Supplement

to

Income and Other Federal Taxes

(Fourth Edition)

By Henry Campbell Black

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SUPPLEMENT

TO

BLACK ON FEDERAL TAXES

JANUARY, 1920

CONTAINING

DECISIONS OF THE COURTS AND REGULATIONS AND RULINGS OF THE TREASURY DEPARTMENT ON INCOME TAXES, EXCESS PROFITS TAXES, AND OTHER TAXES IMPOSED BY THE UNITED STATES REVENUE ACT OF 1918, PROMULGATED TO JANUARY 15, 1920

BY
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The section numbers and black letter headings prefixed to the following paragraphs refer to the correspondingly numbered sections of Black on Federal Taxes (Fourth Edition), where the subject-matter of the paragraphs is discussed.

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§ 16. Taxing Salaries of Federal and State Officers

In accordance with an opinion of the Attorney General, dated May 6, 1919, and based on the well-settled rule that governmental agencies of the States are not subject to taxation by the Federal Government, it is held that salaries of State officials and salaries and wages of employees of a State are not subject to the income tax imposed by the Revenue Act of 1918. (T. D. 2843, May 17, 1919.)

§ 27. Rule of Strict Construction

In case of ambiguity in the income tax law, the language is to be construed most strongly in favor of the taxpayer. U. S. v. Coulby (C. C. A.) 258 Fed. 27.

In construing a revenue law, the court must put itself in the position of Congress when it enacted the law, and from the circumstances and surroundings then existing, and the general purpose then in view, ascertain what was meant to be done. Carbon Steel Co. v. Lewellyn, (C. C. A.) 258 Fed. 533.

§ 35. Statutory Definitions of Income

The tax imposed by the statute is upon income. In the computation of the tax various classes of income must be considered: (*a*) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. It is not limited to cash alone, for the statute recognizes as income-determining factors other items, among which are inventories, accounts receivable, property exhaustion and accounts payable for expenses incurred. See sections 202, 203, 213 and 214 of the statute. (*b*) Gross income, meaning income (in the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by the statute. See section 213 and articles 71–86. (*c*) Net income, meaning gross income less statutory deductions. The statutory deductions are in general, though not exclusively, expenditures, other than capital expenditures, connected with the production of income. See sections 214 and 215 and the articles thereunder. (*d*) Net income less credits. See section 216 and articles 301–307. The surtax is imposed upon net income; the normal tax upon net income less credits. Though taxable net income is wholly a statutory conception it follows, subject to certain modifications as to exemptions and as to some of the deductions, the lines of commercial usage. Subject to these modifications statutory "net income" is commercial "net income." This appears from the fact that ordinarily it is to be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer. (Regulations No. 45, art. 21.)

§ 41. Rent of Land or Buildings

Where an owner of land, in 1907, leased the same for 23 years under an agreement requiring the tenant to construct an expensive brick building, and on the tenant's default the owner retook possession in 1916, the value of the building cannot be deemed income accruing in the year 1917, under the income tax law, for under the lease the title to the building vested in the owner immediately upon construction, and the lessee's default caused the owner a loss. Miller v. Gearin (C. C. A.) 258 Fed. 225.

§ 45. Salaries and Other Fixed Compensations

Where no determination of compensation is had until the completion of the services, the amount received is income for the calendar year of its determination. Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, retired pay of federal and other officers, and pensions or retiring allowances paid by the United States or private persons, are income to the recipients; as are also marriage fees, baptismal offerings, sums paid for saying masses for the dead, and other gifts and contributions received by a clergyman, evangelist or religious worker for services rendered. The salaries of federal officers and employees are subject to tax.

Where services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary such price will be presumed to be the fair value of the compensation received. Compensation paid an employee of a corporation in its stock is to be treated as if the corporation sold the stock for its market value and paid the employee in cash. When living quarters such as camps are furnished to employees for the convenience of the employer, the ratable value need not be added to the cash compensation of the employee, but where a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax. Premiums paid by an employer on life, accident or health policies in favor of his employees as additional compensation of such employees are income to the employees. Promissory notes received in payment for services, and not merely as security for such payment, constitute income to the amount of their fair market value. A taxpayer receiving as compensation a note regarded as good for its face value at maturity, but not bearing interest, may properly treat as income as of the time of receipt the fair discounted value of the note at such time. Thus, if it appears that such a note is or could be discounted on a six or seven per cent basis, the recipient may include such note in his gross income to the amount of its face value less discount computed at the prevailing rate for such transactions. If the payments due on a note so accounted for are met as they become due, there should be included as income in respect of each such payment so much thereof as represents recovery for the discount originally deducted. (Regulations No. 45, arts. 32–34.)

§ 48. Pensions, Subsidies, and Gifts

Forgiveness of indebtedness.—The cancellation and forgiveness of indebtedness is dependent on the circumstances for its effect. It may amount to a payment of income or to a gift or to a capital transaction. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income to that amount is realized by the debtor as compensation for his services. If, however, a creditor merely desires to benefit a debtor and without any consideration therefor cancels the debt, the amount of the debt is a gift from the creditor to the debtor and need not be included in the latter's gross income. If a stockholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation. If, however, a corporation to which a stockholder is indebted forgives the debt, the transaction has the effect of the payment of a dividend. (Regulations No. 45, art. 51.)

§ 52. Proceeds of Insurance Policies

(*a*) Upon the death of an insured the proceeds of his life insurance policies, whether paid to his estate or to individual beneficiaries, directly or in trust, are excluded from the gross income of the beneficiary. (*b*) During his life only so much of the amount received by an insured under life, endowment or annuity contracts as represents a return, without interest, of premiums paid by him therefor is excluded from his gross income. (*c*) Whether he be alive or dead, the amounts received by an insured or his estate or other beneficiaries through accident or health insurance or under workmen's compensation acts as compensation for personal injuries or sickness are excluded from the gross income of the insured, his estate and other beneficiaries. Any damages recovered by suit or agreement on account of such injuries or sickness are similarly excluded from the gross income of the individual injured or sick, if living, or of his estate or other beneficiaries entitled to receive such damages, if dead. Since June 25, 1918, no assessment of any federal tax may be made on any allotments, family allowances, compensation, or death or disability insurance payable under the War Risk Insurance Act of September 2, 1917, as amended, even though the benefit accrued before that date. (Regulations No. 45, art. 72.)

§ 52a. Legacies and Inheritances

Sale of property acquired by gift or bequest.—In the case of property acquired by gift, bequest, devise or descent the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition or as of March 1, 1913, if acquired prior thereto. For the purpose of determining the profit or loss from the sale of property acquired by bequest, devise or descent since February 28, 1913, 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 in the State court for the purpose of State inheritance taxes, should be deemed to be its fair market value when acquired. (Regulations No. 45, art. 1562.)

§ 53. Products of Farming and Stock Raising

Expenses of farmers deductible.—A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming. The cost of ordinary tools, of short life or small cost, such as hand tools, including shovels, rakes, etc., may be included. The cost of feeding and raising live stock may be treated as an expense deduction, in so far as such cost represents actual outlay, but not including the value of farm produce grown upon the farm or the labor of the taxpayer. Where a farmer is engaged in producing crops which take more than a year from the time of planting to the process of gathering and disposal, expenses deducted may be determined upon the crop basis, and such deductions must be taken in the year in which the gross income from the crop has been realized. If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of products may be ignored in rendering a return of income, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions. The cost of farm machinery and farm buildings represents a capital investment and is not an allowable deduction as an item of expense. Amounts expended in the development of farms, orchards and ranches prior to the time when the productive state is reached may be regarded as investments of capital. The amount expended in purchasing draft or work animals or live stock either for resale or for breeding purposes is regarded as an investment of capital. The purchase price of an automobile, even when wholly used in carrying on farming operations, is not deductible, but it is regarded as an investment of capital. The cost of gasoline, repairs and upkeep of an automobile if used wholly in the business of farming is deductible as an expense; if used partly for business purposes and partly for the pleasure or convenience of the taxpayer or his family, such cost may be apportioned according to the extent of the use for purposes of business and pleasure or convenience, and only the proportion of such cost justly attributable to business purposes is deductible as a necessary expense. (Regulations No. 45, art. 110.)

Losses of farmers deductible.—Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage shall be allowed. The total loss by frost, storm, flood or fire of a prospective crop, or of a crop which has not been sold, is not a deductible loss in computing net income. A farmer engaged in raising and selling stock, cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that perish from among those animals that were raised on the farm. If live stock has been purchased for any purpose, and afterwards dies from disease, exposure or injury, or is killed by order of the authorities of a State or the United States, the actual purchase price of such stock, less any depreciation which may have been previously claimed with respect to such perished live stock, and less also any insurance or indemnity recovered, may be deducted as a loss. The actual cost of other property, less depreciation already allowed, destroyed by order of the authorities of a State or of the United States may in like manner be claimed as a loss; but if reimbursement is made by a State or the United States in whole or in part on account of stock killed or property destroyed, the amount received shall be reported as income for the year in which reimbursement is made.

In determining the cost of stock for the purpose of ascertaining the deductible loss there shall be taken into account only the purchase price, and not the cost of any feed, pasturage or care which has been deducted as an expense of operation. If gross income is ascertained by inventories, no deduction can be made for live stock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of live stock or products on hand at the close of the year. If an individual owns and operates a farm, in addition to being engaged in another trade, business or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure. (Regulations No. 45, art. 145.)

Depreciation allowance in case of farmers.—A reasonable allowance for depreciation may be claimed on farm buildings (other than a dwelling occupied by the owner), farm machinery and other physical property, including live stock purchased for draft, dairy or breeding purposes, but no claim for depreciation on live stock raised, or purchased for resale, will be allowed. Live stock purchased for draft, breeding or dairy purposes, or for any purpose other than resale, may be included in the inventory for each year at a figure which will reflect the reduction in value estimated to have occurred during the year through increase of age or other causes. Such a reduction in value should be based on the cost and estimated life of the live stock. If an inventory is not used, a reasonable allowance for depreciation may be claimed based upon the cost of draft and work animals and animals kept solely for breeding purposes and not for resale. (Regulations No. 45, art. 171.)

§ 60. Income from Partnership Business

Distributive shares of partners.—The distributive share of the net income of a partnership which a partner is required to include in his return is his proportionate share of the net income of the partnership, either (*a*) for the taxable year upon the basis of which the partner's net income is computed, or (*b*), if the partner's net income is computed upon the basis of a taxable year different from that upon the basis of which the net income of the partnership is computed, for the taxable year of the partnership ending within the taxable year upon the basis of which the partner's net income is computed. Amounts earned and distributed to a partner by a partnership after the end of its taxable year and before the end of his corresponding taxable year should be accounted for both by the partnership and by the partner in their returns for their next succeeding taxable years. (Regulations No. 45, art. 322.)

Credits allowed partners.—In addition to the credits ordinarily allowed to an individual, a partner is entitled to the following credits: (*a*) a credit against net income for the purpose of the normal tax only of his proportionate share of such dividends from corporations subject to tax and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the partnership; and (*b*) a credit against income tax of the partner's proportionate share of any income, war profits and excess profits taxes of the partnership paid or accrued during the taxable year to a foreign country upon income derived from sources therein, or to any possession of the United States, subject to the limitations of section 222 of the statute. See section 216 and articles 301 and 381–384. (Idem, art. 323.)

Readjustment of partnership interests.—When a partner retires from a partnership, or it is dissolved, he realizes a gain or loss measured by the difference between the price received for his interest and the cost to him or (if acquired prior thereto) the fair market value as of March 1, 1913, of his interest in the partnership, including in such cost or value the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid. If, however, the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received on distribution. See article 1566. Whenever a new partner is admitted to a partnership, or any existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income, in order that the Commissioner may determine whether any gain or loss has been realized by any partner. (Regulations No. 45, art. 1570.)

§ 61a. Sale of Real Estate on Deferred or Installment Payments

On this subject the Treasury Department has made the following rulings, which are found in Regulations No. 45, arts. 44–46:

ART. 44. *Sale of real estate involving deferred payments.*—Deferred payment sales of real estate ordinarily fall into two classes when considered with respect to the terms of sale, as follows:

(1) Installment transactions, in which the initial payment is relatively small (generally less than one-fourth of the purchase price) and the deferred payments usually numerous and of small amount. They include (*a*) sales where there is immediate transfer of title when a small initial payment is made, the seller being protected by a mortgage or other lien as to deferred payments, and (*b*) agreements of purchase and sale which contemplate that a conveyance is not to be

made at the outset, but only after all or a substantial portion of the agreed installments have been paid.

(2) Deferred payment sales not on the installment plan, in which there is a substantial initial payment (ordinarily not less than one-fourth of the purchase price), deferred payments being secured by a mortgage or other lien. Such sales are distinguished from sales on the installment plan by the substantial character of the initial payment and also usually by a relatively small number of deferred payments.

In determining how these classes shall be treated in levying the income tax, the question in each case is whether the income to be reported for taxation shall be based only on amounts actually received in a taxing year, or on the entire consideration made up in part of agreements to pay in the future.

ART. 45. *Sale of real estate on installment plan.*—In the two kinds of transactions included in class (1) in the foregoing article, installment obligations assumed by the buyer are not ordinarily to be regarded as the equivalent of cash, and the vendor may report as his income from such transactions in any year that proportion of each payment actually received in that year which the gross profit to be realized when the property is paid for bears to the gross contract price. If the return is made on this basis and the vendor repossesses the property after default by the buyer, retaining the previous payments, the entire amount of such payments, less the profit previously returned, will be income to the vendor and will be so returned for the year in which the property was repossessed, and the property repossessed must be included in the inventory at its original cost to himself (less any depreciation as defined in articles 161 and 162). If the taxpayer chooses as a matter of settled practice consistently followed to treat the obligations of the purchaser as equivalent to cash and to report the profit derived from the entire consideration, cash and deferred payments, as income for the year when the sale is made, this is permissible. If so treated the rule prescribed in article 46 will apply.

ART. 46. *Deferred payment sales of real estate not on installment plan.*—In class (2) in the next to the last article the obligations assumed by the buyer are much better secured because of the margin afforded by the substantial first payment, and experience shows that the greater number of such sales are eventually carried out according to their terms. These obligations for deferred payments are therefore to be regarded as equivalent to cash, and the profit indicated by the entire consideration is taxable income for the year in which the initial payment was made and the obligations assumed. If the buyer defaults and the seller regains title to the land by agreement or process of law, retaining payments previously made, he may deduct from his gross income as a loss in the year of repossession any excess of the amount previously reported as income over the amount actually received, and must include such real estate in his inventory at its original cost to himself (less any depreciation as defined in articles 161 and 162).

§ 62. Profits on Sales of Securities

Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between the stock and securities purchased for the purpose of determining the portion of the consideration attributable to each class of stock or securities and so representing its cost, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost. The entire amount realized from the sale of rights to subscribe for stock is income. (Regulations No. 45, art. 39.)

§ 62a. Sale and Retirement of Corporate Bonds

Regulations No. 45, art. 544, contains the following provisions on this subject: (1) (*a*) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(2) (*a*) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income) over the purchase price is gain or income for the taxable year.

(3) (*a*) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible as interest and should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

§ 63. Profits of Corporation on Sale of Its Own Stock

If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the stockholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase of its own stock. (Regulations No. 45, art. 542.)

§ 64. Profit on Exchange of Property or Stock

The regulations prescribed by the Treasury Department on this subject are as follows:

Exchanges of property.—Gain or loss arising from the acquisition and subsequent disposition of property is realized when as the result of a transaction between the owner and another person the property is converted into cash or into property (*a*) that is essentially different from the property disposed of and (*b*) that has a market value. In other words, both (*a*) a change in substance and not merely in form, and (*b*) a change into the equivalent of cash, are required to complete or close a transaction from which income may be realized. By way of illustration, if a man owning ten shares of listed stock exchanges his stock certificate for a voting trust certificate, no income is realized, because the conversion is merely in form; or if he exchanges his stock for stock in a small, closely held corporation, no income is realized if the new stock has no market value, although the conversion is more than formal; but if he exchanges his stock for a liberty bond, income may be realized, because the conversion is into independent property having a market value. The property received in exchange may be real estate, personal property, or a chose in action. The exchange of a so-called convertible bond for stock pursuant to such a privilege granted in the bond will produce income if the stock received in exchange has a fair market value in excess of the cost or fair market value as of March 1, 1913, of the bond. (Regulations No. 45, art. 1563.)

Determination of gain or loss from exchange of property.—(*a*) The amount of income derived in the case of an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the bond received in exchange over the original cost of the stock exchanged for it, or over the fair market price or value of such stock as of March 1, 1913, if acquired before that date. The amount of income derived from a subsequent sale of the bond for cash is the excess of the amount so received over the fair market value of such bond when acquired in exchange for the stock. (*b*) On the other hand, if the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old and upon a sale of the new property the amount of income derived is the excess of the amount so received over the cost or fair market value as of March 1, 1913, of the old. (Idem. art. 1564.)

Exchange for different kinds of property.—(*a*) If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost or fair market value as of March 1, 1913, of the original property, as the case may be. If the market value of the bonds is less than such cost or value, the difference represents the cost of the stock. If the market value of the bonds is greater than such cost or value, the difference is taxable income at the time of the exchange and whenever sold the entire proceeds of the stock will be taxable. (*b*) If property is exchanged for two different kinds of property, such as bonds and stock, neither having a market value, the cost or fair market value as of March 1, 1913, of the original property should be apportioned, if possible, between the bonds and stock for the purpose of determining gain or loss on subsequent sales. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales shall have been recovered the entire cost or fair market value as of March 1, 1913, of the original property. (Idem. art. 1565.)

Exchange of property and stock.—Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction and the former owner of the property realizes a gain or loss if the stock has a market value, and such market value is greater or less than the cost or the fair market value as of March 1, 1913 (if acquired prior thereto), of the property given in exchange. (Regulations No. 45, art. 1566, as amended by T. D. 2924, Sept. 26, 1919.

Exchange of stock for other stock of no greater par value.—In general, where two (or more) corporations unite their properties, by either (*a*) the dissolution of corporation B and the sale of its assets to corporation A, or (*b*) the sale of its property by B to A and the dissolution of B, or (*c*) the sale of the stock of B to A and the dissolution of B, or (*d*) the merger of B into A, or (*e*) the consolidation of the corporations, no taxable income is received from the transaction by A or B or the stockholders of either, provided the sole consideration received by B and its stockholders in (*a*), (*b*), (*c*), and (*d*) is stock or securities of A, and by A and B and their stockholders in (*e*) is stock or securities of the consolidated corporation, in any case of no greater aggregate par or face value than the old stock and securities surrendered. The term "reorganization," as used in section 202 of the statute, includes cases of corporate readjustment where stockholders exchange their stock for the stock of a holding corporation, provided the holding corporation and the original corporation, in which it holds stock, are so closely related that the two corporations are affiliated as defined in section 240(b) of the statute and article 633, and are thus required to file consolidated returns. So-called "no-par-value stock" issued under a statute or statutes which require the corporation to fix in a certificate or on its books of account or otherwise an amount of capital or an amount of stock issued which may not be impaired by the distribution of dividends, will for the purpose of this section be deemed to have a par value representing an aliquot part of such amount, proper account being taken of any preferred stock issued with a preference as to principal. In the case (if any) in which no such amount of capital or issued stock is so required, "no-par-value stock" received in exchange will be regarded for purposes of this section as having in fact no par or face value, and consequently as having "no greater aggregate par or face value" than the stock or securities exchanged therefor. (Regulations No. 45, art. 1567, as amended by T. D. 2924, Sept. 26, 1919.)

§ 65. Increase in Value Not Realized by Sale

An increase or decrease in the book value of bonds held by a corporation as an investment does not affect its "income received within the year" for the purpose of federal taxation. Lumber Mut. Fire Ins. Co. v. Malley (D. C.) 256 Fed. 383.

§ 66. Uncollected Interest and Accounts

The following revised regulations on this subject are found in Regulations No. 45, arts. 53, 54:

ART. 53. *Income not reduced to possession.*—Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made. A book entry, if made, should indicate an absolute transfer from one account to another. If the income is not credited, but is set apart, such income must be unqualifiedly subject to the demand of the taxpayer. Where a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until the termination of five years of employment, the mere crediting on the books of the corporation does not constitute receipt. The distinction between receipt and accrual must be kept in mind. Income may accrue to the taxpayer and yet not be subject to his demand or capable of being drawn on or against by him.

ART. 54. *Examples of constructive receipt.*—Where interest coupons have matured, but have not been cashed, such interest payment, though not collected when due and payable, is nevertheless available to the taxpayer and should therefore be included in his gross income for the year during which the coupons matured. This is so if the coupons are exchanged for other property instead of eventually being cashed. Dividends on corporate stock are subject to tax when set apart for the stockholder, although not yet collected by him. The distributive share of the profits of a partner in a partnership or of a stockholder in a personal service corporation is regarded as received. Interest credited on savings bank deposits, even though the bank nominally have a rule, seldom or never enforced, that it may require so many days' notice in advance of cashing depositors' checks, is income to the depositor when credited. An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the shareholder, has a taxable status as income for the year of the credit. Where the amount of such accumulations does not become available to the shareholder until the maturity of a share, the amount of any share in excess of the aggregate amount paid in by the shareholder is income for the year of the maturity of the share.

§ 70. Annuities

Annuities paid by religious, charitable and educational corporations under an annuity contract are subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds any amounts paid by him as consideration for the contract. An annuity charged upon devised land is income taxable to the annuitant, whether paid by the devisee out of the rents of the land or from other sources. The devisee is not required to return as taxable income the amount of rent paid to the annuitant, and he is not entitled to deduct from his taxable income any sums paid to the annuitant. (Regulations No. 45, art. 47.)

§ 74. Interest on Government Bonds

Liberty bonds and Victory notes issued under authority of the acts of Congress approved April 24, 1917, September 24, 1917, April 4, 1918, July 9, 1918, September 24, 1918, and March 3, 1919, are entitled, respectively, to the exemptions from taxation set forth in said acts from which the statements in this circular are summarized and to which they are subject.

I. *4 per cent and 4¼ per cent bonds* are exempt from all Federal, State, and local taxation, except (*a*) estate or inheritance taxes and (*b*) Federal income surtaxes and profits taxes, as follows:

1. First Liberty loan converted 4 per cent bonds of 1932–1947 (first 4s). 2. First Liberty loan converted 4¼ per cent bonds of 1932–1947 (first 4¼s, issue of May 9, 1918). 3. First Liberty loan second converted 4¼ per cent bonds of 1932–1947 (first 4¼s, issue of October 24, 1918). 4. Second Liberty loan 4 per cent bonds of 1927–1942 (second 4s). 5. Second Liberty loan converted 4¼ per cent bonds of 1927–1942 (second 4¼s). 6. Third Liberty loan 4¼ per cent bonds of 1928 (third 4¼s). 7. Fourth Liberty loan 4¼ per cent bonds of 1933–1938 (fourth 4¼s). 8. Victory Liberty loan 4¾ per cent convertible gold notes of 1922–1923 (4¾ per cent Victory notes).	Are exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (*a*) estate or inheritance taxes, and (*b*) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations.

II. *4 per cent and 4¼ per cent bonds* are entitled to limited exemptions from Federal income surtaxes and profits taxes, as follows:

4 per cent and 4¼ per cent Liberty bonds (but not 4¾ per cent Victory notes) are entitled to certain limited exemptions from graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations, in respect to the interest on principal amounts thereof, as follows:

$5,000 in the aggregate of first 4s, first 4¼s (issues of May 9 and October 24, 1918), second 4s and 4¼s, third 4¼s, fourth 4¼s, Treasury certificates, and war-savings certificates.

30,000 of first 4¼s (issue of October 24, 1918, only), until the expiration of two years after the termination of the war.

30,000 of fourth 4¼s, until the expiration of two years after the termination of the war.

30,000 in the aggregate of first 4s, first 4¼s (issues of May 9 and October 24, 1918), second 4s and 4¼s, third 4¼s, and fourth 4¼s, as to the interest received on and after January 1, 1919, until the expiration of five years after the termination of the war.

45,000 in the aggregate of first 4s, first 4¼s (issue of May 9, 1918, only), second 4s and 4¼s, and third 4¼s, as to the interest received after January 1, 1918, until the expiration of two years after the termination of the war; this exemption conditional on original subscription to, and continued holding at the date of the tax return of, two-thirds as many bonds of the fourth Liberty loan.

20,000 in the aggregate of first 4s, first 4¼s (issues of May 9 and October 24, 1918), second 4s and 4¼s, third 4¼s, and fourth 4s, as to the interest received on and after January 1, 1919; this exemption conditional upon original subscription to, and continued holding at the date of the tax return of one-third as many notes of the Victory Liberty loan, and extending through the life of such notes of the Victory Liberty loan.

160,000 total possible exemptions from Federal income surtaxes and profits taxes, subject to conditions above summarized.

III. *3½ per cent bonds and 3¾ per cent notes* are exempt from all Federal, State, and local taxation, except estate or inheritance taxes, as follows:

1. First Liberty loan 3½ per cent bonds of 1932–1947. 2. Victory Liberty loan 3¾ per cent convertible gold notes of 1922–1923.	Are exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority. (T. D. 2836, May 7, 1919.)

