebtedness, after having been executed by the taxpayer, shall be forwarded to the Administration in Washington, DC, with appropriate explanation of the purpose of the proposed withdrawal, including properly certified invoices or other supporting papers. Such instruments of withdrawal, if payable to the Administration, will be deposited by the Administration for collection, and the proceeds thereof, upon collection, will be credited to the appropriate contract with the Administration; but if drawn to the order of payees other than the Administration, after countersignature on behalf of the Administration, will ordinarily be forwarded to the payees.

(2) An amount obligated under a contract for the construction or acquisition of a new vessel or vessels or for the liquidation of existing or subsequently incurred purchase-money indebtedness, whether the obligor has the entire or a partial interest therein within the scope of section 511 of the Act, may not, so long as the contract or indebtedness continues in full force and effect, be withdrawn except to meet payments due or to become due

under such contract or for such liquidation.

(b) *Other withdrawals.* Checks, drafts, or other instruments of withdrawal executed by the taxpayer for purposes other than to meet obligations under a contract for the construction or acquisition of a new vessel or vessels or for the liquidation of existing or subsequently incurred purchase-money indebtedness, whether the taxpayer has the entire or a partial interest therein, shall be drawn by the taxpayer to its own order and forwarded to the Administration in Washington, DC, with appropriate explanation of the purpose of the proposed withdrawal. Such withdrawals may occur by reason of a determination by the Administration that the taxpayer is not entitled to the benefits of section 511 of the Act (see §2.1-5), or that a particular deposit has been improperly made (see §2.1-13), or by reason of the election of the taxpayer to make such withdrawals. Upon receipt of such checks, drafts, or other instruments of withdrawal, the Administration will give notice thereof to the Commissioner of Internal Revenue. The Commissioner will advise the Administration of the receipt of the notice and the date it was received. The Administration shall not countersign such checks, drafts, or other instruments of withdrawal or transmit them to the taxpayer until the expiration of 30 days from the date of receipt of the notice by the Commissioner, unless the Commissioner or such official of the Internal Revenue Service as he may designate for the purpose consents in writing to earlier countersignature by the Administration and transmittal to the taxpayer. Upon the expiration of such 30-day period, or prior thereto if the aforesaid consent of the Commissioner has been obtained, the Administration will countersign the check, draft, or other instrument of withdrawal and forward it to the taxpayer.

(c) *Inapplicability to certain transactions.* The provisions of this section shall not be applicable to transactions deemed to be withdrawals by reason of the sale of securities held in the fund for an amount less than the market

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value thereof at the time of their deposit (see § 2.1-23), nor to the cancellation of an irrevocable commitment deposited in the fund, upon proof satisfactory to the Administration that the terms of such commitment have been fully satisfied.

§ 2.1-11 Time deposits.

Deposits in the construction reserve fund not invested in securities may be placed in time deposits when, in the judgment of the taxpayer, it is desirable and feasible so to do. The taxpayer shall promptly advise the Administration of any time deposit arrangements made with the depository. The Administration reserves the right at any time to require the termination or modification of any such arrangements. With prior approval of the Administration a time deposit may be made in a depository other than the one with which the construction reserve fund is established.

§ 2.1-12 Election as to nonrecognition of gain.

(a) *Election requirements.* As a prerequisite to the nonrecognition of gain on the sale or loss of a vessel (or of a part interest therein) for Federal income tax purposes, the taxpayer, after establishing a construction reserve fund, must make an election with respect to such vessel or interest in the manner set forth in this paragraph.

(1) *In general.* Except as provided in subparagraph (2) of this paragraph, the election must be made in the taxpayer's Federal income tax return (or, in the case of a partnership, in the partnership return of income) for the taxable year in which the gain with respect to the sale or loss of the vessel is realized. The election as to the nonrecognition of gain shall be shown by a statement to that effect, submitted as a part of, and attached to, the return. The statement, which need not be on any prescribed form, shall set forth a computation of the amount of the realized gain, the identity of the vessel, the nature and extent of the taxpayer's interest therein, whether such vessel was sold or lost and the date of sale or loss, the full sale price or full amount of indemnity, and the amount and date of each payment thereof, the basis for tax

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purposes and any other data affecting the determination of the realized gain.