§ 75. Dividends on Corporate Stock

Dividends paid in property.—Dividends paid in securities or other property (other than its own stock), in which the earnings of a corporation have been invested, are income to the recipients to the amount of the fair market value of such property when receivable by the stockholders. A dividend paid in stock of another corporation is not a stock dividend. Where a corporation declares a dividend payable in stock of another corporation, setting aside the stock to be so distributed and notifying the stockholders of its action, the income arising to the recipients of such stock is its fair market value at the time the dividend becomes payable. Scrip dividends are subject to tax in the year in which the warrants are issued. (Regulations No. 45, art. 1544.)

§ 76. Stock Dividends

A dividend paid in stock of the corporation is income to the amount of the earnings or profits distributed, as shown by the transfer of surplus to capital account on the books of the corporation, usually equal to the par value of the stock distributed. But stock distributions made out of surplus other than earnings or profits accumulated since February 28, 1913, when there are no such earnings or profits, are not dividends within the meaning of the statute and are free from tax as dividends. Stock dividends paid from earnings or profits accumulated after February 28, 1913, received by a fiduciary and retained as an accretion to the estate under the terms of the will or trust, are income to the estate.

Sale of stock received as dividend.—As stock dividends were taxable income under the Revenue Act of 1916, as well as the present statute, but were not under the Act of October 3, 1913, different considerations may apply to the sale of stock received as a dividend before 1916 and stock so received thereafter. See article 39. For the purpose of ascertaining the gain or loss derived from the sale of stock of a corporation received as a dividend, or from the sale of the stock in respect of which such dividend was paid, the cost (used to include also, where required, fair market price or value as of March 1, 1913) of such stock is to be determined in accordance with the following rules:

(1) In the case of stock (*a*) received as a dividend in 1913, 1914 or 1915 out of surplus however created, or (*b*) received as a dividend in 1916 or subsequent years out of surplus other than earnings or profits accumulated since February 28, 1913, the cost of each share of new stock is the quotient of the cost of the old stock divided by the number of old and new shares added together.

(2) In the case of the stock in respect of which any stock dividend was paid as described under (1), the cost of each share of old stock is similarly the quotient of the cost of the old stock divided by the number of old and new shares.

(3) In the case of stock received as a dividend in 1916 or subsequent years out of earnings or profits accumulated since February 28, 1913, the cost of each share of new stock is the quotient of the sum of (*a*) the cost of the old stock plus (*b*) the valuation at which the new stock was returnable as income (as shown by the transfer of surplus to capital account on the books of the corporation, usually its par value), divided by the number of old and new shares added together.

(4) In the case of the stock in respect of which any stock dividend was paid as described under (3), the cost of each share of old stock is similarly the quotient of the sum of (*a*) the cost of the old stock plus (*b*) the valuation at which the new stock was returnable as income, divided by the number of old and new shares. (Regulations No. 45, arts. 1545, 1547.)

§ 77. Accumulated or Undivided Profits of Corporation

Profits of corporation taxable to stockholders.—Where a domestic or foreign corporation permits its gains and profits to accumulate for the purpose of preventing the imposition of the surtax upon such income if distributed to its stockholders, it shall not be subject to the income tax as a corporation, but its stockholders shall be subject to tax in the same way as the stockholders of a personal service corporation, except that the war profits and excess profits tax on the corporation shall first be deducted from its net income before computing the proportionate shares of the stockholders. See section 218 of the statute and articles 328–335. In any case the Commissioner or a collector may require a corporation to furnish a statement of its gains and profits and of the names, addresses and shareholdings of the stockholders. If upon the basis of such statement or other evidence the Commissioner certifies that in his opinion its accumulation of profits is unreasonable for the purposes of the business, but only if he so certifies, the corporation and its stockholders shall make their returns accordingly.

Purpose to escape surtax.—The application of section 220 of the statute depends upon the two elements of (*a*) purpose to escape the surtax and (*b*) unreasonable accumulation of gains and profits. Prima facie evidence of (*a*) exists where a corporation has practically no business except holding stocks, securities or other property and collecting the income therefrom, or where a corporation other than a mere holding company permits its gains and profits to accumulate beyond the reasonable needs of the business. The business of a corporation is not limited to that which it has previously carried on, but in general includes any line of business which it may legitimately undertake. However, a radical change of business when a considerable surplus has been accumulated may afford evidence of a purpose to escape the surtax. When one corporation owns the stock of another corporation in the same or a related line of business and in effect operates the other corporation, the business of the latter may be considered in substance the business of the first corporation. Gains and profits of the first corporation put into the second through the purchase of stock or otherwise may therefore, if a subsidiary relationship is established, constitute employment of the income in its own business. To establish that the business of one corporation can be regarded as including the business of another it is ordinarily essential that the first corporation own substantially all of the stock of the second. Investment by a corporation of its income in stock and securities of another corporation is not without more to be regarded as employment of the income in its business.

Unreasonable accumulation of profits.—An accumulation of gains and profits is unreasonable if it is not required for the purposes of the business, considering all the circumstances of the case. No attempt can be made to enumerate all the ways in which gains and profits of a corporation may be accumulated for the reasonable needs of the business. Undistributed income is properly accumulated if invested in increased inventories or additions to plant reasonably needed by the business. It is properly accumulated if retained for working capital required by the business or in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. In the case of a banking institution the business of which is to receive and loan money, using capital, surplus and deposits for that purpose, undistributed income actually represented by loans or reasonably retained for future loans is not accumulated beyond the reasonable needs of the business. The nature of the investment of gains and profits is immaterial if they are not in fact needed in the business. (Regulations No. 45, arts. 351–353.)

§ 79. Sale and Distribution of Assets of Corporation

Regulations No. 45, arts. 1548, 1549, contain the following rulings on this subject:

ART. 1548. *Distribution in liquidation.*—So-called liquidation or dissolution dividends are not dividends within the meaning of the statute, and amounts so distributed, whether or not including any surplus earned since February 28, 1913, are to be regarded as payments for the stock of the dissolved corporation. Any excess so received over the cost of his stock to the stockholder, or over its fair market value as of March 1, 1913, if acquired prior thereto, is a taxable profit. A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, which is in the nature of a recurrent return upon the stock.

ART. 1549. *Distribution from depletion or depreciation reserve.*—A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of its surplus out of which ordinary dividends may be paid. A distribution made from such a reserve will be considered a liquidating dividend and will constitute taxable income to a stockholder only to the extent that the amount so received is in excess of the cost or fair market value as of March 1, 1913, of his shares of stock. No distribution, however, will be deemed to have been made from such a reserve except to the extent that the amount paid exceeds the surplus and undivided profits of the corporation. In general, any distribution made by a corporation other than out of earnings or profits accumulated since February 28, 1913, is to be regarded as a return to the stockholder of part of the capital represented by his shares of stock, and upon a subsequent sale of such stock his profit will be the excess of the selling price over the cost of the stock or its fair market value as of March 1, 1913, after applying on such cost or value the amount of any such capital distribution.

Where a corporation, going out of business, sells all of its property and assets at an advance over the original purchase price, the amount of such advance is a gain or profit received by the corporation during the year, for the purpose of computing its net income. Scott v. Schwab (C. C. A.) 255 Fed. 57.

§ 84. Domestic Corporations Operating Exclusively Abroad

The Treasury Department rules that every corporation, domestic or foreign, not exempt under § 231 of the statute, is liable to the tax. It makes no difference that a domestic corporation may receive no income from sources within the United States. On the other hand, a foreign corporation is taxed only on its income from sources within the United States. (Regulations No. 45, art. 503.)

§ 87. Nonresident Aliens

Income of nonresident alien individuals not subject to tax.—Salaries, wages, commissions and rents paid by domestic business enterprises to nonresident alien employees for services rendered entirely in a foreign country or for property located in a foreign country are not subject to tax as income from a source within the United States. Dividends on stock and interest on notes of corporations organized in the United States, but doing no business and owning no property therein, paid to nonresident alien individuals or corporations, are not subject to the tax. The tax does not apply to charter money or freight payments received by a foreign owner in regard to a vessel operated between the United States and foreign ports, if the person receiving the income maintains no regular agency in the United States and is not doing business in the United States. Compensation received by nonresident alien munitions inspectors and purchasing agents from foreign governments is not subject to the tax.

Income of nonresident aliens from United States bonds.—By virtue of section 4 of the Victory Liberty Loan Act of March 3, 1919, amending section 3 of the Fourth Liberty Bond Act of July 9, 1918, the interest received on and after March 3, 1919, on bonds, notes and certificates of indebtedness of the United States and bonds of the War Finance Corporation, while beneficially owned by a nonresident alien individual, or a foreign corporation, partnership or association, not engaged in business in the United States, is exempt from all income and war profits and excess profits taxes. (Regulations No. 45, arts. 92, 93.)

Deductions allowed nonresident alien individuals.—In the case of a nonresident alien individual the deduction for interest paid or accrued is proportionate to his income from sources within the United States (see paragraph (2) of subdivision (a) of section 214 of the statute); for losses incurred in any transaction entered into for profit, or arising from casualty or theft, is confined to transactions and property within the United States (5), (6); for charitable contributions excludes gifts to foreign corporations (11); and for business expenses, taxes imposed by a foreign country, losses in trade, bad debts, depreciation, amortization, depletion, and loss in inventory (1), (3), (4), (7), (8), (9), (10) and (12), is allowed only if and to the extent that it is connected with income arising from a source within the United States. (Regulations No. 45, art. 271.)

The following provisions are found in Regulations No. 45, arts. 311–316:

ART. 311. *Allowance of deductions and credits to nonresident alien individual.*—Unless a nonresident alien individual shall render a return of income as required in article 404, the tax shall be collected on the basis of his gross income (not his net income) from sources within the United States. Where a nonresident alien has various sources of income within the United States, so that from any one source or from all sources combined the amount of income shall call for the assessment of a surtax, and a return of income shall not be filed by him or on his behalf, the Commissioner will cause a return of income to be made and include therein the income of such nonresident alien from all sources concerning which he has information, and he will assess the tax and collect it from one or more of the sources of income within the United States of such nonresident alien, without allowance for deductions or credits. The benefit of the credits allowed against net income for the purpose of the normal tax may not be received by a nonresident alien by filing a claim with the withholding agent, but only by claiming them upon filing a return of income, except as permitted in article 316.

ART. 312. *Who is a nonresident alien individual.*—"Nonresident alien individual" means an individual (*a*) whose residence is not within the United States and (*b*) who is not a citizen of the United States. Any alien living in the United States who is not a mere transient is a resident of the United States for purposes of the income tax. Whether he is a transient or not is determined by his intentions with regard to his stay. If he lives in the United States and has no definite intention as to his stay, he is a resident. The best evidence of his intention is afforded by the conduct, acts and declarations of the alien. The typical transient is one who stops for a short time in the course of a journey through the United States, sometimes performing labor, sometimes not, or one who enters the United States intending only to stop long enough to carry out some purpose, object or plan not involving an extended stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient.

ART. 313. *Proof of residence of alien.*—An alien's statements as to his intention with regard to residence are not conclusive, but when unequivocal will determine the question of his intention, unless his conduct, acts or other surrounding circumstances contradict the statements. It sometimes occurs that an alien who genuinely intends his stay to be transient may put off his departure from time to time by reason of changed conditions, remaining a transient though living in the United States for a considerable time. The fact that an alien's family is abroad does not necessarily indicate that he is a transient rather than a resident. An alien who enters this country intending to make his home in a foreign country as soon as he has accumulated a sum of money sufficient to provide for his journey abroad is to be considered a transient, provided his expectation in this regard may reasonably, considering the rate of his saving, be fulfilled within a comparatively short time.

ART. 314. *Loss of residence by alien.*—It will be presumed that an alien who has established a residence in the United States, as outlined above, continues to be a resident until he or his family evidence an intention to change their residence to another country by starting to remove. Thus, alien residents who, following the armistice agreement of November 11, 1918, take steps toward returning to their native countries, as by applying for passports, may for the purpose of withholding be regarded as residents for that portion of the taxable year which elapsed up to the time such step was taken. But the status of the alien on the last day of his taxable year or period determines his liability to tax for such year or period as a resident or nonresident.

ART. 315. *Duty of employer to determine status of alien employee.*—Aliens employed in the United States are prima facie regarded as nonresidents. If wages are paid without withholding the tax except as permitted in the following article, the employer should be provided with written proof of facts which overcome the presumption that such alien is a nonresident. Such facts include the following: (*a*) If an alien has been living in the United States for as much as one year immediately prior to the time he entered the employment of the withholding agent, or if he has been regularly employed by a resident individual or corporation in the same county for as much as three months immediately prior to any payment by the employer, he may be treated as a resident in the absence of facts known to the employer showing that he is in fact a transient, such as one of the types mentioned under article 312. The facts with regard to the length of time the alien has thus lived in the country or county and has been so regularly employed may be established by the certificate of the alien. (*b*) The employer may also obtain evidence to overcome the prima facie presumption of nonresidence by securing from the alien form 1078 (revised) or an equivalent certificate of the alien establishing residence. Having secured such evidence from the alien, the employer may rely thereon unless the statement of the alien was false and the employer has reasonable cause to believe it false, and may continue to rely theron until the alien ceases to be a resident under the provisions of article 314. An employer who seeks to account for failure to withhold in the past, if he did not at the time secure form 1078 (revised) or its equivalent, is permitted to prove the former status of the alien by any material evidence.

ART. 316. *Allowance of personal exemption to nonresident alien employee.*—A nonresident alien employee, provided he is entitled under section 216 of the statute and articles 301–307 to credit for a personal exemption or for dependents or both, may claim the benefit of such credit by filing with his employer form 1115, duly filled out and executed under oath. On the filing of such a claim the employer shall examine it. If on such examination it appears that the claim is in due form, that it contains no statement which to the knowledge of the employer is untrue, that such employee on the face of the claim is entitled to credit, and that such credit has not yet been exhausted, such employer need not until such credit be in fact exhausted withhold any tax from payments of salary or wages made to such employee. Every employer with whom affidavits of claim on form 1115 are filed by employees shall preserve such affidavits until the following calendar year, and shall then file them, attached to his annual withholding return on form 1042 (revised), with the collector on or before March 1. In case, however, when the following calendar year arrives such employer has no withholding to return, he shall forward all such affidavits of claim directly to the Commissioner (Sorting Division), with a letter of transmittal, on or before March 15. Where any tax is withheld the employer in every instance shall show on the pay envelope or shall furnish some other memorandum showing the name of the employee, the date and the amount withheld. This article applies only to payments of compensation by an employer to an employee.

Alien seamen, resident and nonresident.—T. D. No. 2869, June 20, 1919, adds the following articles to Regulations No. 45, relating to the income tax:

ART. 92a. *When the wages of a nonresident alien seaman are derived from sources within the United States.*—While resident alien seamen are taxable like citizens on their entire income from whatever source derived, nonresident alien seamen are taxable only on income from sources within the United States. Ordinarily, wages received for services rendered inside the territorial United States are to be regarded as from sources within the United States. The wages of an alien seaman earned on a coastwise vessel are from sources within the United States, but wages earned by an alien seaman on a ship regularly engaged in foreign trade are not to be regarded as from sources within the United States, even though the ship flies the American flag, or although during a part of the time the ship touched at United States ports and remained there a reasonable time for the transaction of its business. The presence of a seaman aboard a ship which enters a port for such purposes of foreign trade is merely transitory and wages earned during that period by a nonresident alien seaman are not taxable. There is no withholding from the wages of alien seamen unless they are nonresidents within the rules laid down in articles 311 to 315. Even in the case of a nonresident alien seaman the employer is not obliged to withhold from wages unless those wages are from sources within the United States as defined above. As to when alien seamen are to be regarded as residents see article 312a.

ART. 312a. *Alien seamen, when to be regarded as residents.*—In order to determine whether an alien seaman is a resident within the meaning of the income tax law, it is necessary to decide whether the presumption of nonresidence is overcome by facts showing that he has established a residence in the territorial United States, which consists of the States, the District of Columbia, and the Territories of Hawaii and Alaska, and excludes other places. Residence may be established on a vessel regularly engaged in coastwise trade, but the mere fact that a sailor makes his home on a vessel flying the United States flag and engaged in foreign trade is not sufficient to establish residence in the United States, even though the vessel, while carrying on foreign trade, touches at American ports. An alien seaman may acquire an actual residence in the territorial United States, within the rules laid down in article 312, although the nature of his calling requires him to be absent from the place where his residence is established for a long period. An alien seaman may acquire such a residence at a sailor's boarding house or hotel, but such a claim should be carefully scrutinized in order to make sure that such residence is bona fide. The filing of Form 1078, revised, or taking out first citizenship papers, is proof of residence in the United States from the time the form is filed or the papers taken out, unless rebutted by other evidence showing an intention to be a transient. The fact that a head tax has been paid on behalf of an alien seaman entering the United States is no evidence that he has acquired residence, because the head tax is payable unless the alien who is entering the country is merely in transit through the country. An alien may remain a nonresident although he is not in transit through the country. As to when the wages of alien seamen are subject to tax see article 92a.

The case of De Ganay v. Lederer (D. C.) 239 Fed. 568, cited in this section in note 19, was affirmed by the Supreme Court of the United States, in De Ganay v. Lederer, 39 Sup. Ct. 524.

§ 88. Taxability of Foreign Governments

The exemption of income of foreign governments applies also to their political subdivisions. Any income collected by foreign governments from investments in the United States in stocks, bonds or other domestic securities, which are not actually owned by but are loaned to such foreign governments, is subject to tax. The income of foreign ambassadors and ministers from investments in bonds and stocks and from interest on bank balances, and the fees of foreign consuls, are exempt from tax, but income of such foreign officials from any business carried by them in the United States would be taxable. The compensation of citizens of the United States who are officers or employees of a foreign government is, however, not exempt from tax. (Regulations No. 45, art. 83.)

§ 91. Estates, Trusts, and Dissolved Corporations

The following rulings (Regulations No. 45, arts. 341–346) on the subject of estates and trusts have been promulgated:

ART. 341. *Estates and trusts.*—While certain estates and trusts are subject to tax as such and others are not, the fiduciary in every case is required to make a return of income. See section 225 of the statute and articles 421–425. The net income of an estate or trust shall be computed in the same manner and on the same basis as the net income of an individual, except that in place of the deduction allowed individuals of certain gifts or contributions there may be deducted from the gross income any part of it which during the taxable year is pursuant to the will or trust deed paid to or permanently set aside for the United States, a State, a Territory, or any political subdivision thereof, the District of Columbia, or any corporation or association of the kind described in section 231 (6) of the statute and article 517. See section 212 and articles 21–26. The income of a revocable trust must be included in the gross income of the grantor.

ART. 342. *Estates and trusts taxed to fiduciary.*—In the case of (*a*) estates of decedents before final settlement and of (*b*) trusts, whether created by will or deed, for accumulation of income, whether for unascertained persons or persons with contingent interests or otherwise, the income is taxed to the fiduciary as to any single individual, except that from the income of a decedent's estate there may first be deducted any amount of income properly paid or credited to a beneficiary. See section 200 of the statute and articles 1521 and 1522. Where under the terms of the will or deed the trustee may in his discretion distribute the income or accumulate it, the income is taxed to the trustee, irrespective of the exercise of his discretion. The imposition of the tax is not affected by the fact that an ultimate beneficiary may be a person exempt from tax. A statutory allowance paid a widow out of the corpus of the estate is not deductible from gross income. As an intestate's real estate does not pass to his administrator, upon a sale by the heirs, whether before or after settlement of the estate, each heir is taxed individually on any profit derived.

ART. 343. *Decedent's estate during administration.*—The "period of administration or settlement of the estate" is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized. Where, however, the executor sells property of the estate for more than its value at the death of the decedent, the excess is income taxable to the estate.

ART. 344. *Incidence of tax on estate of trust.*—Liability for payment of the tax attaches to the person of an executor or administrator up to and after his discharge, where prior to distribution and discharge he had notice of his tax obligations or failed to exercise due diligence in determining whether or not such obligations existed. Liability for the tax also follows the estate itself, and when by reason of the distribution of the estate and the discharge of the executor or administrator it appears that collection of the tax can not be made from the executor or administrator, the legatees or distributees must account for their proportionate share of the tax due and unpaid. The same considerations apply to other trusts. Where the tax has been paid on the net income of an estate or trust by the fiduciary, such income is free from tax when distributed to the beneficiaries.

ART. 345. *Estates and trusts taxed to beneficiaries.*—In the case of (*a*) a trust the income of which is distributable periodically, (*b*) an ordinary guardianship of a minor, and (*c*) an estate of a decedent before final settlement as to any income properly paid or credited as such to a beneficiary, the income is taxable directly to the beneficiary or beneficiaries. Each beneficiary must include in his return his distributive share of the net income, even though not yet paid him, but if the taxable year on the basis of which he makes his returns fails to coincide with the annual accounting period of the estate or trust, then he need only include in his return his distributive share for such accounting period ending within his taxable year. The regulations governing partnerships are generally applicable to such an estate or trust.

ART. 346. *Credits to trust or beneficiary.*—(*a*) In the case of an estate or trust taxed to the fiduciary it is allowed the same credits against net income as a single person, including a personal exemption of $1,000, but no credit for dependents. (*b*) In the case of an estate or trust taxed to the beneficiaries each beneficiary is allowed for the purpose of the normal tax, in addition to his individual credits, his proportionate share of such dividends from domestic and resident foreign corporations and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the estate or trust. Each beneficiary is entitled to but one personal exemption, no matter from how many trusts he may receive income.

Income of corporation in liquidation.—When a corporation is dissolved its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind upon dissolution, however they may have appreciated or depreciated in value since their acquisition. (Regulations No. 45, art. 547.)

A trustee of a bankrupt corporation, who is not carrying on its business, but has received funds as the result of a compromise made by him with a foreign corporation of a claim for nonpayment of salary and commissions, is not liable to pay an income tax thereon, since only net income earned by a trustee while operating the business of a bankrupt corporation is taxable. In re Heller, Hirsh & Co. (C. C. A.) 258 Fed. 208.

§ 92. Partnerships

Under the income tax law of 1913, a member of a partnership need not include as part of his net income, subject to tax, funds derived from or through the partnership which have been received by the firm as dividends on stocks owned by it in corporations taxable on their net income. U. S. v. Coulby (C. C. A.) 258 Fed. 27.

Joint ownership and joint adventure.—Joint investment in and ownership of real and personal property not used in the operation of any trade or business and not covered by any partnership agreement does not constitute a partnership. Co-owners of oil lands engaged in the joint enterprise of developing the property through a common agent are not necessarily partners. In the absence of special facts affirmatively showing an association or partnership, where a vessel is owned by several individuals and operated by a managing owner or agent for the account of all, the relation does not constitute either a joint-stock association or a partnership. The participation of two United States corporations in a joint enterprise or adventure does not constitute them partners. (Regulations No. 45, art. 1507.)

§ 100. Unincorporated Associations

In further explanation of the meaning of the term "associations," as used in the statute, the Treasury Department has promulgated the following rulings, in Regulations No. 45, arts. 1502–1504:

ART. 1502. *Association.*—Associations and joint-stock companies include associations, common law trusts and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the members or shareholders on the basis of the capital stock which each holds or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization.

ART. 1503. *Association distinguished from partnership.*—An organization the membership interests in which are transferable without the consent of all the members, however the transfer may be otherwise restricted, and the business of which is conducted by trustees or directors and officers without the active participation of all the members as such, is an association and not a partnership. A partnership bank conducted like a corporation and so organized that the interests of its members may be transferred without the consent of the other members is a joint-stock company or association within the meaning of the statute. A partnership bank the interests of whose members can not be so transferred is a partnership.

ART. 1504. *Association distinguished from trust.*—Where trustees hold real estate subject to a lease and collect the rents, doing no business other than distributing the income less taxes and similar expenses to the holders of their receipt certificates, who have no control except the right of filling a vacancy among the trustees and of consenting to a modification of the terms of the trust, no association exists and the cestuis que trust are liable to tax as beneficiaries of a trust the income of which is to be distributed periodically, whether or not at regular intervals. But in such a trust if the trustees pursuant to the terms thereof have the right to hold the income for future distribution, the net income is taxed to the trustees instead of to the beneficiaries.. See section 219 of the statute. If, however, the cestuis que trust have a voice in the conduct of the business of the trust, whether through the right periodically to elect trustees or otherwise, the trust is an association within the meaning of the statute.

See Crocker v. Malley, 39 Sup. Ct. 270, reversing Crocker v. Malley (C. C. A.) 250 Fed. 817, cited in this section in note 43.

§ 105. Citizens and Corporations of Porto Rico and the Philippines

The regulations prescribed by the Treasury Department on this subject (Regulations No. 45, arts. 1131–1133) are as follows:

ART. 1131. *Income tax in Porto Rico and Philippine Islands.*—In Porto Rico and the Philippine Islands the Revenue Act of 1916, as amended, is in force and the Revenue Act of 1918 is not. See also section 1400 of the statute. No credit against net income is allowed individuals and no deduction from gross income is allowed corporations with respect to dividends received from a foreign corporation (foreign with respect to the United States) taxed in Porto Rico or the Philippines, but having no income from sources within the United States.

ART. 1132. *Taxation of individuals between United States and Porto Rico and Philippine Islands.*—(*a*) A citizen of the United States who resides in Porto Rico, and a citizen of Porto Rico who resides in the United States, are taxed in both places, but the income tax in the United States is credited with the amount of any income, war profits and excess profits taxes paid in Porto Rico. (*b*) A resident of the United States, who is not a citizen of Porto Rico, is taxable in Porto Rico as a nonresident alien individual on any income derived from sources within Porto Rico, but the income tax in the United States is credited with the tax paid in Porto Rico. (*c*) A resident of Porto Rico, who is not a citizen of the United States, is taxable in the United States as a nonresident alien individual on any income derived from sources within the United States, and receives no credit. The same principles apply in the case of the Philippine Islands.

ART. 1133. *Taxation of corporations between United States and Porto Rico and Philippine Islands.*—(*a*) A United States corporation which derives income from sources within Porto Rico, (*b*) a Porto Rico corporation which derives income from sources within the United States, and (*c*) a corporation of a foreign country which derives income both from sources within Porto Rico and from sources within the United States, are all taxed in both places. In the case of the United States corporation the income, war profits and excess profits taxes in the United States are credited wtih the amount of any income, war profits and excess profits taxes paid in Porto Rico. In the case of the Porto Rico corporation there is no such credit. The corporation of the foreign country deriving income from both places is subject to no double taxation so far as the United States and Porto Rico are concerned. For the purpose of withholding a Porto Rico corporation is a foreign corporation. The same principles apply in the case of the Philippine Islands.

§ 106. Insurance Companies

Only premiums actually received in cash during the year, and not premiums accruing or becoming due but not paid within the year, nor money previously received in payment of a premium, but applied within the year to pay a different premium, on a renewal policy, instead of the policy holder, on expiration of his policy, taking his expiration return premium or dividend in cash, as he had a right to do, are "income received within the year" by a mutual insurance company, within the meaning of Excise Tax Act, § 38, cl. 2; an estimation on a "cash," as opposed to a "revenue," basis being contemplated by the act. Lumber Mut. F. Ins. Co. v. Malley (D. C.) 256 Fed. 380.

§ 115. Exempt Corporations; Cooperative and Mutual Associations

The revised regulation of the Treasury Department on this subject as found in Regulations No. 45, art. 521, is as follows: It is necessary to exemption that the income of the company be derived solely from assessments, dues and fees collected from members. If income is received from other sources, the corporation is not exempt, even though its additional income is tax exempt. Income, however, from sources other than those specified does not prevent exemption where its receipt is a mere incident of the business of the company. Thus the receipt of interest upon a working bank balance, or of the proceeds of the sale of badges, office supplies or equipment, will not defeat the exemption. The same is true of the receipt of interest upon liberty bonds, where they were purchased as a patriotic duty and were afterwards sold. Where, however, such bonds are bought as a permanent investment, the receipt of the interest destroys the exemption. The receipt of what is in substance an entrance fee, charged by a mutual fire insurance company as a condition of membership, does not render the company taxable, although this fee is called a premium. But the issuance of policies for stipulated cash premiums prevents exemption. A local exchange or association to insure the owners of automobiles against fire, theft, collision, public liability and property damage, is exempt, since it performs functions of the same character as a mutual fire insurance company, and is a like organization within the meaning of the statute. A local reservoir and ditch company may likewise be exempt from tax. The exemption does not include a telephone clearing association, whose business is to apportion toll rates between independent telephone companies handling the same calls and whose income consists of compensation paid by such companies and receipts from the sale of form blanks. The phrase "of a purely local character" qualifies only "like organizations."

§ 122. Fraternal Orders and Benefit Societies

A fraternal beneficiary society is exempt from tax only if operated under the "lodge system," or for the exclusive benefit of the members of a society so operating. "Operating under the lodge system" means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident or other benefits. (Regulations No. 45, art. 514.)

§ 123. Religious, Charitable, and Benevolent Associations

Cemetery companies.—A cemetery company having a capital stock represented by shares, or which is operated for profit or for the benefit of others than its members, does not come within the exempted class. A cemetery company of which all lot owners are members, issuing preferred stock entitling the holder to a semi-annual dividend of four per cent, and whose articles of incorporation provide that the preferred stock shall be retired at par as soon as sufficient funds are realized from sales and that all funds realized in addition thereto shall be used by the company for the care and improvement of the cemetery property, is within the exemption. (Regulations No. 45, art. 516.)

Religious and charitable organizations.—Where a religious corporation owns a large quantity of farm land and works it, and also manufactures and sells clothing and other articles for profit, it is not operated exclusively for religious purposes and is not exempt, even though its property is held in common and its profits do not inure to the benefit of individual members of the society.

It does not prevent exemption that private individuals, for whose benefit a charity is organized, receive the income of the corporation or association. The statute refers to individuals having a personal and private interest in the activities of the corporation, such as stockholders. If, however, a corporation issues "voting shares," which entitle the holders upon the dissolution of the corporation to receive the proceeds of its property, including accumulated income, the right to exemption does not exist, even though the by-laws provide that the shareholders shall not receive any dividend or other return upon their shares. (Regulations No. 45, art. 517.)

§ 124. Educational and Scientific Institutions

Educational corporations may include an association whose sole purpose is the instruction of the public. This is true of an association to promote acquaintance with the Spanish language and literature, although it has incidental amusement features; of an association to increase knowledge of the civilization of another country; and of a Chautauqua association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community and whose amusement features are incidental to this purpose. But associations formed to disseminate controversial or partisan propaganda are not educational within the meaning of the statute. Societies designed to encourage the performance of first class orchestral music are not exempt, the purpose being merely to provide a high grade of entertainment. Scientific corporations include an association for the scientific study of law, to the end of improvement in its administration. (Regulations No. 45, art. 517.)

§ 125. Building and Loan Associations

A building and loan association entitled to exemption is one organized pursuant to the laws of the United States or of some State or Territory thereof, which accumulates funds to be loaned to its members and to be repaid in small periodical installments. The statute requires that the members of the association shall share in its profits on substantially the same footing. Subject to this requirement, it does not prevent exemption that the association issues prepaid stock entitled to a specified percentage of the profits. Where, however, the association issues paid-up stock, the holders of which are entitled to a fixed dividend and also to share in the profits with all the other holders of stock, it is not exempt. (Regulations No. 45, art. 515.)

§ 126. Mutual Savings Banks

A Massachusetts savings bank, otherwise exempt, which establishes an insurance department under the statutes of that State, does not thereby become subject to tax upon the income received by such department. (Regulations No. 45, art. 513.)

§ 127. Civic Organizations

Business and civic leagues.—A business league is an association of persons having some common business interest, which limits its activities to work for such common interest and does not engage in a regular business of a kind ordinarily carried on for profit. 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 such a league, since its members have no common business interest, and it is not exempt, 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 stockholder 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 corporation having capital stock and possessing a charter which authorizes it to buy, improve and sell real estate is organized for profit within the meaning of the statute and is not exempt from tax as a civic league or organization, even though it no longer exercises such powers for profit and is operated exclusively for the promotion of social welfare. (Regulations No. 45, arts. 518, 519.)

§ 129. Personal Service Corporations

The following definitions and regulations have been prescribed in Regulations No. 45, arts. 1523–1532:

ART. 1523. *Personal service corporation.*—The term "personal service corporation" means a corporation, not expressly excluded, the income of which is derived from a profession or business (*a*) which consists principally of rendering personal service, (*b*) the earnings of which are to be ascribed primarily to the activities of the principal owners or stockholders, and (*c*) in which the employment of capital is not necessary or is only incidental. No definite and conclusive tests can be prescribed by which it can be finally determined in advance of an examination of the corporation's return whether or not it is a personal service corporation. In the following articles are laid down the general principles under which such determination will be made.

ART. 1524. *Personal service corporation; certain corporations excluded.*—The following classes of corporations are expressly excluded from classification as personal service corporations: (*a*) foreign corporations; (*b*) corporations 50 per cent or more of whose gross income consists of gains, profits or income derived from trading as a principal; and (*c*) corporations 50 per cent or more of whose gross income consists of gains, profits, commissions or other income derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, inclusive. A corporation is not a personal service corporation merely because less than 50 per cent of its gross income was derived from trading as a principal or from Government contracts. A corporation can not be considered a personal service corporation when another corporation owns or controls substantially all of its stock, or when substantially all of its stock and of the stock of another corporation (not itself a personal service corporation) forming part of the same business enterprise is owned or controlled by the same interests.

ART. 1525. *Personal services rendered by personal service corporation.*—In order that a corporation may be deemed to be a personal service corporation its earnings must be derived principally from compensation for personal services rendered by the corporation to the persons with whom it does business. Merchandising or trading either directly or indirectly in commodities or the services of others is not rendering personal service. Conducting an auction, agency, brokerage or commission business strictly on the basis of a fee or commission is rendering personal service. If, however, the corporation assumes any such risks as those of market fluctuation, bad debts, failure to accept shipments, etc., or if it guarantees the accounts of the purchaser or is in any way responsible to the seller for the payment of the purchase price, the transaction is one of merchandising or trading, and this is true even though the goods are shipped directly from the producer to the consumer and are never actually in the possession of the corporation. The fact that earnings of the corporation are termed commissions or fees is not controlling. The fact that a commission or fee is based on a difference in the prices at which the seller sells and the buyer buys raises a presumption that the transaction is one of merchandising or trading, and it will be so considered in the absence of satisfactory evidence to the contrary.

ART. 1526. *Personal services rendered by personal service corporation; more than one business.*—It frequently happens that corporations are engaged in two or more professions or businesses which are more or less related, one of which does not consist of rendering personal service. Thus an engineering concern may also engage in contracting, which amounts to trading in materials and labor, a brokerage concern may guarantee some of its accounts, a photographer may sell pictures, frames, art goods and supplies, or a dealer in a commodity may furnish expert advice or services with respect to its installation, use, etc. In such case the corporation is not a personal service corporation unless the non-personal service element is negligible or merely incidental and no appreciable part of its earnings are to be ascribed to such sources.

ART. 1527. *Activities of stockholders of personal service corporation.*—In determining whether a corporation is a personal service corporation, no weight can be given to the fact that it renders personal services unless (*a*) the principal owners or stockholders are regularly engaged in the active conduct of its affairs and are engaged in such a manner that the earnings are to be ascribed primarily to their activities, and (*b*) its affairs are conducted principally by such owners or stockholders.

ART. 1528. *Activities of stockholders of personal service corporation; conduct of affairs.*—Where the principal owners or stockholders do not render the principal part of the services, but merely supervise or direct a force of employees, the corporation is not a personal service corporation. If employees contribute substantially to the services rendered by a corporation, it is not a personal service corporation unless in every case in which services are so rendered the value of and the compensation charged for such services are to be attributed primarily to the experience or skill of the principal owners or stockholders and such fact is evidenced in some definite manner in the normal course of the profession or business. The fact that the principal owners or stockholders give personal attention or render valuable services to the corporation as a result of which its earnings are greater than those of a corporation engaged in a like or similar business, the principal owners or stockholders of which do not devote personal attention to the management or supervision of its affairs, does not of itself constitute the corporation a personal service corporation.

ART. 1529. *Activities of stockholders of personal service corporation; stock interest required.*—No definite percentage of stock or interest in the corporation which must be held by those engaged in the active conduct of its affairs in order that they may be deemed to be the principal owners or stockholders can be prescribed as a conclusive test, as other facts may affect any presumption so established. No corporation or its owners or stockholders shall, however, make a return in the first instance on the basis of its being a personal service corporation unless at least 80 per cent of its stock is held by those regularly engaged in the active conduct of its affairs.

ART. 1530. *Activities of stockholders of personal service corporation; change in ownership.*—The fact that the owners or stockholders of the corporation may change during the course of the taxable year does not take a corporation which is normally in the personal service class out of that class. Frequent changes in the ownership of any substantial interest or number of shares are, however, evidence bearing on the question as to whether the principal owners or stockholders are actively engaged in the conduct of the affairs of the corporation. The incapacity, retirement or death of a principal owner or stockholder who has been actively engaged in the conduct of its affairs will not be deemed to make any change in the status of the corporation during a reasonable time thereafter.

ART. 1531. *Capital of personal service corporation.*—In determining whether a corporation is a personal service corporation, no weight can be given to the fact that the invested capital of the corporation for the purpose of the war profits and excess profits tax or the actual investment of the principal owners or stockholders is comparatively small. The test established by the statute with respect to capital is entirely different. That test is the nature of the profession or business as indicated (*a*) by the kind of services it renders and (*b*) the extent to which capital is required to carry on such profession or business. If the use of capital is necessary or more than incidental, capital is a material income-producing factor and the corporation is not a personal service corporation. No corporation is a personal service corporation if it carries on business of a kind which ordinarily requires the use of capital, irrespective of whether the owners or stockholders have actually invested a substantial amount of capital.

ART. 1532. *Capital of personal service corporation; inference from use.*—The term "capital" as used in section 200 of the statute and in articles 1523–1532 means not only capital actually invested by the owners or stockholders, but also capital secured in other ways. Thus if capital is borrowed either directly as shown by bonds, debentures, certificates of indebtedness, notes, bills payable or other paper, or indirectly as shown by accounts payable or other forms of credit, or if the business of the corporation is in any way financed by or through any of the owners or stockholders, these facts will be deemed evidence that the use of capital is necessary. If a substantial amount of capital is used to finance or carry the accounts of clients or customers, it will be inferred that because of competition or other reasons such practice is necessary in order to secure or hold business which otherwise would be lost, and that the corporation is not a personal service corporation. If a corporation engaged in an agency, brokerage or commission business regularly employs a substantial amount of capital to lend to principals, to buy and carry goods on its own account, or to buy and carry odd lots in order that it may render more satisfactory service to its principals or customers, it is not a personal service corporation. In general the larger the amount of the capital actually used the stronger is the evidence that capital is necessary and is a material income-producing factor and that the corporation is not a personal service corporation.

Personal service corporations are defined in section 200 of the statute. Such corporations are not subject to tax as corporations, unless they make returns for fiscal years beginning in 1917, but they are required to make returns of income. See sections 231, 239 and 304 of the statute. An individual stockholder of a personal service corporation is, however, subject to tax much like a member of a partnership upon his distributive share of the net income of the corporation. The net income of a personal service corporation, as in the case of a partnership, shall be computed in the same manner and on the same basis as the net income of an individual, except that the deduction of contributions or gifts is not permitted. See section 212. A corporation which is taxable under section 303 is not a personal service corporation and its stockholders are taxed like stockholders in an ordinary corporation. (Regulations No. 45, art. 328.)

Distributive share of stockholders in personal service corporation.—A stockholder of a personal service corporation is required to include in his gross income for the taxable year (*a*) any dividends paid by the corporation in such year out of earnings or profits accumulated since February 28, 1913, and before January 1, 1918; (*b*) his share of any distribution made by the corporation in such year out of earnings or profits accumulated since December 31, 1917, and since the close of its taxable year ending with or during his next preceding taxable year; and (*c*) his distributive share of the undistributed net income of the corporation for its taxable year ending with or during his taxable year, provided he was at the close of its taxable year a stockholder in the corporation, notwithstanding he might since have ceased to be a stockholder. See section 201 of the statute and articles 1541–1543. In the case of personal service corporations with taxable years other than the calendar year, however, such distributive shares or distributions may be subject to different rates of tax. (Idem. art. 330.)

Credits allowed stockholders of personal service corporations.—A stockholder of a personal service corporation is entitled to credit for the purpose of the normal tax only for amounts received in distribution of earnings or profits of the corporation accumulated since February 28, 1913, and prior to January 1, 1918. See sections 201 and 216 of the statute and articles 1541 and 301. In addition to the credits ordinarily allowed to an individual a stockholder of a personal service corporation is entitled to the following credits: (*a*) a credit against net income for the purpose of the normal tax only of his proportionate share of such dividends from a corporation subject to tax and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the personal service corporation, and (*b*) a credit against income tax of the stockholder's proportionate share of income, war profits and excess profits taxes of the personal service corporation paid or accrued during the taxable year to a foreign country upon income derived from sources therein, or to any possession of the United States, subject to the limitations of section 222 of the statute. (Idem. art. 331.)

§ 130. Federal Land Banks

As section 26 of the Federal Farm Loan Act of July 17, 1916, provides that every federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from taxation, except taxes upon real estate, and that farm loan bonds, with the income therefrom, shall be exempt from taxation, the income derived from dividends on stock of federal land banks and national farm loan associations and from interest on such farm loan bonds is not subject to the income tax. See also section 231 (13) of the statute. (Regulations No. 45, art. 75.)

§ 134. Exemptions; Regulations as to Husband and Wife

Date determining exemption.—The following revised regulation has been made on this subject (Regulations No. 45, art. 305):—The status of the taxpayer on the last day of his taxable year determines his right to an additional exemption and to a credit for dependents. If then he is the head of a family, the personal exemption of $2,000 may be taken. If then he is the chief support of a dependent who is under eighteen years of age or incapable of self-support because mentally or physically defective, the credit of $200 may be taken. But an unmarried individual or a married individual not living with husband or wife, who during the taxable year has ceased to be the head of a family or to have dependents, is entitled only to the personal exemption of $1,000 allowed a single person. A husband and wife living together at the end of the taxable year may receive but one personal exemption of $2,000, divisible as they please, against their aggregate net income. If an individual dies during the taxable year, his executor or administrator in making a return for him is entitled to claim his full personal exemption according to his status at the time of his death. See also section 219 (c) of the statute and articles 346 and 421. If a husband or wife so dies and the joint personal exemption is used by the executor or administrator in making a return for the decedent, an undiminished personal exemption according to the status of the survivor at the end of the taxable year may be claimed in the survivor's return. If a taxpayer makes a return for a period other than a taxable year, the last day of such period shall be treated as the last day of the taxable year for the purpose of this article.

Whether or not an individual is the head of a family or has dependents is immaterial in determining his liability to render a return. If an individual is a married person living with husband or wife, no return need be made where their aggregate net income is less than $2,000; but a separate return must be made by each of them, regardless of the amount of the individual income of each, where their aggregate net income is $2,000 or over, unless they join in a single return. The husband shall include in his return the income derived from services rendered by the wife or from the sale of products of her labor if she does not file a separate return or join with him in a return setting forth her income separately. (Regulations No. 45, art. 401.)

§ 135. Nature of Expenses Deductible

Personal and family expenses.—Insurance paid on a dwelling owned and occupied by a taxpayer is a personal expense. Premiums paid for life insurance by the insured are not deductible. In the case of a professional man who rents a property for residential purposes, but incidentally receives there clients, patients or callers in connection with his professional work (his place of business being elsewhere), no part of the rent is deductible as a business expense. If, however, he uses part of the house for his office, such portion of the rent as is properly attributable to such office is deductible. The father is legally entitled to the services of his minor children, and allowances which he gives them, whether said to be in consideration of services or otherwise, are not allowable deductions in his return of income. Alimony and an allowance paid under a separation agreement are not deductible from gross income. The cost of the equipment of an army officer to the extent only that it is specially required by his profession and does not merely take the place of articles required in civilian life is deductible. Accordingly, the cost of a sword is an allowable deduction, but the cost of a uniform is not. (Regulations No. 45, art. 291.)

§ 136. Expenses of Business

A professional man may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid in the operation and repair of an automobile used in making professional calls, dues to professional societies and subscriptions to professional journals, the rent paid for office rooms, the expense of the fuel, light, water, telephone, etc., used in such offices, and the hire of office assistants. Amounts expended for books, furniture and professional instruments and equipment of a permanent character are not allowable as deductions. (Regulations No. 45, art. 104.)

§ 150. Deductions; Wages and Salaries

Treatment of excessive compensation.—As to the treatment of amounts ostensibly paid as compensation, but not allowed to be deducted as such, the following rules apply:

(1) In the case of excessive payments by corporations, if such payments correspond or bear a close relationship to stock holdings, the amount of the excess should be treated as dividends and would thus be exempt from the normal tax in the hands of the recipients; or if such payments represent an appropriation of assets of the corporation by officers who control it and fix their compensation in violation of the rights of the corporation, the amount of the excess, while disallowed as a deduction by the corporation, should be treated as compensation of the individuals subject to the normal tax, compensation illegally secured being none the less subject to tax in all respects; or if such payments constitute in part payment for property, the amount of the excess should be treated by the corporation as a capital expenditure and by the recipient as part of the purchase price.

(2) In the case of excessive payments by individuals or partnerships, the amounts disallowed should ordinarily be treated as shares of the profits of a partnership, except that a payment for property should be treated by the individual or partnership as a capital expenditure and by the recipient as part of the purchase price. (Regulations No. 45, art. 106.)

§ 151. Deductions; Contributions to Religious and Charitable Purposes

Corporations are not entitled to deduct from their gross income the amount of contributions to religious, charitable, scientific, or educational corporations or associations, although such contributions may be made to the Red Cross or to other war activities. (T. D. 2847, May 24, 1919.)

A gift to a common agency (as a war chest) for several such corporations or associations is treated like a gift directly to them. In connection with claims for this deduction there shall be stated on returns of income the name and address of each organization to which a gift was made, and the approximate date and the amount of the gift in each case. Where the gift is other than money, the basis for calculation of the amount of the gift shall be the fair market value of the property at the time given. A gift of real estate to a city to be maintained perpetually as a public park is not an allowable deduction. This article does not apply to gifts by partnerships, estates and trusts, or corporations. (Regulations No. 45, art. 251.)

§ 153. Traveling Expenses

Traveling expenses, as ordinarily understood, include railroad fares and meals and lodging. If the trip is undertaken for other than business purposes, such railroad fares are personal expenses and such meals and lodging are living expenses. If the trip is on business, the railroad fares become business instead of personal expenses, but the meals and lodging continue to be living expenses and are not deductible in computing net income. (*a*) If, then, an individual whose business requires him to travel receives a salary as full compensation for his services, without reimbursement of traveling expenses, his expenses for railroad fares, but not for meals and lodging, are deductible from gross income. (*b*) If such an individual receives a salary and is also repaid his actual traveling expenses, no part of such expenses is deductible from gross income and no part of such repayment is returnable as income. (*c*) If such an individual receives a salary and also an allowance for meals and lodging, as, for example, a per diem allowance in lieu of subsistence, any excess of the cost of such meals and lodging over the allowance is not deductible, but any excess of the allowance over the actual expenses is taxable income. Congressmen and others who receive a mileage allowance for railroad fares should return as income any excess of such allowance over their actual expenses for such fares. A payment for the use of a sample room at a hotel for the display of goods is a business expense. (Regulations No. 45, art. 292.)

§ 155. Deductions; Insurance

Premiums on business insurance.—Where the taxpayer pays premiums on an insurance policy on the life of an officer, employee or individual financially interested in the taxpayer's business, for the purpose of protecting himself from loss in the event of the death of any such person, such premiums are not deductible from his gross income. But if the taxpayer is in no sense a beneficiary under such a policy, except as he may derive advantage from the increased efficiency of the employee, and pays the premiums purely as reasonable additional compensation of such employee, they are allowable deductions. In either case whether the proceeds of such policies paid upon the death of the insured may be excluded from gross income or must be included therein depends upon whether the beneficiary is an individual or a corporation. (Regulations No. 45, art. 294.)

§ 156. Deductions; Rent of Land, Buildings, or Equipment

Where a leasehold is acquired for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. The cost of erecting buildings or permanent improvements on ground leased by a taxpayer is additional rental and is therefore a proper deduction from gross income, provided such buildings and improvements under the terms of the lease revert to the owner of the ground at the expiration of the lease. In such a case the cost will be prorated according to the number of years constituting the term of the lease. The lessee will not be permitted to deduct from gross income any depreciation with respect to such buildings, but the cost of incidental repairs necessary to keep them in an efficient condition for the purposes of their use may be deducted. If, however, the life of the improvement is less than the life of the lease, depreciation may be taken by the lessee instead of treating the cost as rent. (Regulations No. 45, art. 109.)

§ 159. Repairs, New Buildings, and Improvements

The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, should be charged against the depreciation reserve. (Regulations No. 45, art. 103.)

§ 161. Interest on Indebtedness

Interest paid by the taxpayer on a mortgage upon real estate of which he is the legal or equitable owner, even though the taxpayer is not directly liable upon the bond or note secured by such mortgage, may be deducted as interest on his indebtedness. Payments made for Maryland or Pennsylvania ground rents are not deductible as interest. (Regulations No. 45, art. 121.)

§ 162. Deductions; Interest on Bank Deposits

In the case of banks and loan or trust companies interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank or loan or trust company may be deducted from gross income. (Regulations No. 45, art. 564.)

§ 163. Deductions; Bond Discounts

Where a corporation sold its own interest-bearing bonds at a discount during the years 1906, 1907, and 1908, it cannot deduct from its gross income for the years 1909, 1910, and 1911 sums set aside by the corporation to pay such discount at the maturity of the bonds, under the provisions of section 38 of the Corporation Excise Tax Act of August 5, 1909, which authorize corporations to deduct from gross income "all losses actually sustained within the year," and also "interest actually paid within the year on bonded or other indebtedness." Southern Pac. R. Co. v. Muenter (C. C. A.) 260 Fed. 837.

§ 166. Deductions; Taxes Paid or Accrued

Federal taxes (except income, war profits and excess profits taxes), State and local taxes (except taxes assessed against local benefits of a kind tending to increase the value of the property assessed), and taxes imposed by possessions of the United States or by foreign countries (except the amount of income, war profits and excess profits taxes allowed as a credit against the tax), are deductible from gross income. Postage is not a tax. Amounts paid to States under secured debts laws in order to render securities tax exempt are deductible. Automobile license fees are ordinarily taxes. Import or tariff duties paid to the proper customs officers, and business, license, privilege, excise and stamp taxes paid to internal revenue collectors, are deductible as taxes imposed by the authority of the United States, provided they are not added to and made a part of the expenses of the business or the cost of articles of merchandise with respect to which they are paid, in which case they can not be separately deducted. (Regulations No. 45, arts. 131, 132.)