(2) *Certain Government payments.* In case a vessel is purchased or requisitioned by the United States, or is lost, in any taxable year and the taxpayer receives payment for the vessel so purchased or requisitioned, or receives from the United States indemnity on account of such loss, subsequent to the end of such taxable year, the taxpayer shall make his election by filing notice thereof with the Commissioner of Internal Revenue, Washington, DC, 20224, prior to the expiration of 60 days after receipt of the payment or indemnity. The taxpayer shall file a copy of the notice with the Secretary, Federal Maritime Board, Washington, DC, 20573. The form of the notice of election shall be prepared by the taxpayer and shall be substantially as follows:

ELECTION RELATIVE TO NONRECOGNITION OF GAIN UNDER SECTION 511(c)(2), MERCHANT MARINE ACT, 1936

Pursuant to the provisions of section 511(c)(2) of the Merchant Marine Act, 1936, as amended, notice is hereby given that the undersigned taxpayer elects that gain in respect of the sale to the United States, or indemnification received from the United States on account of the loss, of the vessel named below or share therein shall not be recognized. The circumstances involved in the computation of such gain are as follows:

Name and other identification of vessel _____
 Nature and extent of the taxpayer's interest in the vessel _____
 Nature of disposition, i.e., sale or loss _____
 Date of disposition _____
 Full sale price or full amount of indemnity received by taxpayer _____
 Amount and date of each payment of sale price or indemnity received by taxpayer _____
 Amount and date of each previous deposit of such payments in construction reserve fund _____

Identification of each check or other instrument by which payment made to taxpayer _____

Tax basis of taxpayer's interest in vessel _____
 Any other data affecting the determination of the realized gain _____
 Amount of gain (submit computation) _____

(Name of taxpayer)

By _____

(Date of execution)

(b) [Reserved]

§2.1-13 Deposit of proceeds of sales or indemnities.

(a) *Manner of deposit.* The deposit required by section 511 of the Act must be made in a construction reserve fund established with a depository or depositories approved by the Administration and subject to the joint control of the Administration and the taxpayer. It is not necessary to establish a separate fund with respect to each vessel or share in a vessel sold or lost.

(b) *Amount of deposit.* With respect to any vessel sold or lost, or a share therein, the deposit must be in an amount equal to the “net proceeds” of the sale, or the “net indemnity” for the loss. By “net proceeds” and “net indemnity” is meant (1) the depositor’s interest in the adjusted basis of the vessel plus (2) the amount of gain which would be recognized for tax purposes in the absence of section 511 of the Act. In determining “net proceeds”, the amount necessarily paid or incurred for brokers’ commissions is to be deducted from the gross amount of the sales price. In the event the taxpayer is an affiliate or associate of the buyer, the amount of the sales price shall not exceed the fair market value of the vessel or vessels sold as determined by the Administration. In such case the taxpayer shall furnish evidence sufficient, in the opinion of the Administration, to establish that the sales price is not in excess of the fair market value. In determining “net indemnity”, the amount necessarily paid or incurred purely for collection, or rate of exchange discounts on the payment, of the indemnity is to be deducted from the gross amount of collectible indemnity. In case of the sale or loss of several vessels or share therein, a deposit of the “net proceeds” or “net indemnity” with respect to one or more of the vessels or shares is permissible. Where several vessels or shares are sold for a lump sum, the “net proceeds” allocated to each vessel or share shall be determined in accordance with any reasonable rule satisfactory to the Commissioner of Internal Revenue. The taxpayer must deposit the full amount of each payment (including cash, notes, or other evidences of indebtedness) as a single deposit in the construction reserve fund. A payment divided between

two or more depositories will be regarded as a single deposit. Amounts received by the taxpayer prior to the date of consummation of the sale of the vessel shall be considered as having been received by the taxpayer at the time the sale is consummated.