A transfer tax upon a legacy or distributive share of an estate, imposed by the laws of New York, is not an imposition upon either the property passing or the right to receive it, but a deduction from the estate of the decedent, and hence it may not be deducted from the net income of the legatee or distributee for the purpose of computing his income subject to taxation under the federal law. Prentiss v. Eisner (D. C.) 260 Fed. 589.

Meaning of terms in statute.—"Amount of * * * taxes paid during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the individual claiming credit. "Foreign country" includes within its meaning any foreign sovereign state or self-governing colony (for example, the Dominion of Canada), but does not include a foreign municipality (for example, Montreal) unless itself a sovereign State (for example, Hamburg). "Any possession of the United States" includes, among others, Porto Rico, the Philippines and the Virgin Islands. (Regulations No. 45, art. 382.)

Effect of tax-free covenant in bonds.—Corporations may deduct taxes from gross income to the same extent as individuals, except that in the case of corporate bonds or obligations containing a tax-free covenant clause, the corporation paying a federal tax, or any part of it, for some one else pursuant to its agreement is not entitled to deduct such payment from gross income on any ground. In the case, however, of corporate bonds or obligations containing an appropriate tax-free covenant clause, the corporation paying a State tax or any other than a federal tax for some one else pursuant to its agreement may deduct such payment as interest paid on indebtedness. (Regulations No. 45, art. 565.)

§ 168. Adjustment of Taxes Claimed as Accrued

In case credit has been given for taxes accrued, or a proportionate share thereof, and the amount that is actually paid on account of such taxes, or a proportionate share thereof, is not the same as the amount of such credit, or in case any tax payment credited is refunded in whole or in part, the taxpayer shall immediately notify the Commissioner. The Commissioner will thereupon redetermine the amount of the income tax of such taxpayer for the year or years for which such incorrect credit was granted. The amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the collector. The amount of tax, if any, shown by such redetermination to have been overpaid shall be credited against any income, war profits or excess profits taxes, or installment thereof, then due from such taxpayer under any other return, and any balance of such amount shall be immediately refunded to him. See section 252 of the statute. (Regulations No. 45, art. 384.)

§ 169. Taxes Paid for Stockholders

Taxes paid to a state by various corporations upon shares of their stock owned by another corporation are not deductible from the gross income of the latter corporation as taxes "paid by it," such taxes not being paid by such stockholder corporation, but being paid on its behalf by other corporations. United States v. Ætna Life Ins. Co. (U. S. Dist. Ct., D. Conn.), T. D. 2927, Sept. 30, 1919.

§ 170. Taxes; Local Assessments

A tax is considered assessed against local benefits when the property subject to the tax is limited to the property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare. The taxes deductible are those levied for the general public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction. Assessments under the statutes of California relating to irrigation and of Iowa relating to drainage, and under certain statutes of Tennessee relating to levees, are limited to property benefited, and when it is clear that the assessments are so limited, the amounts paid thereunder are not deductible as taxes. When assessments are made for the purpose of maintenance or repair of local benefits, the taxpayer may deduct the assessments paid as an expense incurred in business, if the payment of such assessments is necessary to the conduct of his business. When the assessments are made for the purpose of constructing local benefits, the payments by the taxpayer are in the nature of capital expenditures and are not deductible. Where assessments are made for the purpose of both construction and maintenance or repairs, the burden is on the taxpayer to show the allocation of the amounts assessed to the different purposes. If the allocation can not be made, none of the amounts so paid is deductible. (Regulations No. 45, art. 133, as amended by T. D. 2937, Oct. 16, 1919.)

§ 171. Losses Uncompensated

Loss of the value of corporate stock, acquired by numerous transfers of property to the corporation and payment of corporate debts, the transactions being carried on for a considerable period, and being complicated in character, and involving large sums of money, so that they must have required much time and attention, is a loss incurred in trade, which can be deducted from gross income, for the purpose of computing taxable net income. Bryce v. Keith (D. C.) 257 Fed. 133.

Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by nonresident aliens) if (*a*) incurred in the taxpayer's trade or business, or (*b*) incurred in any transaction entered into for profit, or (*c*) arising from fires, storms, shipwreck or other casualty, or from theft. They must usually be evidenced by closed and completed transactions. In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained since acquisition, or the fair market value as of March 1, 1913, if acquired before that date, less depreciation since sustained, and the price at which they were disposed of. When the loss is claimed through the destruction of property by fire, flood or other casualty, the amount deductible will be the difference between the cost of the property or its fair market value as of March 1, 1913, and the salvage value thereof, after deducting from the cost or value as of March 1, 1913, the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. But the loss should be reduced by the amount of any insurance or other compensation received. A loss in the sale of an individual's residence is not deductible. Losses in illegal transactions are not deductible. (Regulations No. 45, art. 141.)

Loss of useful value.—When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation allowances) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where machinery or other property must be replaced by a new invention, or where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. (Regulations No. 45, art. 143.)

§ 174. Abatement for Losses of Previous Year

On this subject the following regulations have been made (Regulations No. 45, arts. 261–265):

ART. 261. *Losses in inventory and from rebates.*—Taxpayers are allowed deductions from net income for the taxable year 1918 for losses resulting (*a*) from material reductions after the close of the taxable year 1918 of the values of inventories for such taxable year, and (*b*) from actual payments after the close of the taxable year 1918 of rebates in pursuance of contracts entered into during such year upon sales made during such year. The taxable year of the taxpayer, whether calendar or fiscal, is meant in every case. Such deductions may be secured by two methods, either by a claim in abatement or by a claim for refund, and must not be entered upon the regular return.

ART. 262. *Loss from rebates.*—Where after the close of the taxable year 1918 rebates have been bona fide paid in pursuance of contracts entered into during such year upon sales made during such year, the net income for that year may be reduced by the deduction of the amount of such rebates actually paid. No such deduction will be allowed unless the profits from such sales have been included in the income for the taxable year 1918.

ART. 263. *Loss in inventory.*—Inventory losses are allowable either (*a*) where goods included in an inventory at the end of the taxable year 1918 have been sold at a loss during the succeeding taxable year, or (*b*) where such goods remain unsold throughout the taxable year 1919 and at its close have a then market value (not resulting from a temporary fluctuation) materially below the value at which they were inventoried at the end of the taxable year 1918. No deduction is allowable for losses of anticipated profits or for losses not substantial in amount, nor for physical damage or obsolescence occurring in the taxable year 1919. In determining whether goods included in an inventory at the end of the taxable year 1918 have been sold during the succeeding taxable year, and whether loss has resulted therefrom, sales of goods made in the taxable year 1919 will be deemed to have been made from the inventoried stock of 1918 until such inventoried stock is exhausted.

ART. 264. *Loss where goods have been sold.*—Where goods included in the inventory at the end of the taxable year 1918 have been sold during the succeeding taxable year, the loss which may be deducted from net income for the taxable year 1918 is the amount by which the value at which the goods sold were included in the inventory exceeds the actual selling price minus a reasonable allowance for selling expenses and for manufacturing expenses, if any, incurred in the taxable year 1919 and attributable to such goods.

ART. 265. *Loss where goods have not been sold.*—Where goods included in the inventory at the end of the taxable year 1918 have not been sold during the succeeding taxable year, the loss which may be deducted from net income for the taxable year 1918 is the amount by which the net income for such year would be reduced if the inventory were redetermined and such goods taken at their market value (ignoring mere temporary fluctuations of value) at the end of the taxable year 1919.

§ 179. Amortization of Plants for War Work

On this subject the following regulations (Regulations No. 45, arts. 181–188) have been made by the Treasury Department:

ART. 181. *Scope of provision for amortization.*—Any allowance made to a taxpayer by a contracting Department of the Government or by any other contractor for amortization or fall in the value of property, either as a part of the cost of production or as a part of the price of the product, shall be included in gross income. See article 52. The amount to be allowed as a deduction from gross income for amortization for the purpose of the tax is to be based upon the provisions of articles 181 to 188, pursuant to which the deduction should be made instead of upon the basis of any amounts contractually or otherwise determined. The allowance for amortization covers the decline in value of the property subject thereto and is inclusive of the depreciation which would ordinarily be allowable separately. Depreciation for any taxable period after December 31, 1917, should, therefore, not be claimed with respect to property as to which an allowance for amortization is claimed. See also section 204 of the statute and articles 1601–1603.

ART. 182. *Property cost of which may be amortized.*—The taxpayer may make a reasonable deduction from gross income not in excess of a sum sufficient to extinguish the cost of buildings, machinery, equipment or other facilities constructed, erected, installed or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war. In the case of property the construction or installation of which was commenced before April 6, 1917, and completed subsequently to that date, amortization will be allowed with respect only to the cost incurred on or after April 6, 1917.

ART. 183. *Cost recoverable through amortization.*—The total amount to be extinguished by amortization, in general, is the excess of the unextinguished or unrecovered cost of the property over its maximum value (either for sale or for use as part of the plant or equipment of a going business) under stable postwar conditions. Under the provisions of the statute authorizing reexamination of the claim at any time within three years after the termination of the present war, the allowance will be finally determined upon such basis. However, in many cases it will be impracticable during the calendar year 1919 to make final determination either of the length of the amortization period or of the value of the property under stable postwar conditions. Consequently, in returns made during the calendar year 1919 the amortization allowance will tentatively be determined in accordance with articles 184 and 185.

ART. 184. *Cost which may be amortized.*—For the purpose of making returns in 1919 the total amount to be extinguished by amortization is the difference between the value of the property on the bases indicated below and the original cost of the property less any amounts otherwise deducted for depreciation, losses, etc., prior to January 1, 1918; or in the case of property acquired or completed after December 31, 1917, it is the difference between the value of the property on the bases indicated below and the cost of such property at the date of acquisition or completion.

(1) In the case of property useful only during the war period and permanently discarded at the date of the return the basis is the salvage value as of the date when the property was discarded.

(2) In the case of property still in use which will not be required for the future use of the business and which is certain to be permanently discarded before the last installment payment of the tax covered by the return the basis is the salvage value as of the date when the property will be permanently discarded.

(3) In the case of other property the basis is the estimated reproduction cost as of April, 1919, of such property in its then condition. In the final determination such cost will be ascertained under stable postwar conditions, without reference to such date.

A special record of all property falling in classes (1) and (2) must be preserved by the taxpayer and the Commissioner must be promptly advised (*a*) if such property is restored to use; (*b*) the selling price if sold; and (*c*), if still on hand and not in use at the close of the three year period, the reasons why such property has not been disposed of.

ART. 185. *Method of amortization.*—For the purpose of making returns in 1919 the amount to be extinguished by amortization shall be spread in proportion to the net income (computed without benefit of the amortization allowance) between January 1, 1918, and the following dates: (*a*) if the claim is based on subdivision (1) of article 184, the date when the property was permanently discarded; (*b*) if the claim is based on subdivision (2) of article 184, the date upon which the property will be permanently discarded; and (*c*) if the claim is based upon subdivision (3) of article 184, April, 1919. All taxpayers claiming an allowance for amortization will be required to estimate the amount of their net income for the period between January 1, 1918, and the dates specified above, and also to estimate what part of such net income is properly allocable to the calendar year 1918 and what part thereof is properly allocable to the calendar year 1919. Such estimates shall be the basis for apportioning the amounts to be extinguished by amortization between the calendar years 1918 and 1919. Taxpayers reporting on the fiscal year basis (*a*) in all computations based upon 1918 rates shall use the amount of such allowance apportioned to the calendar year 1918; (*b*) in any computation based upon 1919 rates for a year beginning in 1918 and ending in 1919 shall use the amount of such allowance apportioned to the calendar year 1919; and (*c*) in any computation for a fiscal year beginning in 1919 shall use as many twelfths of the allowance apportioned to the calendar year 1919 as there are months of such fiscal year falling in the calendar year 1919.

ART. 186. *Additional requirements for amortization.*—Claims for amortization must be unmistakably differentiated in the return from all other claims for wear, tear, obsolescence and loss. No such claim will be allowed unless it is reflected in any accounts submitted by the taxpayer to stockholders and in any credit statements by the taxpayer to banks, and is given full effect on his financial books of account. If Government or other contracts taken by the taxpayer contained recognition of amortization as an element in the cost of production, copies of such contracts shall be filed with the taxpayer's return, together with a statement and description of any sums received on account of amortization and the basis upon which they were determined. In any case in which an allowance has been made for amortization of cost the taxpayer will not be allowed to restore to his invested capital for the purpose of the war profits and excess profits tax any portion of the amount covered by such allowance.

ART. 187. *Redetermination of amortization allowance.*—A redetermination of the deduction allowed on account of amortization may, or at the request of the taxpayer shall, be made by the Commissioner at any time within three years after the termination of the present war, and if as a result of an appraisal or from other evidence it is found that the deduction originally allowed was incorrect, the amount of tax due for each taxable year during the amortization period will be adjusted by additional assessment or by refund.

ART. 188. *Information to be furnished by taxpayer.*—To obtain the benefit of this provision of the statute the taxpayer must establish to the satisfaction of the Commissioner that the entire deduction claimed and the proportion claimed for any particular year are reasonable. The taxpayer shall also submit a supplementary statement setting forth the following information: (*a*) a description of the property in reasonable detail; (*b*) the date or dates on which the property was acquired, and from whom, or, if constructed, erected or installed by the taxpayer, the dates on which such construction, erection or installation was begun and completed; (*c*) evidence establishing the intention of the taxpayer on and after April 6, 1917, or on and after the date of acquisition or the date of beginning construction, erection or installation, to devote such property or vessels to the production of articles (or, in the case of vessels, the transportation of articles or men) contributing to the prosecution of the present war; (*d*) the cost of construction, erection, installation or acquisition; (*e*) the value of the property after termination of the amortization period; (*f*) a segregation of the property permanently discarded, or of the property which will be permanently discarded before the last installment payment covered by the return; (*g*) all deductions from gross income otherwise taken or claimed with respect to such property; (*h*) the computation by which the total amount to be extinguished by amortization was determined; and (*i*) the computation by which the proportion of the amortization charge claimed as a deduction in the taxable year for which the return is being made was determined.

§ 182. Deductions; Worthless Debts

Only the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim may be deducted as a bad debt. The difference between the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate and the amount of his claim may be considered a worthless debt. A purchaser of accounts receivable which cannot be collected and are consequently charged off the books as bad debts is entitled to deduct them, the amount of deduction to be based upon the price he paid for them and not upon their face value. (Regulations No. 45, art. 152.)

Worthless securities.—Bonds purchased since February 28, 1913, when ascertained to be worthless, may be treated as bad debts to the amount actually paid for them, but not exceeding their amortized value if purchased at a premium. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent year. To authorize a deduction for a bad debt on account of notes held prior to March 1, 1913, their value on that date must be established. (Idem., art. 154.)

§ 188. Depreciation; Rulings and Decisions

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. (Regulations No. 45, art. 163.)

§ 193. Depreciation of Patents

The revised ruling of the Treasury Department on this subject (Regulations No. 45, art. 167) is as follows: In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced is the cost (not already deducted as current expense) of the patent or copyright or its fair market value as of March 1, 1913, if acquired prior thereto. The allowance should be computed by an apportionment of the cost of the patent or copyright or of its fair market value as of March 1, 1913, over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or since March 1, 1913, as the case may be. If the patent or copyright was acquired from the Government, its cost consists of the various Government fees, cost of drawings, experimental models, attorney's fees, etc., actually paid. If a corporation purchased a patent and paid for it in stock or securities, its cost is the fair market value of the stock or securities at the time of the purchase. Depreciation of a patent can be taken on the basis of the fair market value as of March 1, 1913, only when affirmative and satisfactory evidence of such value is offered. Such evidence should whenever practicable be submitted with the return. If the patent becomes obsolete prior to its expiration such proportion of the amount on which its depreciation may be based as the number of years of its remaining life bears to the whole number of years intervening between the date when it was acquired and the date when it legally expires may be deducted, if permission so to do is specifically secured from the Commissioner. Owing to the difficulty of allocating to a particular year the obsolescence of a patent, such permission will be granted only if affirmative and satisfactory evidence that the obsolescence occurred in the year for which the return is made is submitted to the Commissioner. The fact that depreciation has not been taken in prior years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable.

§§ 194, 195. Depletion of Mines and Oil and Gas Wells

The revised and complete regulations of the Treasury Department on this subject (contained in Regulations No. 45, arts. 201–226) are as follows:

ART. 201. *Depletion of mines, oil and gas wells.*—A reasonable deduction from gross income for the depletion of natural deposits and for the depreciation of improvements is permitted, based (*a*) upon cost, if acquired after February 28, 1913, or (*b*) upon the fair market value as of March 1, 1913, if acquired prior thereto, or (*c*) upon the fair market value within 30 days after the date of discovery in the case of mines, oil and gas wells discovered by the taxpayer after February 28, 1913, where the fair market value is materially disproportionate to the cost. The essence of this provision is that the owner of such property, whether it be a leasehold or freehold, shall secure through an aggregate of annual depletion and depreciation deductions a return of the amount of capital invested by him in the property, or in lieu thereof an amount equal to the fair market value as of March 1, 1913, of the properties owned prior to that date, or an amount equal to the fair market value within 30 days after the date of discovery of mines, oil or 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; plus in any case the subsequent cost of plant and equipment (less salvage value) and underground and overground development, which is not chargeable to current operating expense, but not including land values for purposes other than the extraction of minerals. Operating owners, lessors and lessees are entitled to deduct an allowance for depletion, but a stockholder in a mining or oil or gas corporation is not.

ART. 202. *Capital recoverable through depletion allowance in the case of owner.*—In the case of an operating owner in fee or a lessor the capital remaining in any year recoverable through depletion allowances is the sum of (*a*) the cost of the property, or its fair market value as of March 1, 1913, or its fair market value within 30 days after discovery, as the case may be, plus (*b*) the cost of subsequent improvements and development not charged to current operating expenses, but minus (*c*) deductions for depletion which has or should have been taken to date and (*d*) the portion of the capital account, if any, as to which depreciation has been and is being deducted instead of depletion. The value of the surface of the land should be taken into consideration. In no case, however, may a lessor include in his capital recoverable through such an allowance any part of development costs not borne by the lessor nor any part of the discovery value.

ART. 203. *Capital recoverable through depletion allowance in the case of lessee.*—In the case of a lessee the capital remaining in any year recoverable through depletion allowances is the sum of (*a*) the cost of the leasehold, or its fair market value as of March 1, 1913, or its fair market value within 30 days after discovery, as the case may be, plus (*b*) the cost of subsequent improvements and development not charged to current operating expenses, but minus (*c*) deductions for depletion which has or should have been taken to date and (*d*) the portion of the capital account, if any, as to which depreciation has been and is being deducted instead of depletion. Any annual or periodical rents or royalties supplementing the bonus or other amount paid for the lease may be charged to current operating expenses or, until the property reaches the operating stage, to capital account, and in the latter event will form part of the capital returnable through deductions for depletion.

ART. 204. *Apportionment of deductions between lessor and lessee.*—As the value of property comprehends the interests of both lessor and lessee, no computation, for the purpose of depletion allowances, of the value of these interests separately as of any date which combined exceeds the value of the property in fee simple will be permitted. The same principle applies to holders of fractional interests. If the aggregate deduction claimed is deemed excessive, the Commissioner may request the owner or lessee to show that the valuation claimed does not exceed the fair market value of the property at a specified date determined in the manner explained in article 206. The lessor and lessee shall, with the approval of the Commissioner, equitably apportion the allowance in the light of the peculiar conditions in each case and on the basis of their respective interests therein. To the return of every taxpayer claiming an allowance for depletion in respect of (*a*) property in which he owns a fractional interest only or (*b*) a leasehold or (*c*) property subject to a lease, there shall be attached a statement setting forth the name and address and the precise nature of the holdings of each person interested in the property.

ART. 205. *Determination of cost of deposits.*—In any case in which a depletion or depreciation deduction is computed on the basis of the cost or price at which any mine, mineral deposit, mineral right or leasehold was acquired, the owner or lessee will be required upon request of the Commissioner to show that the cost or price at which the property was bought was fixed for the purpose of a bona fide purchase and sale, by which the property passed to an owner in fact as well as in form different from the vendor. No fictitious or inflated cost or price will be permitted to form the basis of any calculation of a depletion or depreciation deduction, and in determining whether or not the price or cost at which any purchase or sale was made represented the actual market value of the property sold, due weight will be given to the relationship or connection existing between the person selling the property and the buyer thereof.

ART. 206. *Determination of fair market value of deposits.*—Where the fair market value of the property at a specified date in lieu of the cost thereof is the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the Commissioner, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or in methods of mining or extraction. The value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date. No rule or method of determining the fair market value of mineral property is prescribed, but the Commissioner will lend due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, market value of stock or shares, royalties and rentals, value fixed by the owner for purposes of the capital stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in probate court, disinterested appraisals by approved methods, and other factors.

ART. 207. *Revaluation of deposits not allowed.*—The cost of the property or its fair market value at a specified date, as the case may be, plus subsequent charges to capital account not deductible as current expense, will be the basis for determining the depletion and depreciation deductions for each year during the continuance of the ownership under which the fair market value or cost was fixed, and during such ownership there can be no revaluation for the purpose of this deduction. This rule will not forbid the redistribution of the capital account over the estimated number of units remaining in the property in accordance with either of the next two articles.

ART. 208. *Determination of quantity of ore in mine.*—Every taxpayer claiming a deduction for depletion will be required to estimate with respect to each separate property the total units (tons, pounds, ounces, or other units) of ores and minerals reasonably known or on good evidence believed to have existed in the ground on March 1, 1913, or on the date of acquisition of the property, or within 30 days after the date of discovery, as the case may be. In estimating the total units of ores and minerals for purposes of depletion the property must be considered in the condition in which it was on March 1, 1913, or the date of acquisition, or within 30 days after the date of discovery, but if subsequently during the ownership of the taxpayer making the return additional recoverable mineral deposits have been discovered or developed which were not taken into account in estimating the number of units for purposes of depletion, or if it shall be discovered by working, development or exploration that ground previously estimated to contain commercially recoverable mineral is barren or contains only commercially unworkable mineral, a new estimate of the recoverable units of ores or minerals (but not of the cost or fair market value at a specified date) shall be made and when made shall thereafter constitute a basis for depletion. In the selection of the unit of estimate the custom or practice applicable to the type of mineral deposit and the character of the operations thereon should be considered. The estimate of the recoverable units of ores or minerals for the purpose of depletion shall include (*a*) the ores and minerals "in sight," "blocked out," "developed," or "assured," in the usual or conventional meaning of these terms in respect to the type of deposit, and may also include (*b*) "prospective" or "probable" ores and minerals (in the same sense), that is, ores and minerals that are believed to exist on the basis of good evidence, although not actually known to occur on the basis of existing development; but "probable" or "prospective" ores and minerals may be computed for purposes of depletion only as extensions of known deposits into undeveloped ground.

ART. 209. *Determination of quantity of oil in ground.*—In the case of either an owner or lessee it will be required that an estimate, subject to the approval of the Commissioner, shall be made of the probable recoverable oil contained in the territory with respect to which the investment is made as of the time of purchase, or as of March 1, 1913, if acquired prior to that date, or within 30 days after the date of discovery, as the case may be. The oil reserves must be estimated for all undeveloped proven land as well as producing land. If information subsequently obtained clearly shows the estimate to have been materially erroneous, it may be revised with the approval of the Commissioner.

ART. 210. *Computation of allowance for depletion of mines and oil wells.*—When the cost or value as of March 1, 1913, or within 30 days after the date of discovery of the property shall have been determined, and the number of mineral units in the property as of the date of acquisition or valuation shall have been estimated, the division of the former amount by the latter figure will give the unit value for purposes of depletion, and the depletion allowance for the taxable year may be computed by multiplying such unit value by the number of units of mineral extracted during the year. If, however, proper additions are made to the capital account represented by the original cost or value of the property, or unforeseen circumstance necessitate a revised estimate of the number of mineral units in the ground, a new unit value for purposes of depletion may be found by dividing the capital account at the end of the year, less deductions for depletion to the beginning of the taxable year which have or should have been taken, by the number of units in the ground at the beginning of the taxable year. This number, unless a revision of the original estimate has been necessary, will equal the number of units in the ground at the date of original acquisition or valuation less the number extracted prior to the taxable year. If, however, a recalculation is needed, the number of units at the beginning of the year will be the sum of the gross production of the year and the estimated mineral reserves in the property at the end of the year.

ART. 211. *Computation of allowance for depletion of gas wells.*—On account of the peculiar conditions surrounding the production of natural gas it will be necessary to compute the depletion allowances for gas properties by methods suitable to the particular cases in question and acceptable to the Commissioner. Usually, the depletion of natural gas properties should be computed on the basis of decline in closed or rock pressure, taking into account the effects of water encroachment and any other modifying factors. The gas producer will be expected to compute the depletion as accurately as possible and submit with his return a description of the method by which the computation was made. The following formula, in which the units of gas are pounds per square inch of closed pressure, may be used and is recommended: the quotient of the capital account recoverable through depletion allowances to the end of the taxable year, divided by the sum of the pressures at the beginning of the year less the sum of the pressures at the time of expected abandonment (which quotient is the unit cost), multiplied by the sum of the pressures at the beginning of the taxable year plus the sum of the pressures of new wells less the sum of the pressures at the end of the tax year, equals the depletion allowance.

ART. 212. *Gas well pressure records to be kept.*—Beginning with 1919 closed pressure readings of representative wells, if not of all wells, must be carefully made and kept. In order to standardize pressure readings the well should remain closed until the pressure does not build up more than 1 per cent. of the total pressure in ten minutes. Ordinarily 24 hours will suffice for this purpose, but some wells will need to remain closed for a longer period. If there is any water in the well it should be blown or pumped off before the well is closed. A closed pressure reading of a gas well which has been producing, or is near gas wells that have been producing, is lower than the actual pressure of the gas in the reservoir by an amount depending on the well's location with reference to other producing wells and the length of time it has been closed in. It is necessary to record the length of time the well has been closed and to show how the pressure built up during this period. Successive readings will indicate the point at which the pressure becomes approximately stationary, that is, the point at which the closed pressure approaches as nearly as possible the maximum pressure which would be shown if all wells in the pool were closed for several months. The length of time required varies with the character of the sand, position of the packer, the location of the well with reference to other wells, the limits of the pool, and other factors. The depth of the well, diameter of tubing, and line pressure when the well was shut off, should be noted. Since readings at the exact end of the taxable year will ordinarily not be available, the pressure of that date may be obtained by interpolation or extrapolation. In certain cases readings taken regularly in September or some other month may be applicable to the end of the taxable year. As a general rule September closed pressure readings furnish the best indication of depletion and it is recommended that such readings be made with regularity and care. Where interpolated or extrapolated readings are used the data from which they are obtained should be given. Gauges should be of appropriate capacity and should be frequently tested. A record should be kept of the number of gauges, date each was tested, names of men testing, and other significant details.

ART. 213. *Computation of allowance where quantity of oil or gas uncertain.*—If by reason of the youth of the field, the restricted production, or for any other cause, it is not possible to determine with any degree of certainty the quantity of oil or gas in a property, it will be necessary to make a tentative estimate which will apply until production figures are available from which an accurate determination may be made.

ART. 214. *Computation of depletion allowance for combined holdings of oil and gas wells.*—(1) The recoverable oil belonging to the taxpayer shall be estimated separately on the smallest unit on which data are available, such as individual wells or tracts, and these added together into a grand total to be applied to the total capital account returnable through depletion. The capital account shall include the cost or value, as the case may be, of all oil or gas leases or rights within the United States and its possessions, plus all incidental costs of development not charged as expense nor returnable through depreciation. The unit value of the total recoverable oil or gas is the quotient obtained by dividing the total capital account recoverable through depletion by the total estimated recoverable oil or gas. This unit multiplied by the total number of units of oil or gas produced by the taxpayer during the taxable year from all of the oil and gas properties will determine the amount which may be allowably deducted from the gross income of that year.

(2) In the case of the gas properties of a taxpayer the depletion allowance for each pool may be computed by using the combined capital account returnable through depletion of all the tracts of gas land owned by the taxpayer in the pool and the average decline in rock pressures of all the taxpayer's wells in such pool in the formula given in article 211. The total allowance for depletion of the gas properties of the taxpayer will be the sum of the amounts computed for each pool.

ART. 215. *Depletion of mine based on advance royalties.*—Where the owner has leased a mining property for a term of years with a requirement in the lease that the lessee shall mine and pay for annually a specified number of tons or other agreed units of measurement of such mineral, or shall pay annually a specified sum of money which shall be applied in payment of the purchase price or agreed royalty per unit of such mineral whenever the same shall thereafter be mined and removed from the leased premises, the value in the ground to the lessor for purposes of depletion of the number of units so paid for in advance of mining will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the mining or removal in such year of any ore or mineral so paid for in advance and for which deduction has been once made. If for any reason any such mining lease shall be terminated before the ore or mineral therein which has been paid for in advance has been mined and removed, and the lessor repossesses the leased property, an amount equal to the aggregate deductions for depletion allowed in respect of ore or mineral not mined and removed by the lessee, but still in the ground, will be deemed income to the lessor and will be returned as such for the year in which the property is repossessed.

ART. 216. *Depletion and depreciation accounts on books.*—Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate ledger accounts in which shall be charged the fair market value as of March 1, 1913, or within 30 days after the date of discovery, or the cost, as the case may be, (*a*) of the property, and (*b*) of the plant and equipment, together with such amounts expended for development of the property or additions to plant and equipment since that date as have not been deducted as expense in his returns. These accounts shall be credited with the amount of the depreciation and depletion deductions claimed and allowed each year, or the amount of the depreciation and depletion shall be credited to depletion and depreciation reserve accounts, to the end that when the sum of the credits for depletion and depreciation equals the value or cost of the property, plus the amount added thereto for development or additional plant and equipment, less salvage value of the physical property, no further deduction for depletion and depreciation with respect to the property will be allowed. If dividends are paid out of a depletion or depreciation reserve, the stockholders must be expressly notified that the dividend is a return of capital and not an ordinary dividend out of profits. See article 1549.

ART. 217. *Statement to be attached to return where depletion of mine claimed.*—To the return of the taxpayer claiming a deduction for depletion or depreciation or both there should be attached a statement setting out: (*a*) whether the owner is a fee owner or lessee or both; (*b*) a description of the property owned in fee, if any, and a description of the leasehold property, if any, including the date of acquisition and the date of expiration of the lease; (*c*) the fair market value as of March 1, 1913, or within 30 days of the date of discovery, or the cost, as the case may be, of the property owned in fee and the leasehold property, together with a statement of the precise method by which the value or the cost of freehold and leasehold property was determined; (*d*) the estimated number of units of mineral or ore at the date of acquisition or of valuation in the property owned in fee and in the leasehold property separately, together with an explanation of the method used in estimating in each case the number of units of mineral or ore for purposes of depletion; (*e*) the amount of capital applicable to each unit; (*f*) the number of units removed and sold during the year for which the return was made; (*g*) the total amount deducted on account of depletion and on account of depreciation, stated separately, up to the taxable year during the ownership of the taxpayer; and (*h*) any other data which would be helpful in determining the reasonableness of the depletion and depreciation deductions claimed in the return.

ART. 218. *Statement to be attached to return where depletion of oil or gas claimed.*—To each return made by a person owning or operating oil or gas properties, there should be attached a statement showing for each property the following information, which may be given in the form of a table, if desired, by taxpayers owning more than one property: (*a*) the fair market value of the property (exclusive of machinery, equipment, etc., and the value of the surface rights) as of March 1, 1913, if acquired prior to that date; or the fair market value of the property within 30 days after the date of discovery; or the actual cost of the property, if acquired subsequently to February 28, 1913, and not covered by the foregoing clause; (*b*) how the fair market value was ascertained, if the property came under the first or second head under (*a*); (*c*) the estimated quantity of oil or gas in the property at the time that the value or cost was determined; (*d*) the name and address of the person making the estimate and the manner in which this estimate was made, including a summary of the calculations; (*e*) the amount of capital applicable to each unit (this being found by dividing the value or cost, as the case may be, by the estimated number of units of oil or gas in the property at the time the value or cost was determined); (*f*) the quantity of oil or gas produced during the year for which the return is made (in the case of new properties it is desirable that this information be furnished by months); (*g*) the number of acres of producing and proven oil or gas land; (*h*) the number of wells producing at the beginning and end of the taxable year; (*i*) the date of completion of wells finished during the taxable year; (*j*) the date of abandonment of all wells abandoned during the taxable year; (*k*) a property map showing the location of the property and of the producing and abandoned wells, dry holes, and proven oil and gas land; (*l*) the average gravity of the oil produced on the tract; (*m*) the number of pay sands and average thickness of each pay sand or zone on the property; (*n*) the average depth to the top of each of the different pay sands; (*o*) any data regarding change in operating conditions, such as flooding, use of compressed air, vacuum, shooting, etc., which have a direct effect on the production of the property; (*p*) the monthly or annual production of individual wells and the initial daily production of new wells (this is highly desirable information and should be furnished wherever possible); (*q*) (for the first year in which the above information is filed for a property which was producing prior to the taxable year covered by the above statement the following information must be furnished) annual production of the tract or of the individual wells, if the latter information is available, from the beginning of its productivity to the beginning of the taxable year for which the return was filed; the average number of wells producing during each year; and the initial daily production of each well; and (*r*) any other data which will be helpful in determining the reasonableness of the depletion deduction. When a taxpayer has filed adequate maps with the Commissioner he may be relieved of filing further maps of the same properties, provided all additional information necessary for keeping the maps up to date is filed each year. This includes records of dry holes, as well as producing wells, together with logs, depth and thickness of sands, location of new wells, etc. By "production" is meant the net production of oil or gas belonging to the taxpayer. In those leases where no account is kept of the oil or gas used for fuel, the production will necessarily be that remaining after the fuel used in the property has been taken out. In cases of this kind an estimate of the fuel used from each tract should be given for each year.

ART. 219. *Discovery of mine.*—The discovery of a mine or a natural deposit of mineral, whether it be made by an owner of the land or by a lessee, shall be deemed to mean (*a*) the bona fide discovery of a commercially valuable deposit of ore or mineral of a value materially in excess of the cost of discovery in natural exposure or by drilling or other exploration conducted above or below ground, or (*b*) the development and proving of a mineral or ore deposit which has been abandoned or apparently worked out, or sold, leased or otherwise disposed of, by an owner or lessee prior to the development of a body of ore or mineral of sufficient size, quality and character to determine it, in connection with the physical and geological conditions of its occurrence, to be a mineable deposit of ore or mineral having a value materially in excess of the cost of the proving and development. In determining whether a discovery has been made the Commissioner will take into account the peculiar conditions of the case, and every taxpayer claiming the value of a mineral deposit on the date of discovery or within 30 days thereafter for purposes of depletion will be required to attach to his return a statement setting forth the conditions and circumstances of the discovery and the size, character and location of the deposit, together with the cost of discovery, its value and the precise method used in determining the value.

ART. 220. *Oil and gas wells.*—Section 214 (a) (10) and section 234 (a) (9) provide that taxpayers who discover oil and gas wells on or after March 1, 1913, may, under the circumstances therein prescribed, determine the fair market value of such property at the date of discovery or within 30 days thereafter for the purpose of ascertaining allowable deductions for depletion. Before such valuation may be made the statute requires that two conditions precedent be satisfied, (1) that the fair market value of such property (oil and gas wells) on the date of discovery or within 30 days thereafter became materially disproportionate to the cost, by virtue of the discovery, and (2) that such oil and gas wells were not acquired as the result of purchase of a proven tract or lease.

ART. 220 (a). *Discovery—Proven tract or lease—Property—Disproportionate value.*—(1) For the purpose of these sections of the revenue act of 1918, an oil or gas well may be said to be discovered when there is either a natural exposure of oil or gas, or a drilling that discloses the actual and physical presence of oil or gas in quantities sufficient to justify commercial exploitation. Quantities sufficient to justify commercial exploitation are deemed to exist when the quantity and quality of the oil or gas so recovered from the well are such as to afford a reasonable expectation of at least returning the capital invested in such well through the sale of the oil or gas, or both, to be derived therefrom.

(2) A proven tract or lease may be a part or the whole of a proven area. A proven area for the purposes of this statute shall be presumed to be that portion of the productive sand or zone or reservoir included in a square surface area of 160 acres having as its center the mouth of a well producing oil or gas in commercial quantities. In other words, a producing well shall be presumed to prove that portion of a given sand, zone, or reservoir which is included in an area of 160 acres of land, *regardless of private boundaries.* The center of such square area shall be the mouth of the well, and its sides shall be parallel to the section lines established by the United States system of public land surveys in the district in which it is located. Where a district is not covered by the United States land surveys, the sides of said area shall run north and south, east and west.

So much of a taxpayer's tract or lease which lies within an area proven either by himself or by another is "a proven tract or lease" as contemplated by the statute, and the discovery of a well thereon will not entitle such taxpayer to revalue such well for the purpose of depletion allowances, unless the tract or lease had been acquired before it became proven. And even though a well is brought in on a tract or lease not included in a proven area as heretofore defined, nevertheless it may not entitle the owner of the tract or lease in which such well is located to revaluation for depletion purposes, if such tract or lease lies within a compact area which is immediately surrounded by proven land, and the geologic structural conditions on or under the land so inclosed may reasonably warrant the belief that the oil or gas of the proven area extends thereunder. Under such circumstances the entire area is to be regarded as proven land.

(3) The "property" which may be valued after discovery is the "well." For the purposes of these sections the "well" is the drill hole, the surface necessary for the drilling and operation of the well, the oil or gas content of the particular sand, zone, or reservoir (limestone, breccia, crevice, etc.) in which the discovery was made by the drilling and from which the production is drawn, to the limit of the taxpayer's private bounding lines, but not beyond the limits of the proven area as heretofore provided.

(4) A taxpayer to be entitled to revalue his property after March 1, 1913, for the purpose of depletion allowances must make a discovery after said date and such discovery must result in the fair market value of the property becoming disproportionate to the cost. The fair market value of the property will be deemed to have become disproportionate to the cost when the output of such well of oil or gas affords a reasonable expectation of returning to the taxpayer an amount materially in excess of the cost of the land or lease if acquired since March 1, 1913, or its fair market value on March 1, 1913, if acquired prior thereto, plus the cost of exploration and development work to the time the well was brought in.

ART. 221. *Proof of discovery of oil and gas wells.*—In order to meet the requirements of the preceding article to the satisfaction of the commissioner, the taxpayer will be required, among other things, to submit the following with his return: (*a*) a map of convenient scale, showing the location of the tract and discovery well in question and of the nearest producing well, and the development for a radius of at least 3 miles from the tract in question, both on the date of discovery and on the date when the fair market value was set; (*b*) a certified copy of the log of the discovery well, showing the location, the date drilling began, the date of completion and beginning of production, the formations penetrated, the oil, gas, and water sands penetrated, the casing record, including the record of perforations, and any other information tending to show the condition of the well and the location of the sand or zone from which the oil or gas is produced on the date the discovery was claimed; (*c*) a sworn record of production, clearly proving the commercial productivity of the discovery well; (*d*) a sworn copy of the records, showing the cost of the property; and (*e*) a full explanation of the method of determining the value on the date of discovery or within 30 days thereafter, supported by satisfactory evidence of the fairness of this value. (T. D.

2956, Dec. 2, 1919, substituting the foregoing articles 220 and 221 for the corresponding articles in Regulations No. 45, as originally issued.)

ART. 222. *Charges to capital and to expense in the case of mine.*—In the case of mining operations all expenditures for plant, equipment, development, rent and royalty prior to production, and thereafter all major items of plant and equipment, shall be charged to capital account for purposes of depletion and depreciation. After a mine has been developed and equipped to its normal and regular output capacity, however, the cost of additional minor items of equipment and plant, including mules, motors, mine cars, trackage, cables, trolley wire, fans, small tools, etc., necessary to maintain the normal output because of increased length of haul or depth of working consequent on the extraction of mineral, and the cost of replacements of these and similar minor items of worn-out and discarded plant and equipment, may be charged to current expense of operations, unless the taxpayer elects to write off such expenditures through charges for depreciation.

ART. 223. *Charges to capital and to expense in the case of oil and gas wells.*—Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as an operating expense or charged to the capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. The cost of drilling nonproductive wells may at the option of the operator be deducted from gross income as an operating expense or charged to capital account returnable through depletion and depreciation as in the case of productive wells. An election once made under this option will control the taxpayer's returns for all subsequent years. Casing-head gas contracts have been construed to be tangible assets and their cost may be added to the capital account returnable through depletion, following the rate set by the oil wells from which the gas is derived, or, if the life of the contract is shorter than the reasonable expectation of the life of the wells furnishing the gas, the capital invested in the contract may be written off through yearly allowances equitably distributed over the life of the contract. All oil produced during the taxable year, whether sold or unsold, must be considered in the computation of the depletion allowance for that year. In computing net income all oil in storage at the beginning and at the end of the taxable year must be inventoried at cost, that is, unit cost plus lifting cost. Where deductions for depreciation or depletion have either on the books of the taxpayer or in his returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return.

ART. 224. *Depreciation of improvements in the case of mine.*—It shall be optional with the taxpayer, subject to the approval of the Commissioner, (*a*) whether the cost or value of the mining property, including ores and minerals, plant and equipment, and charges and additions to capital account not charged to expense and deducted as expense on the returns of the taxpayer, shall be recovered at a rate established by current exhaustion of mineral, or (*b*) whether the cost or value of the mineral and charges to capital account of expenditures other than for physical property shall be recovered by appropriate charges based on depletion and the cost or value of plant and equipment shall be recovered by reasonable charges for depreciation calculated by the usual rules for depreciation or according to the peculiar conditions of the taxpayer's case by a method satisfactory to the Commissioner. Nothing in these regulations shall be interpreted to mean that the value of a mining plant and equipment may be reduced by depreciation or depletion deductions to a sum below the value of the salvage when the property shall have become obsolete or shall have been abandoned for the purpose of mining, or that any part of the value of land for purposes other than mining may be recoverable through depletion or depreciation.

ART. 225. *Depreciation of improvements in the case of oil and gas wells.*—Both owners and lessees operating oil or gas properties will, in addition to and apart from the deduction allowable for the depletion or return of capital 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 fair market value as of March 1, 1913, 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. Accordingly, where it can be shown to the satisfaction of the Commissioner that the reasonable expectation of the economic life of the oil or gas deposit with which the property is connected is shorter than the normal useful life of the physical property, the amount annually deductible for depreciation may for such property be based upon the length of life of the deposit. See articles 161–170.

ART. 226. *Depletion and depreciation of oil and gas wells in years before 1916.*—If upon examination it is found that in respect of the entire drilling cost of wells, including physical property and incidental expenses, between March 1, 1913, and December 31, 1915, a taxpayer has been allowed a reasonable deduction sufficient to provide for the elements of exhaustion, wear and tear, and depletion, it will not be necessary to reopen the returns for years prior to 1916 in order to show separately in these years the portions of such deduction representing depletion and depreciation, respectively. Such separation will be required to be made of the reserves for depreciation on January 1, 1916, and proper allocation between depreciation and depletion must be maintained after that date. In any case in which it is found that the deductions taken between March 1, 1913, and December 31, 1915, are not reasonable, amended returns may be required for these years.

§ 196. Depreciation of Timber Lands

New and revised regulations on this subject have been promulgated by the Treasury Department, in Regulations No. 45, arts. 227–233, as follows:

ART. 227. *Depletion of timber.*—A reasonable deduction from gross income for the depletion of timber and for the depreciation of improvements is permitted, based (*a*) upon cost if acquired after February 28, 1913, or (*b*) upon the fair market value as of March 1, 1913, if acquired prior thereto. The essence of this provision is that the owner of timber property, whether it be a leasehold or a freehold, shall secure through an aggregate of annual depletion and depreciation deductions a return of the amount of capital invested by him in the property, or in lieu thereof an amount equal to its fair market value as of March 1, 1913, plus in any case the subsequent cost of plant, equipment and development which is not chargeable to current operating expenses, but not including cut-over land values.

ART. 228. *Capital recoverable through depletion allowance in the case of timber.*—In general, the capital remaining in any year recoverable through depletion allowances may be determined as indicated in articles 202 and 203. In the case of leases the apportionment of deductions between the lessor and lessee should be made as specified in article 204. Where it becomes necessary to determine the cost or fair market value as of March 1, 1913, of the property, the rules laid down in articles 205 and 206 should be followed so far as possible.

ART. 229. *Computation of allowance for depletion of timber.*—An allowance for the depletion of timber in any taxable year shall be based upon the number of feet of stumpage cut during the year and the unit cost of the stumpage at the date of acquisition or the unit market value on March 1, 1913, if acquired prior thereto. The unit market value as of March 1, 1913, shall be the unit price at which the standing timber in its then condition and in view of its then environment could have been sold for cash or its equivalent. The amount of the deduction for depletion in any taxable year shall be the product of the number of feet of stumpage cut during the year multiplied by such unit cost or market value of the stumpage.

ART. 230. *Revaluation of stumpage not allowed.*—The fair market value of stumpage when determined as of March 1, 1913, for the purpose of depletion allowances in the case of timber acquired prior thereto, shall be the basis for determining the depletion deduction for each year during the continuance of the ownership under which the fair market value of the stumpage was fixed, and during such ownership there can be no redetermination of the fair market value of the stumpage for such purpose. However, the unit market value of stumpage adopted by the taxpayer may subsequently be changed if from any cause such value, if continued as a basis of depletion, should upon evidence satisfactory to the Commissioner be found inadequate or excessive for the extinguishment of the fair market value of the timber as of March 1, 1913.

ART. 231. *Charges to capital and to expense in the case of timber.*—In the case of timber operations all expenditures for plant, equipment, development, rent and royalty prior to production, and thereafter all major items of plant and equipment, shall be charged to capital account for purposes of depreciation. After a timber operation and plant has been developed and equipped to its normal and regular output capacity, the cost of additional minor items of equipment and the cost of replacement of minor items of worn-out and discarded plant and equipment may be charged to current expenses of operations.

ART. 232. *Depreciation of improvements in the case of timber.*—The cost or value as of March 1, 1913, as the case may be, of development not represented by physical property having an inventory value, and such cost or value of all physical property which has not been deducted and allowed as expense in the returns of the taxpayer, shall be recoverable through depreciation. It shall be optional with the taxpayer, subject to the approval of the Commissioner, (*a*) whether the cost or value, as the case may be, of the property subject to depreciation shall be recovered at a rate established by current exhaustion of stumpage, or (*b*) whether the cost or value shall be recovered by appropriate charges for depreciation calculated by the usual rules for depreciation or according to the peculiar conditions of the taxpayer's case by a method satisfactory to the Commissioner. In no case may charges for depreciation be based on a rate which will extinguish the cost or value of the property prior to the termination of its useful life. Nothing in these regulations shall be interpreted to mean that the value of a timber plant and equipment, so far as it is represented by physical property having an inventory value, may be reduced by depreciation deductions to a sum below the value of the salvage when the plant and equipment shall have become obsolete or worn out or shall have been abandoned, or that any part of the value of cut-over land may be recoverable through depreciation.

ART. 233. *Statement to be attached to return where depletion of timber claimed.*—To the return of the taxpayer claiming a deduction for depletion or depreciation or both there should be attached a statement setting out (*a*) whether the owner is an owner in fee or a lessee or both; (*b*) a description of the property owned in fee, if any, and a description of the leasehold property, if any, including the date of acquisition and the date of expiration of the lease; (*c*) the cost of the freehold and the leasehold property; (*d*) the number of feet of timber removed and sold during the year for which the return was made; (*e*) the total amount deducted on account of depletion and on account of depreciation, stated separately, up to the taxable year during the ownership of the taxpayer; and (*f*) any other data which would be helpful in determining the reasonableness of the depletion and depreciation deductions claimed in the return. The taxpayer shall keep accurate ledger accounts as outlined in article 216, and in general should comply with the requirements of the foregoing articles relating to the depletion of mines and oil and gas wells so far as applicable.

Two new articles on this subject were added to Regulations No. 45 by T. D. 2916, September 5, 1919, as follows:

ART. 234. *Determination of fair market value of timber.*—Where the fair market value of the property at a specified date in lieu of the cost thereof is the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the commissioner, by the owner of the property in the light of the most reliable and accurate information with reference to the condition of the property as it existed at that date, regardless of all subsequent changes, such as changes in surrounding circumstances, in methods of exploitation, in degree of utilization, etc. The value sought should be that established, assuming a transfer between a willing seller and a willing buyer as of that particular date. No rule or method of determining the fair market value of timber property is prescribed, but the commissioner will give due weight and consideration to any and all facts and evidence having a bearing on the market value, such as cost, actual sales, and transfers of similar properties, market value of stock or shares, royalties and rentals, value fixed by the owner for purposes of the capital-stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in probate court, disinterested appraisals by approved methods, and other factors. For depletion purposes the cost of the timber or its fair market value at a specified date shall not include any part of the cost or value of the land.

ART. 235. *Determination of quantity of timber.*—Each taxpayer claiming a deduction for depletion is required to estimate with respect to each separate timber account the total units (feet board measure, cords, or other units) of timber reasonably known or on good evidence believed to have existed on the ground on March 1, 1913, or on the date of acquisition of the property, as the case may be. The taxpayer, according to his best knowledge and belief and in the light of the most accurate and reliable information, will estimate the number of units of timber actually present upon the specified date; this estimate will state the number of units which would have been found present by a careful estimate made on the specified date with the object of determining 100 per cent of the quantity of timber which the area would have produced on that date if all of the merchantable timber had been cut and utilized in accordance with the standards of utilization prevailing in that region at that time. If subsequently during the ownership of the taxpayer making the return additional units of timber are found to be available for utilization as the result of the growth of the timber, of closer utilization of the timber, of the utilization of species of trees not formerly utilized, of underestimates of the quantity of timber available on the specified date, etc., which were not taken into account in estimating the number of units for purposes of depletion, or if it shall be found in the course of operation that timber included in the estimate is not merchantable as the result of deterioration through rot or otherwise, or that the original estimate was too great, a new estimate of the recoverable units of timber (but not of the cost or the fair market value at a specified date) shall be made and when made shall thereafter constitute a basis for depletion. In the selection of the unit or units of estimate the custom applicable to the given type of timber in the given region should be considered.