(c) *Purchase-money obligations.* Where the proceeds from the sale of a vessel include purchase-money obligations, such obligations together with the entire collateral therefor, or, in the case of deposit of the proceeds of a share in the vessel, a proportionate part of the obligations and collateral as determined by the Administration, shall be deposited, with the remainder of the proceeds, in the construction reserve fund as a part of the “net proceeds”. The depository shall receive payment of all amounts due on such purchase-money obligations and such amounts shall be placed in the fund in substitution for the portion of the obligations paid. All installments of purchase-money obligations shall be paid directly into the fund by the obligor. In the event any such installment is not so deposited, the Administration, at any time after the due date, may require the taxpayer to deposit an amount equal to such installment. If the taxpayer so desires, he may deposit in the construction reserve fund cash or approved securities in an amount equal to the face value of any purchase-money obligations in lieu of depositing such obligations.

(d) *Vessel subject to mortgage at time of sale or loss.* Where a vessel is subject to a mortgage or other encumbrance at the time of its sale or loss and the taxpayer actually receives only an amount representing the equity therein or a share in such equity corresponding to his share in the vessel, he shall deposit in the construction reserve fund such amount and concurrently therewith other funds in an amount equal to the difference between the amount received and the “net proceeds” or “net indemnity”. Such other funds may be in the form of cash, or, subject to the approval of the Administration, (1) interest-bearing securities, or (2) an irrevocable and unconditional commitment to finance the construction or acquisition of a new vessel in whole or in

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part by an obligor approved by the Administration in an amount equal to the amount by which the “net proceeds” exceed the cash or securities deposited in the fund.

(e) *Unauthorized deposits.* A deposit which is not provided for by section 511 of the Act shall, without unreasonable delay, be withdrawn from the fund and tax liability will be determined as though such deposit had not been made. (See §§ 2.1-10 and 2.1-24.)

§ 2.1-14 Deposit of earnings and receipts.

(a) *Earnings.* A citizen may deposit all or any part of earnings derived from the operation, within the scope of § 2.1-3, of a vessel or vessels owned either by himself or any other person, if such earnings are intended for construction or acquisition of new vessels. Such earnings may include payments received by an owner, as compensation for use of his vessel, from other persons by whom it is so operated. Earnings from other sources may not be deposited. The earnings from operation of vessels which are eligible for deposit are the net earnings determined without regard to any deduction for depreciation, obsolescence, or amortization with respect to such vessels.

(b) *Receipts.* Receipts from deposited funds, in the form of interest or otherwise, may be deposited.

§ 2.1-15 Time for making deposits.

(a) *Proceeds of sale or indemnification.* Deposits of amounts representing proceeds of the sale or indemnification for loss of a vessel or share therein must be made within 60 days after receipt by the taxpayer.

(b) *Earnings and receipts.* Earnings and receipts for the taxable year may be deposited at any time. (See § 2.1-14.)

§ 2.1-16 Tax liability as to earnings deposited.

Deposit in the construction reserve fund of earnings from the operation of a vessel or vessels, or receipts, in the form of interest or otherwise, with respect to amounts previously deposited does not exempt the taxpayer from tax liability with respect thereto nor postpone the time such earnings or receipts are includible in gross income. Earn-

ings and receipts deposited in a construction reserve fund established in accordance with the provisions of section 511 of the Act and the regulations in this part will be deemed to have been accumulated for the reasonable needs of the business within the meaning of part 1 (section 531 and following), Subchapter G, Chapter I of the Internal Revenue Code of 1954, so long as the requirements of section 511 of the Act and the regulations in this part are satisfied relative to the use of the fund in the construction, reconstruction, reconditioning, or acquisition of new vessels, or for the liquidation of purchase-money indebtedness on such vessels. For incurrence of tax liability due to noncompliance with the requirements of section 511 of the Act and the regulations in this part with respect to deposits in the construction reserve fund, see the provisions of § 2.1-23.

§ 2.1-17 Basis of new vessel.

The basis for determining gain or loss and for depreciation for the purpose of the Federal income tax with respect to a new vessel constructed, reconstructed, reconditioned, or acquired by the taxpayer, or with respect to which purchase-money indebtedness is liquidated as provided in section 511(g) of the Act, with funds deposited in the construction reserve fund, is reduced by the amount of the unrecognized gain represented in the funds allocated under the provisions of the regulations in this part to the cost of such vessel. (See § 2.1-18.)

§ 2.1-18 Allocation of gain for tax purposes.

(a) *General rules of allocation.* As provided in § 2.1-17, if amounts on deposit in a construction reserve fund are expended, obligated, or withdrawn for construction, reconstruction, reconditioning, or acquisition of new vessels, or for the liquidation of purchase-money indebtedness of such vessels, the portion thereof which represents gain shall be applied in reduction of the basis of such new vessels. The rules set forth below in this paragraph shall apply in allocating the unrecognized gain to the amounts so expended, obligated, or withdrawn:

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(1) If the "net proceeds" of a sale or "net indemnity" in respect of a loss are deposited in more than one deposit, the portion thereof representing unrecognized gain shall be considered as having been deposited first.

(2) Amounts expended, obligated, or withdrawn from the construction reserve fund shall be applied against amounts deposited in the order of deposit.

(3) If any deposit consists in part of gain not recognized under section 511(c) of the Act, then any expenditure, obligation, or withdrawal applied against such deposit shall be considered to consist of gain in the same proportion that the part of the deposit which constitutes gain bears to the total amount of the deposit.

(b) *Date of obligation.* The date funds are obligated under a contract for the construction, reconstruction, reconditioning, or acquisition of new vessels, or for the liquidation of purchase-money indebtedness on such vessels, rather than the date of payment from the fund, will determine the order of application against the deposits in the fund. When a contract for the construction, reconstruction, reconditioning, or acquisition of new vessels, or for the liquidation of purchase-money indebtedness on such vessels is entered into, amounts on deposit in the construction reserve fund will be deemed to be obligated to the extent of the amount of the taxpayer's liability under the contract. Deposits will be deemed to be so obligated in the order of deposit, each new contract obligating the earliest deposit not previously expended, obligated, or withdrawn. If the liability under the contract exceeds the amount in the construction reserve fund, the contract will be deemed to obligate, to the extent of that part of such excess not otherwise satisfied, the earliest deposit or deposits thereafter made.

(c) *Illustration.* The foregoing rules are illustrated in the following example:

Example. (1) A taxpayer who makes his returns on the calendar year basis sells a vessel in 1963 for \$1,000,000, realizing a gain of \$400,000. Payment of \$100,000 is received in March 1963 when the contract is signed, and the balance of \$900,000 is received in June 1963 on delivery of the vessel. The \$1,000,000 is deposited in a construction reserve fund in

July 1963. In December 1963, the taxpayer also deposits \$150,000, representing earnings of that year. In 1964, he sells another vessel for \$1,000,000, realizing a gain of \$250,000. The sale price of \$1,000,000 is received on delivery of the vessel in February 1964, and deposited in the construction reserve fund in March 1964. In September 1964, the taxpayer purchases for cash out of the construction reserve fund a new vessel for \$1,750,000. To the cost of this vessel must be allocated the 1963 deposits of \$1,150,000 and \$600,000 of the March 1964 deposit. This leaves in the fund \$400,000 of the March 1964 deposit. The amount of the unrecognized gain to be applied against the basis of the new vessel is \$550,000, computed as follows: Gain of \$400,000 represented in the 1963 deposits, plus the same proportion of the \$250,000 gain represented in the March 1964 deposit (\$1,000,000) which the amount (\$600,000) allocated to the vessel is of the amount of the deposit, i.e., \$400,000 plus 600,000/1,000,000 of \$250,000 or \$150,000, a total of \$550,000. This reduces the basis of the new vessel to \$1,200,000 (\$1,750,000 less \$550,000).