§ 199. Rules as to Insurance Companies

A life insurance company is not entitled to exclude from its total income during the taxable year, for the purpose of ascertaining its gross income, any dividends paid or credited to policyholders from whom it did not receive any premium during that year; and as to those policyholders from whom it did receive premiums for that year, it is entitled to exclude only such part of the dividends paid to those policyholders as did not exceed the amount received from them, respectively, by way of premiums during that year. Lederer v. Penn Mut. Life Ins. Co. (C. C. A.) 258 Fed. 81.

Insurance companies are entitled to the same deductions from gross income as other corporations, and also to the deduction of the net addition required by law to be made within the taxable year to reserve funds and of the sums other than dividends paid within the taxable year on policy and annuity contracts. "Paid" includes "accrued" or "incurred" (construed according to the method of accounting upon the basis of which the net income is computed) during the taxable year, but does not include any estimate for losses incurred but not reported during the taxable year. As payments on policies there should be reported all death, disability and other policy claims (other than dividends as above specified) paid within the year, including fire, accident and liability losses, matured endowments, annuities, payments on installment policies and surrender values actually paid. (Regulations No. 45, art. 568.)

§ 201. Insurance Companies; Reserve Funds

The revised regulations of the Treasury Department on this subject (Regulations No. 45, arts. 569, 570) are as follows:

Insurance companies may deduct from gross income the net addition required by law to be made within the taxable year to reserve funds, including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds. This is considered to mean the net addition required by the specific statutes of the States within which the taxpayer transacts business. A requirement by a State insurance commissioner that a net addition shall be made to certain amounts retained to meet specified liabilities is not a net addition required by law to be made to reserve funds within the meaning of the statute. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law. In the case of a fire insurance company the only reserve fund commonly recognized is the "unearned-premium" fund. Casualty companies may deduct losses incurred within the taxable year; but unless the net addition to the unpaid loss reserve required by law exceeds such losses incurred, no deduction for the net addition to the unpaid loss reserve may be taken. In any event only the excess of such net addition over such losses may be deducted. In the case of life insurance companies the net addition to the "reinsurance reserve" and the "reserve for supplementary contracts not involving life contingencies," and the net addition to any other reserve funds necessarily maintained for the purpose of liquidating policies at maturity, are legally deductible. An increase in the reserve maintained by a life insurance company to pay dividends on deferred dividend policies may not be deducted from gross income. Mutual hail and mutual cyclone insurance companies are entitled to deduct from gross income the net addition which they are required to make to the "guaranty surplus" fund or similar fund.

Special deductions allowed in the case of combined life, health and accident policies.—Corporations which issue combination policies of life, health and accident insurance on the weekly premium payment plan, continuing for life and not subject to cancellation, may deduct from gross income only such portion of the net addition not required by law made within the taxable year to reserve funds as is needed for the protection of the holders of such combination policies. In general the net addition to any fund especially maintained for the protection of such policyholders may be deducted. The determination by the company of the need for such addition is subject to review by the Commissioner, and the return of income should be accompanied by a full explanation of the basis upon which such fund and the additions to it are determined.

§ 203. Rules as to Foreign Corporations

Foreign corporations are allowed the same deductions from their gross income arising from sources within the United States as are allowed to domestic corporations, to the extent that such deductions are connected with such gross income, with the exception that the interest deductible is that proportion of so much of the entire interest paid on the corporate indebtedness as would be deductible if paid by a domestic corporation which the gross income from sources within the United States bears to the total gross income, and that full deduction may be made for taxes imposed by the United States or any of its possessions, or by any State, Territory, or political subdivision thereof, except taxes for local benefits and income, war profits and excess profits taxes. A Canadian manufacturing corporation which sells part of its product in the United States and part in Canada should report its deductions for cost of manufacture, exclusive of interest paid on its indebtedness, in the same proportion as the quantity of its product sold in the United States bears to the total quantity sold. (Regulations No. 45, art. 573.)

§ 208. Certificates of ownership

Interest coupons without ownership certificates.—Where interest coupons are received unaccompanied by certificates of ownership the first bank shall require of the payee an affidavit showing the name and address of the payee, the name and address of the debtor corporation, the date of the maturity of the interest, the name and address of the person from whom the coupons were received, the amount of the interest, and a statement that the owner of the bonds is unknown to the payee. Such affidavit shall be forwarded to the collector with the monthly return on form 1012 (revised). The first bank receiving such coupons shall also prepare a certificate on form 1000 (revised), crossing out "owner" and inserting "payee" and entering the amount of interest in the space provided for a foreign corporation having no office or place of business within the United States, and shall stamp or write across the face of the certificate "Affidavit furnished," adding the name of the bank. (Regulations No. 45, art. 368.)

Ownership certificates in the case of fiduciaries and joint owners.—When fiduciaries have the control and custody of more than one estate or trust, and such estates and trusts have as assets bonds of corporations and other securities, a certificate of ownership shall be executed for each estate or trust, regardless of the fact that the bonds are of the same issue. When bonds are owned jointly by several persons, a separate ownership certificate must be executed in behalf of each of the owners. (Idem, art. 374.)

§ 211. Nonresident Aliens; Treasury Regulations

The final edition of Regulations No. 45 is amended by inserting immediately after Article 363, a paragraph which will be known as Article 363a as follows:

ART. 363a. *Personal exemption of nonresident aliens.*—In case a nonresident alien is entitled to personal exemption and credits for dependents in accordance with paragraphs (c), (d), and (e), section 216 of the revenue act of 1918, and his gross income from sources in the United States, including bond interest, does not exceed his personal exemption and credits for dependents, a certificate, Form 1001B, should be executed and filed with the withholding agent, if any part of the gross income is derived from interest upon bonds of a domestic corporation which contain a tax-free covenant clause. The certificate may be filed with the withholding agent at the end of the calendar year but not later than February 1 of the succeeding year and all such certificates should be attached to the annual list return, Form 1013. The amount of tax due from the withholding agent, as shown by Form 1013, may be reduced by two per cent of the aggregate amount of interest payments made to the nonresident alien upon tax-free covenant bonds during the calendar year, and the amount of tax represented by the certificates, payment of which was assumed on monthly list return, Form 1012, will not be included in the assessment against the withholding agent. The certificate may be filed only by a citizen or subject of the countries enumerated in paragraph (a) or (b) of Article 307, as amended. In case tax in excess of a nonresident alien's tax liability has been withheld from interest upon bonds which do not contain a tax-free covenant clause, the nonresident alien should file or cause to be filed with the collector of internal revenue a return of his gross income from all sources within the United States, accompanied by a claim for refund on Form 46. (T. D. 2920, September 15, 1919.)

§§ 221, 222. Kinds of Income Not Taxable at Source

Fixed or determinable annual or periodical income.—Only (a) fixed or determinable (b) annual or periodical income is subject to withholding. Among such income, giving an idea of the general character of income intended, the statute specifies interest, rent, salaries, wages, premiums, annuities, compensations, remunerations and emoluments. But other kinds of income may be included. (*a*) Income is fixed when it is to be paid in amounts definitely predetermined. On the other hand, it is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. (*b*) The income need not be paid annually if it is paid periodically, that is to say, from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished in accordance with someone's will or with the happening of an event does not make the payments any the less determinable or periodical. A salesman working by the month for a commission on sales which is paid or credited monthly receives determinable periodical income. (Regulations No. 45, art. 362.)

§ 230. Minors Having Separate Income.

The following additional regulation as to returns of minors has been promulgated as article 403 of Regulations No. 45: An individual under 21 years of age or under the statutory age of majority where he lives, whatever it may be, is required to render a return of income if he has a net income of his own of $1,000 or over for the taxable year. If he is married see article 401. If the aggregate of the net income of a minor from any property which he possesses, and from any funds held in trust for him by a trustee or guardian, and from any earnings for his own use, is at least $1,000, a return as in the case of any other individual must be made by him or by his guardian or some other person charged with the care of his person or property for him. If, however, a minor is dependent upon his parent, who appropriates or may appropriate his earnings, such earnings are income of the parent and not of the minor for the purpose of the normal tax and surtax. In the absence of proof to the contrary a parent will be assumed not to have emancipated his minor child and must include in his return any earnings of the minor.

§ 231. Returns by Fiduciaries

Return by Receiver.—A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on form 1040 (revised) or 1040A (revised). When acting for a corporation a receiver is not treated as a fiduciary, and in such a case the return shall be made as if by the corporation itself. See section 239 of the statute and article 622. A receiver in charge of the business of a partnership shall render a return on form 1065 (revised). A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common law receivers of all the property or business of an individual or corporation must make returns. (Regulations No. 45, art. 424.)

§ 232. Returns; Executors and Administrators

Time for filing return upon death or termination of trust.—As soon as possible after his appointment and qualification, without waiting for the close of the taxable year, an executor or administrator shall file a return of income for the decedent. Upon the completion of the administration of an estate and final accounting an executor or administrator shall file a return of income of the estate for the portion of the taxable year in which the administration was closed, attaching to the return a certified copy of the order for his discharge. An ancillary administrator need make no separate return if the domiciliary administrator includes in his return the entire income of the estate. Similarly, upon the termination of any other trust the trustee shall make a return without waiting for the close of the taxable year. In any such case the requirements with respect to the payment of the tax are the same as if the return were for a full taxable year closing at the end of the month during which the decedent dies or the estate is settled or the trust is terminated, as the case may be. The payment of the tax before the end of the taxable year in such circumstances does not relieve the taxpayer from liability for any additional tax which might subsequently be imposed upon income of the taxable year. (Regulations No. 45, art. 442.)

§ 234. Returns; Nonresident Aliens.

Regulations No. 45, art. 404, prescribes the following revised regulation on this subject: A nonresident alien individual shall make or have made a full and accurate return on form 1040 (revised) or form 1040A (revised) of his income received from sources within the United States, regardless of amount, unless the tax on such income has been fully paid at the source. See section 217 of the statute and articles 311–316. The responsible representatives of nonresident aliens in connection with any sources of income which such nonresident aliens may have within the United States shall make a return of such income, and shall pay any and all tax, normal and additional, assessed upon the income received by them in behalf of their nonresident alien principals, in all cases where the tax on income so in their receipt, custody or control shall not have been withheld at the source. The agent of a nonresident alien is responsible for a correct return of all income accruing to his principal within the purview of the agency. The agency appointment will determine how completely the agent is substituted for the principal for tax purposes. Where upon filing a return of income it appears that a nonresident alien is not liable for tax, but nevertheless a tax shall have been withheld at the source, in order to obtain a refund on the basis of the showing made by the return there should be attached to it a statement showing accurately the amounts of tax withheld, with the names and post-office addresses of all withholding agents.

§ 235. Form and Contents of Returns

Under the law and the regulations of the Treasury Department, the officers who are authorized to administer an oath to an income-tax return include all such as are authorized by the local law to take oaths in their several districts, including a commissioner of deeds; and where an oath taken before such commissioner is false, an indictment for perjury will lie under § 125 of the Criminal Code of the United States. United States v. Benowitz (U. S. D. C., S. D. N. Y., Oct. 20, 1919) T. D. 2952, Nov. 19, 1919.

§ 237. Returns by Partnerships

The Treasury regulation quoted in this section to the effect that "partnerships having a net income of $6,000 or over will be required to render returns for the purpose of excess-profits tax," was applicable to the War Revenue Act of 1917, under which partnerships and individuals as well as corporations were subject to this tax, but is not now in force, as the Revenue Act of 1918 imposes excess-profits taxes on corporations only.

§ 238. Returns by Corporations

Returns of personal service corporations.—Every personal service corporation must make a return of income, regardless of the amount of its net income. The return shall be on form 1065 (revised). It shall be made for the taxable year of the personal service corporation; that is, for its annual accounting period (fiscal year or calendar year, as the case may be), regardless of the taxable years of its stockholders. If the personal service corporation makes any change in its accounting period it shall render its return in accordance with the provisions of section 226 of the statute and article 431. The return of a personal service corporation shall state specifically (*a*) the items of its gross income enumerated in section 213 of the statute; (*b*) the deductions enumerated in section 214 of the statute, other than the deduction provided in paragraph (11) of subdivision (a) of that section; (*c*) the amounts specified in subdivisions (a) and (b) of section 216 of the statute received by the personal service corporation; (*d*) the amount of any income, war profits and excess profits taxes of the personal service corporation paid during the taxable year to a foreign country or to any possession of the United States, and the amount of any such taxes accrued but not paid during the taxable year; (*e*) the amounts distributed by the corporation during its taxable year with the dates of distribution; (*f*) the names and addresses of the stockholders of the corporation at the close of its taxable year and their respective shares in such corporation; (*g*) such facts as tend to show whether or not the corporation is a personal service corporation; and (*h*) such other facts as are required by the form. (Regulations No. 45, art. 624.)

§ 240. Returns by Affiliated Corporations

The regulations made by the Treasury Department on this subject are contained in Regulations No. 45, arts. 631–638. They are as follows:

ART. 631. *Affiliated corporations.*—The provision of the statute requiring affiliated corporations to file consolidated returns is based upon the principle of levying the tax according to the true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation. Where one corporation owns the capital stock of another corporation or other corporations, or where the stock of two or more corporations is owned by the same interests, a situation results which is closely analogous to that of a business maintaining one or more branch establishments. In the latter case, because of the direct ownership of the property, the invested capital and net income of the branch form a part of the invested capital and net income of the entire organization. Where such branches or units of a business are owned and controlled through the medium of separate corporations, it is necessary to require a consolidated return in order that the invested capital and net income of the entire group may be accurately determined. Otherwise opportunity would be afforded for the evasion of taxation by the shifting of income through price fixing, charges for services and other means by which income could be arbitrarily assigned to one or another unit of the group. In other cases without a consolidated return excessive taxation might be imposed as a result of purely artificial conditions existing between corporations within a controlled group.

ART. 632. *Consolidated returns.*—Affiliated corporations, as defined in the statute and in article 633, are required to file consolidated returns on form 1120. The consolidated return shall be filed by the parent or principal reporting corporation in the office of the collector of the district in which it has its principal office. Each of the other affiliated corporations shall file in the office of the collector of its district form 1122, along with the several schedules indicated thereon. The parent or principal corporation filing a consolidated return shall include in such return a statement specifically setting forth (*a*) the name and address of each of the subsidiary or affiliated corporations included in such return, (*b*) the par value of the total outstanding capital stock of each of such corporations at the beginning of the taxable year, (*c*) the par value of such capital stock held by the parent corporation or by the same interests at the beginning of the taxable year, (*d*) in the case of affiliated corporations owned by the same interests, a list of the individuals or partnerships constituting such interests, with the percentage of the total outstanding stock of each affiliated corporation held by each of such individuals or partnerships during all of the taxable year, and (*e*) a schedule showing the proportionate amount of the total tax which it is agreed among them is to be assessed upon each affiliated corporation. Foreign corporations and personal service corporations need not file consolidated returns.

ART. 633. *When corporations are affiliated.*—Corporations will be deemed to be affiliated (*a*) when one domestic corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (*b*) when substantially all the stock of two or more domestic corporations is owned or controlled by the same interests. The words "substantially all the stock" cannot be interpreted as meaning any particular percentage, but must be construed according to the facts of the particular case. The owning or controlling of 95 per cent. or more of the outstanding voting capital stock (not including stock in the treasury) at the beginning of and during the taxable year will be deemed to constitute an affiliation within the meaning of the statute. Consolidated returns may, however, be required even though the stock ownership is less than 95 per cent. When the stock ownership is less than 95 per cent., but in excess of 50 per cent., a full disclosure of affiliations should be made, showing all pertinent facts, including the stock owned in each subsidiary or affiliated corporation and the percentage of such stock owned to the total stock outstanding. Such statement should preferably be made in advance of filing the return, with a request for instructions as to whether a consolidated return should be made. In any event such a statement should be filed as a part of the return. The words "the same interests" shall be deemed to mean the same individual or partnership or the same individuals or partnerships, but when the stock of two or more corporations is owned by two or more individuals or by two or more partnerships a consolidated return is not required unless the percentage of stock held by each individual or each partnership is substantially the same in each of the affiliated corporations.

ART. 634. *Change in ownership during taxable year.*—When one corporation owns substantially all the stock of another corporation at the beginning of any taxable year, but during the taxable year sells all or a majority of such stock to outside interests not affiliated with it, or when one corporation during any taxable year acquires substantially all the capital stock of another corporation with which it was not previously affiliated, a full disclosure of the circumstances of such changes in ownership shall be submitted to the Commissioner. In accordance with the peculiar circumstances in each case the Commissioner may require separate or consolidated returns to be filed, to the end that the tax may be equitably assessed.

ART. 635. *Corporation deriving chief income from Government contracts.*—In the case of any affiliated corporation organized after August 1, 1914, and not a successor to a then existing business, 50 per cent. or more of whose gross income consists of gains, profits, commissions or other income derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, the net income and invested capital of such corporation shall be taken out of the consolidated net income and invested capital of the group of affiliated corporations and the corporation so segregated shall be separately assessed on the basis of its own invested capital and net income, the remainder of such affiliated group being assessed on the basis of the remaining consolidated invested capital and net income.

ART. 636. *Domestic corporation affiliated with foreign corporation.*—A domestic corporation which owns a majority of the stock of a foreign corporation shall not be permitted or required to include the net income or invested capital of such foreign corporation in a consolidated return, but for the purpose of section 238 of the statute a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be entitled to credit its income, war profits and excess profits taxes with any income, war profits or excess profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources without the United States in an amount equal to the proportion which the amount of any dividends (not deductible under section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid. But in no such case shall the amount of the credit for such taxes exceed the amount of such dividends (not deductible under section 234) received by such domestic corporation during the taxable year. A domestic corporation seeking such credit must comply with those provisions of subdivision (*a*) of article 383 which are applicable to credits for taxes already paid, except that in accordance with article 611 the form to be used is form 1118 instead of form 1116.

ART. 637. *Consolidated net income of affiliated corporations.*—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions, the consolidated taxable net income shall be the combined net income of the several corporations consolidated, except that the net income of corporations coming within the provisions of article 635 shall be taken out. In respect of the statement of gross income and deductions and the several schedules required under form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited.

Art. 638. *Different fiscal years of affiliated corporations.*—In the case of all consolidated returns, consolidated invested capital must be computed as of the beginning of the taxable year of the parent or principal reporting company and consolidated income must be computed on the basis of its taxable year. Whenever the fiscal year of one or more subsidiary or other affiliated corporations differs from the fiscal year of the parent or principal corporation, the Commissioner should be fully advised by the taxpayer in order that provision may be made for assessing the tax in respect of the period prior to the beginning of the fiscal year of the parent or principal company.

§ 241. Returns of Dividends Paid

The following is the regulation of the Treasury Department on the subject: Dividends on stock of domestic corporations or resident foreign corporations are prima facie income of the record owner of the stock, and such record owner will be liable for any additional tax based thereon, unless a disclosure of the actual ownership is made to the Commissioner on form 1087 (revised) which shall show that the record owner is not the actual owner and who the owner is and his address. In all cases where the actual owner is a nonresident alien individual and the record owner is a person in the United States, the record owner will be considered for tax purposes to have the receipt, custody, control and disposal of the dividend income and will be required to make return for the actual owner, regardless of the amount of the income, and to pay any surtax found by such return to be due. (Regulations No. 45, art. 405.)

When directed by the Commissioner, either specially or by general regulation, every domestic or resident foreign corporation and every personal service corporation shall render a return on form 1097 of its payments of dividends and distributions to stockholders for such period as may be specified, stating the name and address of each stockholder, the number and class of shares owned by him, the date and amount of each dividend paid him, and when the surplus out of which it was paid was accumulated. (Regulations No. 45, art. 1051.)

§ 243. Information Returns

Regulations on this subject have been prescribed by the Treasury Department (Regulations No. 45, arts. 1071–1073) as follows:

Art. 1071. *Return of information as to payments of $1,000.*—All persons making payment to another person of fixed or determinable income of $1,000 or more in a taxable year must render a return thereof to the Commissioner (Sorting Division) for the preceding calendar year on or before March 15 of each year, except as specified in articles 1073, 1074, 1075, 1076 and 1079. The return shall be made in each case on form 1099 (revised), accompanied by a letter of transmittal on form 1096 (revised) showing the number of returns filed and the aggregate amount represented by the payments. The street and number where the recipient of the payment lives and whether he is single, married or head of a family should be stated, if possible. Where no present address is available, the last known post-office address must be given. Although to make necessary a return of information the income must be fixed or determinable, it need not be annual or periodical.

ART. 1072. *Return of information as to payments to employees.*—The names of all employees to whom payments exceeding $1,000 a year are made, whether such total sum is made up of wages, salaries, commissions or compensation in any other form, must be reported. Heads of branch offices and subcontractors employing labor, who keep the only complete record of payments therefor, should file returns of information in regard to such payments directly with the Commissioner. When both main office and branch office have adequate records, the return should be filed by the main office. In the case of an employer having a large number of employees who are moved from place to place as the exigencies of the service require, and who consequently has no complete record of annual payments to them at any one place, the salary of two representative months may be taken to establish a fair monthly wage, and unless the yearly payment based on this estimate in the case of an employee amounts to $1,000 or more, no return of payments to such employee is required.

ART. 1073. *Return of information by partnerships, personal service corporations and fiduciaries.*—Partnerships and personal service corporations shall prepare reports on form 1099 (revised) for each member of the partnership or personal service corporation, and fiduciaries shall prepare such reports for each beneficiary of the estate or trust, showing in every case the distributive shares of the members or beneficiaries, whether or not actually distributed. The words "Partnership," "Personal service corporation" or "Fiduciary," as the case may be, should be entered on the blank line of the form under "Kind of income paid." Such reports on form 1099 (revised) are to be filed with the collector with the returns of income of such partnerships, personal service corporations or fiduciaries, instead of being transmitted to the Commissioner accompanied by form 1096 (revised).

§ 245. Time for Filing Returns

Extension of time by collector.—It is important that the taxpayer render before the return due date a return as complete and final as it is possible for him to prepare. However, in cases of sickness or absence collectors are authorized to grant an extension of not exceeding 30 days where, in their judgment, such further time is actually required for the making of an accurate return. (See article 1002.) The application for such extension must be made prior to the expiration of the period for which the extension is desired. The absence or sickness of one or more officers of a corporation at the time the return is required to be filed will not be accepted as a reasonable cause for failure to file the return within the prescribed time unless it is satisfactorily shown that there were no other principal officers available and sufficiently informed as to the affairs of the corporation to make and verify the return. As a condition of granting an extension of time for filing a return, the collector may require the submission of a tentative return and estimate of the tax on Form 1040—T in the case of individuals, or on Form 1031—T in the case of corporations, and the payment of one-fourth of the estimated amount of tax. Where a taxpayer has filed a tentative return and has failed to file a complete return within the period of the extension requested by him, the complete return when filed is subject to penalties prescribed for delinquency. Where a tentative return has been filed and no time has been fixed within which a complete return must be filed, the collector may at any time send notice to the taxpayer to file a complete return within a period of time therein specified by him, and a taxpayer who fails to comply with such request will incur the penalties prescribed by statute for delinquency in filing a return. (Regulations No. 45, art. 443, as amended by T. D. 2935, Oct. 16, 1919.)

Extension of time by Commissioner.—If before the end of an extension of thirty days granted by the collector an accurate return can not be made, an appeal for a further extension must be made to the Commissioner with a full recital of the causes for the delay. The Commissioner will not grant an additional extension without a clear showing that a complete return can not be made at the end of the thirty day period. The Commissioner will grant no such extension beyond the original due date of the third installment of the tax. Either a complete or a tentative return, as complete as possible and giving a ground for assessment of the tax, must be submitted on or before the due date as extended, and the tax shown to be due must be paid with the submission of the return. If a complete return can not be made at that time, the facts must be submitted to the Commissioner for such further action as he deems warranted. In exceptional circumstances the taxpayer may apply originally to the Commissioner for an extension of time. (Regulations No. 45, art. 444.)

Extension of time in the case of persons abroad.—In view of the disturbed conditions abroad and the consequent interference with the usual channels of communication, an extension of time for filing returns of income for 1918 and subsequent years and for paying the tax is hereby granted in the case of nonresident alien individuals and nonresident foreign corporations, or their proper representatives in the United States, and of American citizens residing or traveling abroad, including persons in military or naval service on duty outside the United States, for such period as may be necessary, not exceeding ninety days after proclamation by the President of the end of the war with Germany. The whole tax shown to be due must be paid at the time of filing the return. In all such cases an affidavit must be attached to the return, stating the causes of the delay in filing it, in order that the Commissioner may determine whether the failure to file the return in time was due to a reasonable cause and not to willful neglect. If the showing justifies the conclusion that the failure to file the return in time was excusable, no penalty will be imposed. (Idem. art. 445.)

§ 248. Publicity or Inspection of Returns

Revised regulations of the Treasury Department on this subject, contained in Regulations No. 45, arts. 1091–1094, are as follows:

ART. 1091. A person having the privilege of inspection will not be furnished a copy of the return, but may make a copy or take notes for his own or an authorized use. Beneficiaries of an estate or trust are not entitled as such to an inspection of returns of income filed by the fiduciary. A receiver of a corporation is entitled to have access to its returns.