(2) In 1965, the taxpayer sells a third vessel for \$3,000,000, realizing a gain of \$900,000. The \$3,000,000 is received and deposited in the construction reserve fund in June 1965, making a total in the fund of \$3,400,000. In December 1965, the taxpayer contracts for the construction of a second new vessel to cost a maximum of \$3,200,000, thereby obligating that amount of the fund, and in June 1966, receives permission to withdraw the unobligated balance amounting to \$200,000. To the cost of the second new vessel must be allocated the \$400,000 balance of the March 1964 deposit and \$2,800,000 of the June 1965 deposit. The unrecognized gain to be applied against the basis of such new vessel is that proportion of the gain represented in each deposit which the portion of the deposit allocated to the vessel bears to the amount of such deposit, i.e., 400,000/1,000,000 of \$250,000, or \$100,000 plus 2,800,000/3,000,000 of \$900,000, or \$840,000 making a total of \$940,000. The \$200,000 withdrawal is applied against the June 1965 deposit and the portion thereof which represents gain will be recognized as income for 1965, the year in which realized. The computation of the recognized gain is as follows: 200,000/3,000,000 of \$900,000, or \$60,000.

§2.1-19 Requirements as to new vessels.

(a) *Requirements.* For the purposes of section 511 of the Act and the regulations in this part, the new vessel must be—

(1) Documented under the laws of the United States when it is acquired by the taxpayer, or the taxpayer must

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agree that when acquired it will be documented under the laws of the United States;

(2)(i) Constructed in the United States after December 31, 1939, or (ii) its construction has been financed under title V or title VII of the Act, or (iii) its construction has been aided by a mortgage insured under title XI of the Act; and

(3) Either (i) of such type, size, and speed as the Administration determines to be suitable for use on the high seas or Great Lakes in carrying out the purposes of the Act, but of not less than 2,000 gross tons or of less speed than 12 knots, except that a particular vessel may be of lesser tonnage or speed if the Administration determines and certifies that the particular vessel is desirable for use by the United States in case of war or national emergency, or (ii) constructed to replace a vessel or vessels requisitioned or purchased by the United States, in which event it must be of such type, size, and speed as to constitute a suitable replacement for the vessel requisitioned or purchased, but if a vessel already built is acquired to replace a vessel or vessels requisitioned or purchased by the United States, such vessel must meet the requirements set forth in subdivision (i) of this subparagraph. Ordinarily, under subdivision (i) of this subparagraph, a vessel constructed more than five years before the date on which deposits in a construction reserve fund are to be expended or obligated for acquisition of such vessel will not be considered suitable for use in carrying out the purpose of the Act, except that the five-year age limitation provided above in this sentence shall not apply to a vessel to be reconstructed before being placed in operation by the taxpayer.

(b) *Time of construction.* A vessel will be deemed to be constructed after December 31, 1939, only if construction was commenced after that date. Subject to the provisions of this section, a new vessel may be newly built for the taxpayer, or may be acquired after it is built.

(c) *Replacement of vessels.* It is not necessary that vessels shall be replaced vessel for vessel. The new vessels may be more or less in number than the re-

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placed vessels, provided the other requirements of this section are met.

§ 2.1-20 Obligation of deposits.