ART. 1092. *Inspection of returns by State.*—By express exception in the statute the proper officers of a State imposing an income tax are entitled as of right upon the request of its governor to have access to the returns of income of any corporation or to an abstract thereof showing its name and income. Upon written application by the governor of a State as prescribed in paragraph 7 of article 1091, except that the application may be made directly to the Commissioner instead of to the Secretary, the Commissioner will set a convenient time for inspection of the returns (or an abstract thereof as he may determine) of corporations organized or doing business in such State. The authority to inspect returns granted to officers of a State includes authority to inspect lists furnished to supplement and become a part of the returns.

ART. 1093. *Inspection of returns by stockholder.*—By express exception in the statute a bona fide stockholder of record owning one per cent of the outstanding stock of a corporation is entitled as of right to examine the returns of income of such corporation and its subsidiaries. A stockholder desiring the privilege of inspection shall apply in writing to the Commissioner, specifying his address, the name of the corporation, its outstanding capital stock, the number of shares owned by him, the date of their acquisition and whether or not he has the beneficial as well as the record title to such shares, and in other respects complying with the requirements of paragraph 4 of article 1091. A stockholder who has acquired his shares for the purpose of inspection of the income returns of the corporation is not a bona fide stockholder.

ART. 1094. *Penalties for disclosure of returns.*—A stockholder who examines the return of a corporation and reveals without express authority of law any particulars of its income statement is guilty of a misdemeanor and liable to fine and imprisonment.

§ 255. Penalties for Failure to Make Returns

In case of failure to make a return on time, a penalty of 25 per cent of the amount of the tax is added to it, unless the return is later filed and the failure to file it is satisfactorily shown to be due to a reasonable cause. Two classes of delinquents are liable to the penalty: (*a*) those who do not file returns and for whom returns are made by the collector or Commissioner; and (*b*) those who file tardy returns and are unable to show reasonable cause for the delay. Taxpayers wishing to avoid the penalty must make an affirmative showing of the facts alleged as a reasonable cause for failure to make a return on time in the form of an affidavit under oath, which should be attached to the return. If such an explanation is furnished with the return or upon the collector's demand, the collector, unless otherwise directed by the Commissioner, will forward the affidavit with the return, and if the Commissioner determines that the delinquency was due to a reasonable cause the 25 per cent penalty will not be assessed. "Reasonable cause" is such a condition of fact that had the taxpayer in default exercised ordinary business care and prudence it would have been impracticable or impossible for him to file a return in the prescribed time. (Regulations No. 45, art. 1004.)

§ 270. Nature and Validity of Tax

The Treasury Department rules as follows: The statute takes no account of the citizenship of the decedent, but prescribes different rules according to whether the decedent was a "resident" or a "nonresident" of the United States. A person residing in Italy is a "nonresident," for the purpose of the tax, although a citizen of the United States; a person residing in the United States is a "resident," although a citizen of Italy. A "resident" is one who at the time of his death resided in the States, the Territories of Alaska or Hawaii, or the District of Columbia. All other persons are "nonresidents." Persons residing in Porto Rico or the Philippine Islands are "nonresidents." A person is a "resident" of the United States, for the purposes of this tax, only in case he had a *domicile* therein at the time of his death. A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal. A decedent who died while abroad will be presumed to be a nonresident, and the burden of proving the contrary rests upon the executor. (Regulations No. 37, arts. 4, 5.)

§ 272. What is Included in Gross Estate

The revised regulations of the Treasury Department (found in Regulations No. 37, 1919, arts. 12–20) on this subject are as follows:

ART. 12. *Character of interests included.*—This provision is designed to include all property interests of the decedent, of whatever character. It is the commonest form of taxable transfer. As a basis for tax, there must be an actual, beneficial ownership in the decedent, not a bare legal title, or one held in trust. Thus, property actually devoted to religious or charitable purposes, and placed in the name of an individual solely for convenience in administration, is not included in his gross estate. The statute also includes only property rights existing in the decedent in his lifetime and passing to his estate. It consequently does not include a right which came into existence only after the decedent's death, such as a cause of action by statute for causing the death. The proceeds of such a cause of action should not be included in the gross estate, whether payable generally to the estate or to some specified class of persons, such as the widow or children.

The value of a vested remainder should be included in the gross estate. Nothing should be included, however, on account of a contingent remainder where the contingency does not happen in the lifetime of the decedent, and the interest consequently lapses at his death. Nor should anything be included on account of a life estate in the decedent. There should be included, however, the value of an annuity payable to the decedent upon the life of a third person who survives him, and the value of an estate for the life of a person other than the decedent. For rules as to valuing such annuities and illustrations, see Article 20.

ART. 13. *Specific property to be included.*—Real property owned by the decedent, when situated in the United States, should be included in the gross estate, whether the decedent was a resident or a nonresident, and whether the property came into the possession and control of the executor or administrator or passed directly to heirs or devisees. Real property not situated in the United States should not be included, whether the decedent was a resident or nonresident. Where the decedent was a resident, all personal property owned by him should be included, wherever situated. Where decedent was a nonresident, so much of his personal property as was actually situated in the United States at the time of his death should be included.

A cemetery lot owned by the decedent is part of his gross estate, but its value is limited to the salable value of such part of it as is not designed for the interment of the decedent or members of his family. Rent which had accrued upon real property at the time of the decedent's death, whether then payable or not, is included in the gross estate. The amount of interest accrued upon bonds on the day of death, whether payable then or subsequently, should be included. All matured coupons, whether presented for payment or not, should be included. The value of notes or other claims held by the decedent should be included, though they are canceled by his will or appear to be barred by the statute of limitations. As to the valuation of notes or claims apparently barred, see Article 15, paragraph 3. All bonds, whether federal, state, or municipal, and whether or not containing a tax-free covenant, should be included.

Dividends, whether upon preferred or common stock, should not be included unless actually declared prior to the date of death. The amount of dividends upon stock which have been declared, but not paid, must be returned where the value of the stock at the time of the decedent's death does not reflect the dividends; that is, where the death occurs after the closing of the books of the corporation and the stock consequently sells "ex dividend." Where the death occurs before the closing of the books, the value of the stock reflects the dividend, and it should not be included.

ART. 14. *Value.*—The value at which property included in the gross estate is to be returned for tax purposes is the value at the time of the decedent's death. Neither depreciation nor appreciation in value subsequent to the date of death is considered. The value to be ascertained is the market, or sale, value of the property. The highest price obtainable for the property within a reasonable period of the decedent's death is the value to be included. A sale of the property, however, in order to be accepted as the criterion of value, must be made in such manner as to insure the best price obtainable under existing circumstances. This requires (*a*) that the sale be made as a matter of business, and not merely in order to establish value; (*b*) that it be made in absolute good faith, with a view to realizing as high a price as possible; and (*c*) that reasonable care and skill be exercised to obtain such price. If one method brings better results than another, the better method must be employed.

For example, if individual sales of property are better adapted to procure a good price than auction sales, the price obtained at an auction sale will be accepted only after reasonable effort to find individual purchasers has been made. See further on this point Article 15.

Great care must be exercised by the executor to arrive at a fair valuation of every asset of the gross estate.

ART. 15. *Rules for the valuation of property.*—(1) *Real estate.*—Where real property has been sold, the amount received will be taken as its value provided the sale was made within a reasonable period of the decedent's death, and in such manner as to insure the highest possible price. Where no sale has been made, the criterion of value is the best price which could have been obtained within a reasonable period of the decedent's death. The amount brought at an auction sale should be considered, but will be accepted only if it appears that there was no available method of obtaining a higher price. The assessed valuation of the property should be considered, but is not conclusive. All relevant facts and all elements of value should be considered in every case. See further the general rules laid down in Article 14.

(2) *Stocks and bonds.*—The value of stocks and bonds listed upon a stock exchange should be obtained by taking the mean between the highest and the lowest sale price upon the day of death, provided the sales were made in the regular course of business, and not for the special purpose of establishing value. If there were no sales upon the date of death, the price nearest to that date, and within a reasonable period thereof, either before or after death, should be taken. Such sale price obtains irrespective of the number of shares held by the estate. If the security was listed upon more than one exchange, the records of the exchange where the security is principally dealt in should be employed. If the decedent died on Sunday or a legal holiday, the business of the previous day will govern.

If the stock is not listed upon an exchange, but is dealt in actively by brokers or has other active market, the latest sale price prior to the day of death will govern. If there is no active market for the stock and no sales of it have been made within a reasonable period of the decedent's death, and in particular where it is closely held (stock of a "close corporation"), return should be made upon the basis of the value of the stock, as evidenced by the clear value of the excess of the assets of the corporation over its liabilities, and its earning capacity for the five years preceding the death of the decedent. Where the earnings of the corporation have been greater than a fair return on its invested capital, computed according to the nature of the business, and where the business is a going business, there should be added to the net value of the other assets of the business the value of the good will, computed in accordance with sound accounting principles. Where the earnings of the corporation have been less than a fair return on the invested capital, if the difference is material and the decreased earnings affect value, the net worth of the corporation as disclosed by its balance sheet may be adjusted on a reasonable basis to allow for this decreased value. In all cases where stock of this character forms a principal asset, there should be submitted with the return, Form 706, a copy of the balance sheets for the five preceding years, and of the balance sheet on the day of death or the nearest date thereto, together with a statement of the net earnings of the invested capital for the preceding five years.

The full value of securities pledged to secure a loan should be included in the gross estate. If the decedent had a trading account with a broker, all securities belonging to the decedent held by the broker at the date of death must be included at their market value on that date. Securities purchased on margin for the decedent's account and held by the broker should also be returned at their market value on the day of death. The amount of the decedent's indebtedness to the broker will be allowed as a deduction from the gross estate.

(3) *Notes, secured and unsecured.*—Notes, whether secured or unsecured, will be presumed to be worth their full face value, plus accrued interest to the date of decedent's death, unless the executor establishes the right to return them at a lower valuation. Interest should be computed upon the basis of 365 days to the year. In the case of an unsecured note it must be shown by satisfactory evidence, in order to justify failure to include it, that the note is uncollectible, either in whole or in part, from the maker or other parties to the note, on account of the insolvency of the parties thereto, or other cause. Where the note is secured it must also be shown that the security is insufficient to satisfy it. Where a note appears to be barred by the statute of limitations its value must be included in the gross estate in the absence of proof that the liability has not revived by promise to pay or part payment, and also that the parties liable refuse to pay the debt and intend to assert the defense.

(4) *Cash on hand or on deposit.*—Bank deposits should be returned at the amount for which the bank would be liable if the deposit were withdrawn upon the date of the decedent's death. Interest

which the bank agreed to pay upon condition that the money remain on deposit after the death should not be included.

(5) *Interest in business.*—Care should be taken to arrive at an accurate valuation of any business in which the decedent was interested, whether as partner or proprietor. The executor should not return the interest at its book value unless he is satisfied that the accounts of the business are kept upon a scientific basis. A fair appraisal as of the date of death should be made of all the assets of the business, tangible and intangible. Special attention should be given to fixing an adequate figure for the value of the good will of the business in all cases in which the decedent had an interest in the good will which passed to his estate. Where the original copartnership articles, or a renewal thereof, provide that the value of the interest of a deceased partner shall be determined without reference to good will, but that the surviving partners shall take the entire good will, nothing is to be included in the estate of the deceased partner on account of good will. Where, however, the deceased partner makes a gift of his interest in the good will to the surviving partners, to take effect upon his death, the value of such interest should be included in the decedent's gross estate. Such a gift exists where the only consideration for the surrender of the good will at death consists of similar promises by the other partners. The business should be given a net worth equal to the amount a financially competent buyer, whether an individual or corporation, might be expected to pay at a normal sale in view of the net value of the assets and the demonstrated earning capacity.

(6) *Patents, trade-marks, and copyrights.*—The basis for valuation of intangible assets of this character is the present worth of the estimated future earnings of the exclusive right during the rest of its existence. The return received by the decedent should be considered in estimating future earnings.

(7) *Accounts receivable, claims, judgments, etc.*—A fair valuation for assets of this character at the time of death should be fixed by the executor according to the best information available to him at the time of making return. A right of action which died with the decedent should not be included in the gross estate.

(8) *Furniture, personal effects, and other tangible property.*—For the method of valuation to be employed in the case of household furniture and personal effects see Articles 16 to 19. With respect to all other tangible property the executor should endeavor to arrive at the sound and actual value at the day of death. Where such property is subsequently sold the sale price must be returned if the sale was a

bona fide sale and for the best price obtainable. In the case of growing crops the executor should ascertain from expert opinion what the value of the growing crop was on the day of death, as evidenced by subsequent yield and crop prices. Where the crop is matured the value is the value of the crop unit on the day of death for the entire yield, less the cost of harvesting and marketing. Where the crop is not matured these factors should be considered; and the opinion of those expert in such matters should be ascertained as to what the crop was reasonably worth as a growing crop on the day of death.

ART. 16. *Appraisal of household and personal effects—General provisions.*—Executors and administrators are required to have careful appraisal made of all household and personal effects of the decedent, and to furnish in duplicate detailed lists and affidavits in the manner directed below. No distribution of such effects may be made until the lists and affidavits have been filed with the collector, and, if deemed necessary, sufficient time afforded the Bureau to have personal inspection made by an official appraiser. Where it is desired to distribute or sell all the property in advance of the filing of the return, the lists and affidavits should be filed with the collector, together with a letter stating when it is desired to effect distribution. If personal inspection by an internal revenue officer is not deemed necessary, a waiver of such examination will be sent to the executor, who may thereupon proceed with distribution.

ART. 17. *Same.—When value is less than $2,000.*—When the value of the personalty involved is less than $2,000, the detailed lists may be prepared by the executor personally. A room by room appraisal is desirable; and all the articles should be named specifically, except those of small value, such as common bric-a-brac or cheap books. A separate value should be given for each article named, except that the values of a number of articles contained in the same room may be grouped. The value of an article worth more than $50 should be stated separately.

If there should be included in the lot, however, jewelry or silverware of more than ordinary value, or articles having a marked artistic value, the executor must furnish an appraisal by persons thoroughly qualified by training and experience to judge of the value of such articles.

In the case of effects having a total value of less than $2,000, the executor may furnish as an alternative requirement a sworn estimate in duplicate of the approximate total value of the property by a professional appraiser of recognized standing and ability, or by a dealer in the class of personalty involved.

In addition to the lists or estimates described above, the executor must furnish in duplicate his affidavit as to the completeness of the lists and the qualifications of the appraiser.

ART. 18. *Same—When value is more than $2,000.*—When the value of the effects is more than $2,000, detailed lists must be furnished, prepared by professional appraisers of recognized competence, or by dealers in the particular classes of personalty involved. The lists must be prepared in the same detail as that indicated above for the executor's list. Where the personalty includes jewelry, silverware, or like articles, except in cases where the value of these items is insignificant, the appraisal of a reputable dealer or appraiser of jewelry must be furnished.

In the case of articles having marked artistic value, such as paintings, engravings, etchings, statuary, vases, oriental rugs, or antiques, the appraisals of experts will be required. The description of such articles should be fully given. Where paintings having artistic value are listed, the size, subject, and artist should be named. In the case of oriental rugs, the size, make, age, etc., should be given. The weight in ounces of each article of silverware should be stated. With the duplicate lists there must be filed the executor's affidavit as to the completeness of the list and the qualifications of the appraisers.

ART. 19. *Same—Appraisers and basis of appraisals.*—Where expert appraisers are to be employed, care should be taken to see that they are men of recognized competence with respect to the particular class of property involved. In order to facilitate the acceptance of the appraisal, appraisers should be employed whose competence is well established.

The basis to be employed in appraising articles of this character is what they would bring at a bona fide sale to individual purchasers, to dealers, or upon a well-advertised auction sale. If there has been an actual bona fide sale, the amount received may be returned as the value of the property. Where property is valued by legatees for purposes of distribution, such value will not necessarily be accepted. The original cost of the articles is not necessarily a proper basis, on account of depreciation or appreciation in value.

ART. 20. *Valuation of annuities, life, and remainder interests.*—Where the decedent was entitled to receive an annuity of a definite amount during the lifetime of another person, and the right constitutes an asset of his estate, the present worth of the annuity at the time of the decedent's death must be computed upon the basis of the expectancy of life of the other person. The table marked "A" upon page 19 should be used for this computation. The amount of annual income should be multiplied by the figure in column 3 of the table opposite the number of years in column 1 nearest to the actual age of the other person.

Where the decedent was entitled to receive the annuity during a specified number of years, the table marked "B" upon page 20 should be used.

Where the decedent was entitled to receive the entire income of certain property during the life of another or for a term of years, and where the rate of income is fixed by the instrument creating the trust or is definitely determinable at the time of the decedent's death, the average annual income which the property actually yields should be determined, and its present worth computed, as explained above in the case of annuities.

Where the rate of annual income is not determinable, or where the decedent was entitled merely to the personal use of nonincome-bearing property, a hypothetical annuity at a rate of 4 per cent. of the value of the property should be made the basis of the calculation.

Where the decedent possessed a remainder interest in property subject to the life estate of another, and such interest constituted an asset of his estate, the present worth of the remainder interest at the time of death should be obtained by multiplying the value of the property at the time of death by the figure in column 4 of Table A opposite the number of years nearest to the age of the life tenant. Where the remainder interest is subject to an estate for a term of years Table B should be used.

Dower and courtesy.—The provision of the statute as to what shall be included in gross estate includes dower and courtesy at common law, and all interests created by statute in lieu thereof, although the estate or interest so created is different in character. The effect of this provision is to require the inclusion of the full value of the land, without deduction of the value of the interest of a surviving husband or wife. This rule applies to the estate of any decedent dying after September 8, 1916. (Regulations No. 37, art. 21.)

Taxable insurance.—The statute provides for the inclusion in the gross estate of certain forms of insurance taken out by the decedent upon his own life. Two kinds of insurance are taxable: (*a*) all insurance payable to the estate; (*b*) insurance payable to individual beneficiaries to the extent that it exceeds $40,000. The term "insurance" refers to life insurance of every description, including death benefits paid by fraternal beneficial societies, operating under the lodge system. Insurance is deemed to be taken out by the decedent in all cases where he pays the premiums, either directly or indirectly, whether or not he makes the application. On the other hand, the insurance should not be included in the gross estate, even though the application is made by the decedent, where the premiums are actually paid by some other person or corporation, and not out of funds belonging to, or advanced by, the decedent. Where the decedent takes out insurance in favor of another person or corporation, as collateral security for a loan or other accommodation, and the decedent, either directly or indirectly, pays the premiums thereon, the insurance must be considered in determining whether there is an excess over $40,000. Where the decedent assigns a policy, and retains no interest therein, and thereafter pays no part of the premiums, the insurance will not be considered in determining whether there is such a taxable excess.

Insurance in favor of the estate.—The provision requiring the inclusion in the gross estate of all insurance receivable by the executor, without any deduction, applies to policies made payable to the decedent's estate or his executor or administrator, and all insurance, regardless of the manner of execution, which is in fact receivable by the estate, or which must be used to pay charges against the estate or the expenses of administration. This provision includes insurance taken out to provide funds to meet the estate tax, state inheritance taxes, or any other legal charge upon the estate. The manner in which the policy is drawn is immaterial so long as there is an obligation, legally binding upon the beneficiary, to use the proceeds in payment of the charge.

Insurance receivable by other beneficiaries.—The estate is entitled to only one exemption of $40,000 upon insurance payable to beneficiaries other than the executor. For example, if the decedent left life insurance payable to three persons in amounts of $10,000, $40,000, and $50,000 (total, $100,000), the amount of $60,000 should be returned for taxation, which is the excess of the sum of the three policies over the exempted amount. The word "beneficiary," as used in reference to the $40,000 exemption, means a person entitled to the actual enjoyment of the insurance money.

Effective date of insurance provisions.—Insurance receivable by the executor must be included in the gross estate of all decedents who died after September 8, 1916. Insurance payable to beneficiaries other than the executor, however, need not be included in the gross estate of decedents who died before February 25, 1919, the effective date of the Revenue Act of 1918, unless the insurance was originally payable to the estate, and was transferred by the decedent to specific beneficiaries in contemplation of death.

Valuation of insurance.—The amount to be returned in the case of any policy is the amount actually receivable by the executor or beneficiary. In cases where the proceeds of a policy are made payable to the beneficiary in the form of an annuity for life or for a term of years, the present worth of the annuity at the time of death should be included in the gross estate. For the method of computing the value of such an annuity, see Article 20. Where the insurance contract gives an option to receive a fixed sum of money in lieu of an annuity, this sum, if accepted, represents the value of the insurance for the purpose of the tax. If such sum is not accepted the value of the annuity is to be included in the gross estate. Where there is more than one option, and none of them is convertible, the value of the insurance should be determined in accordance with the option actually exercised. (Regulations No. 37, arts. 32–36.)

§ 274. Property Passing Under Power of Appointment

As a general rule, property passing under a general power of appointment must be included in the gross estate of the person exercising the power (known as the donee, or appointor) where the power is exercised by will, or by deed executed in contemplation of death, or intended to take effect at or after death. This general rule applies wherever the decedent died after September 8, 1916, although the power was created prior to that date. In certain cases, however, the transfer is taxable under the Revenue Act of 1918, when it would not be taxable under the Revenue Act of 1916.

Only property passing under a *general* power should be included. A general power is one to appoint to any person or persons in the discretion of the donee. Where the donee is required to appoint to a specified person or class of persons, the property should not be included in his gross estate. Property appointed under a general power should be included in the estate of the appointor, although the persons to whom the appointment was made would have taken the property had the power not been exercised. A copy of the instrument granting the power should be filed with Form 706 in all cases in order that the Bureau may determine whether the power is general or special. (Regulations No. 37, art. 30.)

§ 275. Property Transferred in Contemplation of Death

Nature of transfer.—The words "in contemplation of death" do not refer to the general expectation of death which all persons entertain. 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. The cause which induces such bodily or mental conditions is immaterial; and it is not necessary that the decedent be in the immediate expectation of death. Such a transfer is taxable, although the decedent parts absolutely and immediately with his title to and possession of the property. Transfers made within two years of a decedent's death are presumed to be taxable if they are of a material part of his property and are in the nature of a final disposition thereof. Where a transfer is of this character, the executor must disclose the transfer in the return; but he may submit therewith evidence that it was not made in contemplation of death. The executor must also return transfers by the decedent of a material part of his property to relatives, though made more than two years before his death; but he need not list them as taxable if he contends otherwise. All facts relating to the transfer should be stated, including the motive therefor, the decedent's state of health, and his anticipation of death. The presumption of taxability may be rebutted by proof that the transfer was not induced by bodily or mental conditions leading the grantor to make a disposition of property testamentary in its nature. 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; but it is a circumstance to be considered in determining whether the transfer was made in contemplation of death. (Regulations No. 37, art. 23.)

Reservation of income.—A transfer is taxable where the grantor reserves to himself during life the income of the property transferred. In such a case the transfer of the principal takes effect in possession and enjoyment after the death of the grantor, and the value of the entire property should be included in the gross estate. Where the grantor reserves a proportionate part of the income, only a corresponding proportion of the property should be included in the gross estate, unless the transfer was made in contemplation of death. If, for example, he reserves one-half of the income, the value of one-half of the property transferred should be included in the gross estate. If he reserves an annuity, so much of the property as is necessary to produce the annuity should be included in the gross estate. Where the property does not produce income, its value as of the date of the decedent's death should be ascertained, and so much of this sum as is necessary to produce the annuity should be included in the gross estate. A transfer is taxable in accordance with these principles whether the grantor makes a reservation of the annuity out of the property conveyed, or exacts from the grantee an agreement to pay the annuity. A gift of the principal of a trust fund which takes effect at or after the decedent's death is taxable, although the income during the decedent's life is payable to some one other than himself. Example: The decedent transfers property to his son, the latter agreeing to pay the income to his mother during the decedent's life. The transfer to the son is taxable.

Power of revocation or control.—A transfer by way of trust is taxable where the grantor reserves a power of revocation, even though he does not reserve any interest in the trust created. For example, where a father places property in trust for the present benefit of his son, but reserves power to revoke the trust at any time during his life, the entire property transferred should be included in the gross estate. A transfer by way of trust is also taxable where the grantor reserves power to control the administration of the trust, as by reserving power to change the trustee, the trust period, the trust property, or the respective interests of the beneficiaries in such property. (Idem., arts. 24, 25.)

§ 277. Material Transfers Within Two Years of Death

Nature and time of transfer.—A transfer made by the decedent in his lifetime, if made by way of gift, is taxable when made in contemplation of death, or intended to take effect in possession or enjoyment at or after the death of the transferor. No distinction is made between ordinary transfers and transfers involving the creation of a trust. Where a transfer, however, constitutes a *bona fide* sale for a fair consideration in money or money's worth, it is not taxable. In order to constitute such a *bona fide* sale, there must be a valuable consideration, as distinguished from love and affection. A sale implies the receipt of a price, in money or thing of value. The release of an existing claim, by way of accord and satisfaction, is not sufficient. The price must also be a fair equivalent for the property transferred. Where the price is not a fair one, the sale will not be considered to have been made *bona fide*. Such transfers are taxable whether made before or after September 8, 1916. (Regulations No. 37, art. 22.)