(a) *Time for obligation.* Within three years from the date of any deposit in a construction reserve fund, unless extension is granted as provided in § 2.1-22, such deposit must be obligated under a contract for the construction or acquisition of a new vessel or vessels (or in the discretion of the Administration for a share therein), with not less than 12½ percent of the construction or contract price of the entire vessel or vessels actually paid or irrevocably committed on account thereof or must be expended or obligated for the liquidation of existing or subsequently incurred purchase-money indebtedness to persons other than a parent company of, or a company affiliated or associated with, the mortgagor on a new vessel or vessels. Amounts on deposit in a construction reserve fund will be deemed to be obligated for expenditure when a binding contract of construction or acquisition has been entered into or when purchase-money indebtedness has been incurred and, if obligated under a contract of construction or acquisition, will be deemed to be irrevocably committed when due and payable in accordance with the terms of the contract of construction or acquisition.

(b) *Requirements for obligations.* Unless otherwise authorized by the Administration, contracts for the construction of new vessels must be for a fixed price, or provide for a base price that may be adjusted for changes in labor and material costs not exceeding 15 percent of the base price. The fixed or base price, as the case may be, shall be fair and reasonable as determined by the Maritime Administration. Any financial or other interests between the taxpayer and the contractor shall be disclosed to the Administration by the taxpayer. Plans and specifications for the new vessel or vessels must be approved by the Administration to the extent it deems necessary. A deposit in a construction reserve fund may be expended or obligated for expenditure for procurement under an acquisition or construction contract of a part interest in

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a new vessel or vessels only after obtaining the written consent of the Administration. The granting of such consent shall be entirely in the discretion of the Administration and it may impose such conditions with respect thereto as it may deem necessary or advisable for the purpose of carrying out the provisions of section 511 of the Act. Applications for such consent shall be executed in triplicate, and, together with eight conformed copies thereof, filed with the Administration.

§ 2.1-21 Period for construction of certain vessels.

A new vessel constructed otherwise than under the provisions of title V of the Act, and not purchased from the Administration must, within six months from the date of the construction contract, or within the period of any extension, be completed to the extent of not less than 5 percent as estimated by the Administration and certified by it to the Secretary of the Treasury. In case of a contract covering more than one vessel it will be sufficient if one of the vessels is 5 percent completed within the six months' period from the date of the contract or within the period of any extension, and so certified. All construction must be completed with reasonable dispatch as determined by the Administration. If, for causes within the control of the taxpayer, the entire construction is not completed with reasonable dispatch, the Administration will so certify to the Secretary of the Treasury. For the effect of such certification, see § 2.1-23.

§ 2.1-22 Time extensions for expenditure or obligation.

(a) *Extensions.* The Administration, upon application and a showing of proper circumstances, (1) may allow an extension of time within which deposits shall be expended or obligated, not to exceed one year, and upon a second application received before the expiration of the first extension, may allow an additional extension not to exceed one year, and (2) may allow an extension or extensions of time within which five percent of the construction shall have been completed as provided in § 2.1-21 not to exceed one year in the

aggregate, and (3) may allow any other extensions that may be provided by amendment to the Act.

(b) *Application required.* A taxpayer seeking an extension of time shall make application therefor, and transmit it with an appropriate statement of the circumstances, including the reasons justifying the requested extension or extensions, and appropriate documents in substantiation of the statement, to the Administration. The Administration will notify the Commissioner of Internal Revenue of any extension granted. In case an application for extension is denied, the taxpayer will be liable for delay as though no application had been made.

§ 2.1-23 Noncompliance with requirements.

(a) *Noncompliance.* The amount of the gain which is that portion of the construction reserve fund otherwise constituting taxable income under the law applicable to the taxable year in which such gain was realized shall be included in the taxpayer's gross income for such taxable year for income or excess-profits tax purposes, if—

(1) A portion of such fund is withdrawn for purposes other than—

(i) The construction, reconstruction, reconditioning, or acquisition of a new vessel; or

(ii) The liquidation of existing or subsequently incurred purchase-money indebtedness to persons other than a parent company of, or a company affiliated or associated with, the mortgagor on a new vessel or vessels; or

(2) The taxpayer fails to comply with the requirements of section 511 of the Act or the regulations in this part relating to the utilization of construction reserve funds in the construction, reconstruction, reconditioning, or acquisition of a new vessel, or the liquidation of purchase-money indebtedness on such a vessel.

If securities on deposit in a construction reserve fund are sold and the amount placed in the fund in lieu thereof is less than the value of the securities at the time of their deposit, the difference between such value and the amount placed in the fund in lieu of the securities will be deemed to have been withdrawn. With respect to the

substitution of new financing in the case of an irrevocable commitment, see paragraph (d) of § 2.1-13.

(b) *Amount recognized.* In the event of noncompliance with the prescribed conditions relative to any contract for construction, reconstruction, reconditioning, or acquisition of new vessels, or for the liquidation of purchase-money indebtedness on such vessels, recognition will extend to the entire amount of the gain represented in that portion of the construction reserve fund obligated under such contract. Thus, if the Administration determines and certifies to the Secretary of the Treasury that for causes within the control of the taxpayer construction under a contract is not completed with reasonable dispatch, the entire amount of the gain represented in the portion of the construction reserve fund obligated under the contract will be recognized even though all other conditions have been satisfied. In case of noncompliance with the requirements of section 511 of the Act or the regulations in this part, see the provisions of § 2.1-18 as to the allocation of gain.

(c) *Unreasonable accumulation.* Noncompliance with the provisions of section 511 of the Act or the regulations in this part relative to the utilization of the deposited amounts may also, inasmuch as the provision of section 511(f) of the Act is then inapplicable, warrant an examination to ascertain whether such amounts constitute an unreasonable accumulation of earnings and profits within the meaning of Part I (section 531 and following), Subchapter G, Chapter I of the Internal Revenue Code of 1954, or corresponding provisions of prior law. If amounts are deposited and the fund maintained in good faith for the purpose of construction, reconstruction, reconditioning, and acquisition of new vessels, or for the liquidation of purchase-money indebtedness on such vessels, such amounts will be deemed to have been accumulated for the reasonable needs of the business.

§ 2.1-24 Extent of tax liability.

(a) *Declared value excess-profits tax.* Gain which is includible in gross income under § 2.1-23 shall be included in gross income for all income and excess-

profits tax purposes, but not for the purposes of the declared value excess-profits tax and the capital stock tax as provided in section 511(i) of the Act. In lieu of any adjustment with respect to such declared value excess-profits tax, there is imposed for any taxable year ending on or before June 30, 1945, in which the gain is realized an additional tax of 1.1 percent of the amount of the gain. No additional capital stock tax liability is incurred.

(b) *Improper deposits.* In the case of deposits in the construction reserve fund of amounts derived from sources other than those specified in section 511 of the Act, or in the case of failure to deposit an amount equal to the "net proceeds" or "net indemnity" within the period prescribed in section 511(c) of the Act and § 2.1-15, the taxpayer obtains no suspension or postponement of any tax liability and the tax is collectible without regard to the provisions of section 511(c) of the Act.

(c) *Time for filing claim subsequent to election under section 511(c)(2).* If an election is made under section 511(c)(2) of the Act and paragraph (a)(2) of § 2.1-12, and if computation or recomputation in accordance therewith is otherwise allowable but is prevented, on the date of filing of notice of such election, or within six months thereafter, by any statute of limitation; such computation or recomputation nevertheless shall be made notwithstanding such statute if a claim therefor is filed within six months after the date of making such election. If as the result of such computation or recomputation an overpayment is disclosed a claim for refund should be made in accordance with § 301.6402-3 within such six months' period. For other rules applicable to the filing of claims for credit or refund of an overpayment of tax, see § 301.6402-2 of this chapter (Regulations on Procedure and Administration), relating to claims for credit or refund.

[T.D. 6820, 30 FR 6030, Apr. 29, 1965, as amended by T.D. 7410, 41 FR 11020, Mar. 16, 1976]

§ 2.1-25 Assessment and collection of deficiencies.

Any additional tax, including the 1.1 percent amount imposed by section 511(i) of the Act, due on account of withdrawal from a construction reserve

fund, or failure to comply with section 511 of the Act or the regulations in this part, is collectible as a deficiency. Interest upon such deficiency will run from the date the withdrawal or non-compliance occurs. The amount of any deficiency, including interest and additions to the tax, determined as a result of such withdrawal or noncompliance, may be assessed, or a proceeding in court for the collection thereof may be begun without assessment, at any time and without regard to any period of limitations or any other provisions of law or rule of law, including the doctrine of res judicata.

§ 2.1-26 Reports by taxpayers.

(a) *Information required.* With each income tax return filed for a taxable year during any part of which a construction reserve fund is in existence the taxpayer shall submit a statement setting forth a detailed analysis of such fund. The statement, which need not be on any prescribed form, shall include the following information with respect to the construction reserve fund:

(1) The actual balance in the fund at the beginning and end of the taxable year;

(2) The date, amount, and source of each deposit during the taxable year;

(3) If any deposit referred to in subparagraph (2) of this paragraph consists of proceeds from the sale, or indemnification of loss, of a vessel or share thereof, the amounts of the unrecognized gain;

(4) The date, amount, and purpose of each expenditure or withdrawal from the fund; and

(5) The date and amount of each contract, under which deposited funds are deemed to be obligated during the taxable year, for the construction, reconstruction, reconditioning, or acquisition of new vessels, or for the liquidation of purchase-money indebtedness on such vessels, and the identification of such vessels.

(b) *Records required.* Taxpayers shall keep such records and make such additional reports as the Commissioner of Internal Revenue or the Administration may require.

§ 2.1-27 Controlled corporation.

For the purpose of section 511 of the Act and the regulations in this part a new vessel is considered as constructed, reconstructed, reconditioned, or acquired by the taxpayer if constructed, reconstructed, reconditioned, or acquired by a corporation at a time when the taxpayer owns not less than 95 percent of the total number of shares of each class of stock of the corporation.

§ 2.1-28 Administrative jurisdiction.

Sections 2.1-3 to 2.1-11, inclusive, §§2.1-13 to 2.1-15, inclusive, and §§2.1-19 to 2.1-22, inclusive, deal primarily with matters under the jurisdiction of the Administration. Sections 2.1-12, 2.1-16 to 2.1-18, inclusive, and §§2.1-23 to 2.1-27, inclusive, deal primarily with matters under the jurisdiction of the Commissioner of Internal Revenue. Generally, matters relating to the establishment, maintenance, expenditure, and use of construction reserve funds and the construction, reconstruction, reconditioning, or acquisition of new vessels are under the jurisdiction of the Administration; and matters relating to the determination, assessment, and collection of taxes are under the jurisdiction of the Commissioner of Internal Revenue. Correspondence should be addressed to the particular authority having jurisdiction in the matter.

PART 3—CAPITAL CONSTRUCTION FUND

Sec.

3.0 Statutory provisions; section 607, Merchant Marine Act, 1936, as amended.

3.1 Scope of section 607 of the Act and the regulations in this part.

3.2 Ceiling on deposits.

3.3 Nontaxability of deposits.

3.4 Establishment of accounts.

3.5 Qualified withdrawals.

3.6 Tax treatment of qualified withdrawals.

3.7 Tax treatment of nonqualified withdrawals.

3.8 Certain corporate reorganizations and changes in partnerships, and certain transfers on death. [Reserved]

3.9 Consolidated returns. [Reserved]

3.10 Transitional rules for existing funds.

3.11 Definitions.

AUTHORITY: Sec. 21(a) of the Merchant Marine Act of 1970 (84 Stat. 1026); sec. 7805 of the