§ 278. Property Owned Jointly

Property held jointly or as tenants in the entirety.—The statute provides for the taxation of interests held jointly, or as tenants in the entirety, by the decedent and any other person or persons. This class of property includes all interests, whether in real or personal property, in which the survivor takes the entire property by right of survivorship, and it consequently does not form part of the decedent's estate for purposes of administration. It does not include interests held as tenants in common, where the interest of each tenant passes to his estate, free from any right of survivorship.

The following are examples of this class of property: Real estate held jointly; real estate held by husband and wife (known as an estate in the entirety); money deposited in a bank or trust company in the joint names of the decedent and another and payable to either or the survivor; joint trading accounts with brokers; stocks and bonds held in the joint names of several owners.

Taxable portion.—The value of such property to be returned for tax is the value of the entire property, unless it can be shown that part of it originally belonged to the other joint owner and never belonged to the decedent. In order to exclude any part of such property from the gross estate the executor must show an original contribution of value by some person other than the decedent. If such a contribution can be established, the proportion thereof to the entire purchase price represents the interest in the property which should be excluded from the gross estate. Three cases may arise: (1) The decedent may have paid the entire purchase price, in which case the entire property should be included; (2) the decedent may have paid only a portion of the purchase price, in which case only a corresponding portion of the property should be included; (3) the decedent may have paid no part of the purchase price, in which case no part of the property should be included. In the case of bank deposits, the same rule applies; that is, the interest of the decedent in the account is determined by the amount of his contribution. For example: An account of $1,000 is opened, of which the decedent contributes one-half. Interest of $40 has accumulated at the time of the decedent's death, and nothing has been withdrawn. Under these facts $520 should be included in the gross estate.

Husband and wife.—Property owned by husband and wife as tenants in the entirety is governed by the rule given above. The whole value of the property must be included, in the absence of a showing as to the original contributions. An exception is made, however, where property is conveyed to husband and wife without valuable consideration, or where the property was purchased out of common funds, representing the savings of husband and wife, or was the fruit of joint labor, the proportion of the several contributions having been lost sight of. In such cases one-half of the total value of the property should be returned. (Regulations No. 37, arts. 27–29.)

§ 283. Deductions to Determine Net Estate

The revised regulations of the Treasury Department on this subject (found in Regulations No. 37, arts. 38–49) are as follows:

ART. 38. *General provisions relating to deductions.*—In order to be deductible, the item must be of the character described in the statute; and it must also be one the payment of which out of the estate is allowed by the law of the jurisdiction administering it. Where the item is not one of those described, it is not deductible merely because payment is allowed by the local law. On the other hand, no item is deductible unless its payment is so allowed. It must appear in every case either that payment of the item has been made, or that such payment is clearly contemplated. Where the amount which may be expended for the particular purpose is limited by the local law, no deduction in excess of such limitation is permissible. Where the local courts have approved the expenditure it will ordinarily be allowed for deduction. (See Art. 39.) Where the disbursement has not been made, the item may be entered for deduction where the amount is certain, and it appears satisfactorily that it will be paid. No deduction may be taken upon the basis of a vague or uncertain estimate. Where an uncertain or contingent liability, not allowed as a deduction, becomes fixed, and payment is made, the remedy is a claim for a refund of the excess tax.

ART. 39. *Effect of court decree.*—The decision of a local court as to the amount of a claim or administration expense will ordinarily be accepted where the court passes upon the fact upon which deductibility depends. Where the court does not pass upon such fact its decree will, of course, not be followed. For example, where the question before the court is whether a claim should be allowed, the decree allowing it will ordinarily be accepted as establishing that the claim is valid and the amount of it. Where, however, a legacy is left to an executor in lieu of commissions, the allowance of the legacy does not establish that the executors claim for commissions is equal to the amount bequeathed, and that this amount is consequently deductible. (See Art. 42.) Nor will the decree necessarily be accepted even where it purports to decide the fact upon which deductibility depends. It must appear that the court actually passed upon the merits of the case. This will be presumed in all cases where there is an active and genuine contest. Where the result reached appears to be unreasonable, this is some evidence that there was not such a contest, but it may be rebutted by proof to the contrary. Where the decree was rendered by consent, it will be accepted, provided the consent was a bona fide recognition of the validity of the claim—not a mere cloak for a gift—and was accepted by the court as satisfactory evidence upon the merits. It will be presumed that the consent was of this character, and was so accepted, where it is made by all parties having an interest adverse to the claim, when all aspects of the matter, including its effect upon taxation, are considered. The decree will not be accepted where it appears to be at variance with the law of the State; as, for example, if an allowance is made to an executor in excess of the rate prescribed by statute.

ART. 40. *Funeral expenses.*—An executor may deduct such amounts for funeral expenses as are actually expended by him, provided expenditures of this nature are a liability of the estate under the laws of the local jurisdiction. A reasonable expenditure by the executor for a tombstone, monument or mausoleum, or for a burial lot, either for the decedent or his family, may be deducted under this heading, provided such an expenditure is made a charge upon the estate by the local law. Included in funeral expenses is the transportation of the person bringing the body to the place of burial.

ART. 41. *Administration expenses.*—The amounts deductible from the gross estate as "administration expenses" are such expenses as are actually and necessarily incurred in the administration of the estate; that is, in the collection of assets, payment of debts, and distribution among the persons entitled. The expenses contemplated in the law are such only as attend the settlement of an estate by the legal representative preliminary to the transfer of the property to individual beneficiaries or to a trustee, whether such trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions. Administration expenses include (1) executor's commissions; (2) attorney's fees; (3) miscellaneous expenses. Each of these classes is considered separately. (See Arts. 42 to 44.)

ART. 42. *Executor's commission.*—No amount may be deducted as commission in excess of that actually paid, or to be paid. Where the commission has not been allowed by the probate court, it may be deducted if its amount and future allowance are reasonably certain. In such case the executor must furnish satisfactory evidence at the time investigation is made that an account will be filed and the commission claimed. Where the executor does not intend to make any charge upon the estate for his services, or where he does not intend to file any account with the local court, no deduction may be claimed.

No deduction may be made for trustees' commissions, and an executor who acts as trustee is not entitled to deduct the fee he receives for his services in the latter capacity. The executor's duties are complete when he has turned over the estate or the proceeds to the persons entitled thereto. Such persons may be beneficiaries entitled to receive the property in their own right, or trustees entitled to receive it in the right of their cestuis que trust. The services of the trustees, in character and in time of rendition, are distinct from, and additional to, the ordinary duties of an executor in the settlement of estates; and fees for such trustees' services do not constitute an expense of administration.

Where a bequest is made to an executor in lieu of commissions, the deduction of the amount allowed by the local law for services rendered will be permitted, without reference to the amount of the legacy. If the legacy is in excess of the amount so allowed, the excess may not be deducted.

Where commissions not actually allowed are deducted upon the basis of reasonable compensation, attention should be given to the size of the estate, the character of the property, the amount of work performed by the executor, and the commissions allowed in the case of similar estates. The value of the real estate should not be taken into account in estimating the commission unless it has actually passed through the executor's hands, or there is a mandatory provision in the will, or a court decree, directing its sale, and commissions are allowed by the local law.

Where the allowance of a commission is based upon services in relation to income of the estate, as well as principal, the entire commission is deductible.

ART. 43. *Attorney's fee.*—Deduction may be taken for an attorney's fee for services rendered to the executor or administrator, in his official capacity, to the extent that such fees are allowed by the laws of the local jurisdiction. Fees may be deducted, although not allowed by decree of court, provided they are reasonable in amount, and have actually been paid, or will be paid. Where the disbursement has not been made, the executor must furnish at the time of the investigation satisfactory evidence that payment will be made, and the amount of such payment.

The fees of an attorney employed by the executor to conserve the assets of the estate, to resist claims, and to defend the will may be deducted, since these are duties which the executor is required to perform. The cost of litigation instituted by the beneficiaries as to the amount of their respective interests may not be deducted, since expenses of this character are properly charges against the beneficiaries personally, rather than against the general estate.

ART. 44. *Miscellaneous administration expenses.*—This item includes expenses incident to court proceedings, or the administration of the estate, such as court costs, surrogates' fees, accountants' fees, appraisers' fees, clerk hire, etc. Expenses necessarily incurred in distributing the estate are deductible. This includes the cost of storing or maintaining property of the estate, where it is impossible to effect immediate distribution to the beneficiaries. Expenses for preserving and caring for the property may be deducted, but do not include additions or improvements; nor will such expenses be allowed for a longer period than the executor is required to retain the property. A brokerage fee for selling property of the estate is deductible where the sale is necessary in order to pay the decedent's debts, or the expenses of administration, or to effect distribution. Other expenses attending the sale are deductible, such as the fees of an auctioneer, where it is reasonably necessary to employ one.

ART. 45. *Claims against the estate.*—The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, whether then matured or not. Obligations contracted by the executor are not deductible. Only such claims as are actually enforcible against the estate may be deducted.

ART. 46. *Taxes.*—Taxes upon real property should be accrued to the date of death. This is done by ascertainng the time between the first day of the taxable period wherein the death occurs and the date of death, and computing the proportion of the entire tax which this period bears to the entire taxable period. Such proportion of the tax has accrued upon the date of death, and is deductible.

Taxes upon personal property are either wholly deductible, or are not deductible at all, depending upon whether the tax did, or did not, become the personal obligation of the taxpayer in his lifetime. If the tax became his personal obligation during his life, the whole amount is deductible as a claim against his estate. If it did not become such personal obligation in his lifetime, no part of it is deductible. The question when the tax became the personal obligation of the taxpayer depends upon the law of the jurisdiction where the decedent was domiciled at the time of his death. Prima facie, the date when the tax became the personal obligation of the taxpayer is the date when the assessment was laid.

In the case of federal taxes upon income, the tax upon income received or accrued during the decedent's lifetime constitutes the personal obligation of the decedent, and is deductible. Taxes upon income received after the decedent's death are not deductible. No estate, succession, legacy, or inheritance tax is deductible.

ART. 47. *Unpaid mortgages.*—The full amount of unpaid mortgages on property included in the gross estate should be deducted under this heading, including interest which had accrued at the time of death, whether payable at that time or not. Interest should be computed upon the basis of 365 days to the year. The full value of the real estate, without any deduction for mortgages, must be returned as part of the gross estate. As real property situated outside of the United States is not part of the gross estate, the amount of mortgages upon such property should be deducted only where the decedent was personally liable for the mortgage debt.

ART. 48. *Losses from casualty or theft.*—There may be deducted under this heading 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 by insurance or otherwise. If the loss is partly compensated, the excess of the loss over such compensation may be deducted. Losses not of the nature described are not deductible. Losses sustained by reason of depreciation in the value of the assets of the estate subsequent to the decedent's death are not deductible. The term "casualty" includes only losses of a fortuitous and unusual character, such as result from violence, or from a disaster which could not be foreseen or prevented by the exercise of reasonable care. Losses due to the death of animals from disease are deductible. In order to be deductible a loss must occur during the settlement of the estate. Where property has been delivered to the beneficiary, settlement has been effected, and no deduction may be had for loss of the property.

ART. 49. *Support of dependents.*—The support during the settlement of the estate of dependents of the decedent should be deducted, but pursuant to the following rules:

(1) In order to be deductible, the allowance must be authorized by the laws of the jurisdiction in which the estate is being administered; and no sum is deductible in excess of the amount so authorized, whether actually expended or not.

(2) The only subject for deduction is *money* thus allowed and paid. The turning over of furniture or other personal property, although under the authority of a statute, is not a proper subject for deduction.

(3) The amount sought to be deducted must be reasonably required for support. This means that the alleged dependent shall actually require the allowance for his support. Mere relationship to the decedent is not enough. A person is not dependent where he has means of his own sufficient to support him according to his station in life. This implies, however, the possession of *income,* either from property or earnings, sufficient to support him according to his scale of living at the time of the decedent's death. A person is not removed from the dependent class by the possession of property, which he might sell or mortgage. Where a person is thus dependent at the time of the allowance, it does not affect the deduction that he subsequently comes into the possession of money or property, through the distribution of the estate or otherwise. The whole amount of the allowance is deductible, whether paid in one sum or in installments.

(4) The money must be actually expended for support. This means that the executor or administrator must pay it to the persons entitled. After the payment has been made, the deduction of the sum is proper, and is not affected by the fact that the dependents do not use the whole of it during the period of administration.

Public, charitable, and similar bequests.—Bequests to religious, charitable, scientific, literary, or educational corporations are deductible only if the corporation is organized or operated exclusively for one of the purposes specified. Similarly, in the case of a trust, the trust must be exclusively for such purposes. It does not prevent deduction, however, that the property placed in trust is also subject to another trust for a private purpose. Thus, where money or property is placed in trust to pay the income to an individual during life, and then to pay or deliver the same to a charitable corporation, or apply the principal to a charitable purpose, the charitable bequest or devise forms the basis for a deduction. The amount of the deduction, in such case, is the value, at the date of the decedent's death, of the remainder interest in the money or property which is devised or bequeathed to charity. Gifts made in the decedent's lifetime are deductible only if made in contemplation of death, or intended to take effect at or after death, and the property is consequently included in the gross estate. Gifts made in satisfaction of a legacy are also deductible. The deduction is not limited in the case of the estates of residents to bequests to domestic corporations or to trustees for use within the United States. (Regulations No. 37, art. 53.)

§ 285. Deductions in Case of Estates of Nonresidents

The gross estate of a resident and of a nonresident are made up in the same way. In ascertaining the net estate, however, which is subject to tax, there is a radical difference between the two cases. Whereas the net estate in the case of a resident is determined by making the specified deductions from the entire gross estate, the net estate in the case of a nonresident is determined by making the deductions from the value of so much of the gross estate as is situated in the United States. Thus, in substance, the statute attempts to tax only the transfer of so much of the estate of a nonresident as is situated in the United States. On the other hand, nonresident estates are not entitled to the specific exemption of $50,000. (Regulations No. 37, art. 59.)

§ 286. Notice to be Filed by Executors

The revised Treasury regulation on this subject is as follows: A preliminary notice, called the 60-day notice, is required to be filed in the case of every resident decedent who died on or after February 25, 1919, the gross amount of whose estate exceeds $50,000. This notice must be filed in duplicate with the collector in whose district the decedent had his domicile at the time of death. Where there is doubt as to whether the gross estate exceeds $50,000, the notice should be filed, as matter of precaution, in order to avoid penalties.

Prior to February 25, 1919, the notice was required if the gross estate exceeded $60,000, or if there was any net estate after the deductions allowed by law, including the $50,000 exemption, had been taken. These provisions are not now in effect except to determine delinquency under previous acts.

In the case of the estates of nonresident decedents, notice is required if there is any property situated in the United States, without reference to its value.

The executor or administrator of an estate is required to file notice on Form 704 within 60 days of his appointment by the court, or of coming into possession of any property of the estate, whichever event occurs first. The primary purpose of the notice is to advise the Government of the existence of taxable estates, and filing should not be delayed beyond the 60-day period because of uncertainty as to the exact value of the assets. Since the filing of the notice within the prescribed period is mandatory, the estimate of the gross estate called for by the notice is merely the best approximation of value which can be made within the time allowed. The instructions upon the back of the form should be read carefully before executing the notice. The signature of one executor or administrator upon Form 704 is sufficient. (Regulations No. 37, arts. 66, 67.)

§ 287. Notice to be Given by Others than Executors

The revised regulations of the Treasury Department on this subject (in Regulations No. 37, arts. 68–70) are as follows:

ART. 68. *Notice by others than the executor or administrator.*—The notice upon Form 704 must be filed by others than the executor or administrator if either of the following situations exists:

(1) No executor or administrator has been appointed.

(2) There is property included in the gross estate, as defined by statute, which has not, and will not, come into the custody and control of the executor.

In these cases, the persons in possession of the property included in the gross estate are executors, within the meaning of the statute, for the purpose of filing the notice.

ART. 69. *Notice when no executor appointed*.—Where no executor or administrator has been appointed, the person taking possession of property at the time of death is required to file notice within 60 days of the date of death. The notice must be filed whether possession of the property was held at the date of death, or was acquired thereafter. The notice on Form 704 must be filed by such persons in any case where an executor or administrator has not been appointed within 60 days of the decedent's death, although one is appointed subsequently.

Where an executor or administrator is appointed within the 60-day period, the duty of filing the notice devolves upon him; and all other persons are relieved from liability to file with respect to property coming into the custody and control of the executor or administrator.

ART. 70. *Notice where property not within executor's control.*—Where there is property that will not come into the custody and control of the executor, but which is included in the gross estate as defined by the statute, the notice on Form 704 must be filed within 60 days of the date of death by the person in possession or control of the property at the time of death.

The persons required to file Form 704, in compliance with this requirement, include the following:

(1) The surviving husband or wife in the case of property owned as tenants in the entirety.

(2) Donees who have received within two years prior to the decedent's death any gift of material value from the decedent, or who have received at any time whatever gifts made by the decedent in contemplation of death or intended to take effect at or after death.

(3) Trustees holding property conveyed during lifetime by decedent in contemplation of death, or with intent to provide for others at or after the decedent's death, regardless of the date of execution of the instrument making the conveyance.

(4) Fiduciaries holding property of any kind jointly for the decedent and another or others. Example: A savings bank holding a joint account in the name of the decedent and another, payable to either or to the survivor, must file Form 704 for the full amount of the account.

(5) Trustees having in charge property over which the decedent exercised a general power of appointment, and which will not come into the possession and control of the executor or administrator.

(6) Beneficiaries other than the executor who receive insurance upon the decedent's life, provided the total amount of the insurance receivable by all such beneficiaries exceeds $40,000.

§ 299. Payment of Tax

Medium of payment.—Payment of the estate tax may be made by the delivery of Liberty Bonds or other bonds of the United States bearing interest at a higher rate than 4 per cent per annum, provided they were owned by the decedent for at least six months prior to the date of his death. Such bonds are received in payment to the amount of par and interest accrued at the time of the payment. (See T. D. 2802 and T. D. 2905.)

Collectors may accept uncertified checks in payment of the estate tax provided such checks are collectible at par—that is, for their full amount, without any deduction for exchange or other charges. If the bank on which any such check is drawn should refuse to pay it at par, the check should be returned through the depositary bank, and be treated in the same manner as a bad check. All expenses incident to the attempt to collect such a check and the return of it through the depositary bank must be paid by the drawer of the check to the bank on which it is drawn, since no deduction can be made from amounts received in payment of taxes. (See Revised Statutes, Sec. 3210.)

The executor shall pay the tax.—The statute provides that the executor shall pay the tax. This duty applies to the tax upon the transfer of the entire estate, including property which will not come into the possession of the executor or administrator. As to the personal liability of the executor, see Article 113.

Extension of time for payment.—In any case where the Commissioner finds that payment of the tax within one year after the decedent's death would impose undue hardship upon the estate, extensions of time will be granted for the payment of the tax for a period not to exceed in all three years from the due date. Extensions of time for tax payment will be granted only in exceptional cases, where it is evident that the payment of the tax within the statutory period would cause the estate serious financial loss. No extension shall be for more than one year, and a substantial payment shall be made before each extension. Application for extension of time for payment should be filed with the collector, and should contain a full statement of the facts upon which the application is based. The collector will refer the application to the Commissioner, with suitable recommendations.

The extension of time for the payment of the tax should not be confused with extension of time for filing the return. An extension of time to pay the tax does not relieve from the duty of filing the return within one year from the date of death. An extension of time for tax payment will not operate to prevent the accrual of interest upon the tax. (Regulations No. 37, arts. 91–93.)

§ 305. Imposition and Rate of Tax

Computation of tax after 1918.—For the taxable year 1919 and subsequent years, (*a*) if the net income, as defined in section 320 (a) (3) of the statute, is not in excess of 20 per cent of the invested capital, as defined in section 326, then under the first bracket the tax payable is 20 per cent of the amount of the net income in excess of the excess profits credit, as defined in section 312, and the second bracket is not applicable. (*b*) If the net income is in excess of 20 per cent of the invested capital, then under the first bracket the tax is 20 per cent of the excess of an amount of net income equal to 20 per cent of the invested capital over the excess profits credit, and under the second bracket the tax is 40 per cent of the amount of the remaining net income less any excess profits credit not exhausted under the first bracket. The sum of the taxes computed under the two brackets is the tax payable. But see the following article and section 302. (Regulations No. 45, art. 713.)

Computation of tax on income from government contracts.—In the case of a corporation which derives in any taxable year after 1918 a net income of more than $10,000 from any Government contracts made after April 5, 1917, and before November 12, 1918, the tax shall be such a proportion of a tax computed at the rates for 1918 as the portion of the net income attributable to the Government contracts bears to the entire net income, plus such a proportion of a tax computed at the rates for 1919 as the amount of the remaining net income bears to the entire net income. In computing such taxes, however, the excess profits credit and the war profits credit applicable to the taxable year shall be used. But see section 302 of the statute. The part of the net income attributable to such Government contracts shall be determined in accordance with the following article. (Idem. art. 714.)

Allocation of net income to particular source.—Whenever it is necessary to determine the portion of the net income derived from or attributable to a particular source, the corporation shall allocate to the gross income derived from such source, and to the gross income derived from each other source, the expenses, losses and other deductions properly appertaining thereto, and shall apply any general expenses, losses and deductions (which can not properly be otherwise apportioned) ratably to the gross income from all sources. The gross income derived from a particular source, less the deductions properly appertaining thereto and less its proportion of any general deductions, shall be the net income derived from such source. The corporation shall submit with its return a statement fully explaining the manner in which such expenses, losses and deductions were allocated or distributed. (Idem. art. 715.)

§ 307. Corporations Partly of the Personal Service Kind

Regulations No. 45, arts. 741–743, provide as follows:

Art. 741. *Apportionment of invested capital and net income.*—For the purpose of determining whether or not a corporation partly partaking of the nature of a personal service corporation is within the scope of section 303 of the statute and also for the purpose of establishing the basis for the computation of the tax, the corporation shall apportion or allocate its invested capital between each trade or business or branch thereof as nearly as may be in accordance with the actual facts, and shall submit with its return an explanatory statement setting forth the manner in which the apportionment of the invested capital employed in the production of each part of its net income has been determined. There must be assigned to any personal service trade or business or branch thereof an amount of invested capital at least as great as that which would ordinarily be employed by a personal service corporation of similar size and standing for the payment of salaries and office expenses, maintenance of library and equipment, credit advances to clients, etc. For the method of determining the portion of the net income derived from each trade or business or branch thereof see article 715.

ART. 742. *Computation of tax upon net income.*—(1) The tax upon the non-personal service part of the net income is computed upon the basis of (*a*) such part of the entire average net income for the pre-war period as was derived from the same trade or business or branch thereof; (*b*) such part of the entire average invested capital for the prewar period as was employed in the production of the part of the net income for that period determined under (*a*); (*c*) such part of the entire invested capital for the taxable year as has been employed in the production of the net income upon which the tax is being computed; and (*d*) the same proportion of the specific exemption and credits as the proportion which the part of the net income upon which the tax is being computed is of the entire net income. If the corporation was in existence during the prewar period, but did not conduct this trade or business or branch thereof during that period, the war profits credit shall be computed as provided in section 311 (b) of the statute.

(2) The tax upon the personal service part of the net income is the same percentage thereof as the tax computed under (1) is of the non-personal service part of the net income. The tax under this paragraph shall in no case be less than 20 per cent of the personal service part of the entire net income, unless the tax upon the entire net income if computed in the ordinary way would be less than 20 per cent of such entire net income. In that event, and in any case in which the amount of the total tax as computed under this article is the same as or greater than the tax as computed in the ordinary way, the tax shall be computed under section 301 of the statute.

ART. 743. *Illustration of computation of tax where partly personal service business.*—A corporation is engaged in contracting and construction work (a non-personal service business in which the employment of capital is necessary) and also renders consulting engineering service (a personal service business which if constituting its sole business would bring it within the class of personal service corporations). It has an average prewar invested capital of $50,000 (of which $38,000 was used in contracting work and $12,000 in engineering); an average prewar net income of $52,000 (of which $12,000 was derived from contracting and $40,000 from engineering); an invested capital for 1918 of $100,000 (of which $81,000 is used in contracting and $19,000 in engineering); and a net income for 1918 of $90,000 (of which $30,000 is derived from contracting and $60,000 from engineering).

(1) In computing the tax upon the first or non-personal service part of the net income (i. e., $30,000 derived from contracting) the specific exemption is $1,000 (i. e., the same proportion of $3,000 which $30,000 is of the entire net income of $90,000). The excess profits credit is a specific exemption of $1,000, plus 8 per cent of the invested capital used in contracting (i. e., 8 per cent of $81,000) or $6,480, a total of $7,480. The war profits credit is a specific exemption of $1,000, plus the average prewar net income derived from contracting or $12,000, plus 10 per cent of $43,000 (the difference in invested capital used in contracting) or $4,300, making a total of $17,300.

First bracket.—The amount of the net income derived from contracting ($30,000) in excess of the excess profits credit ($7,480) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of $81,000) or $16,200 is $8,720. The tax under this bracket is 30 per cent of this amount (i. e., 30 per cent of $8,720) or $2,616.

Second bracket.—The amount of the net income derived from contracting ($30,000) in excess of 20 per cent of the invested capital used in contracting (i. e., 20 per cent of $81,000) or $16,200 is $13,800. The tax computed under this bracket is 65 per cent of this amount (65 per cent of $13,800) or $8,970.

Third bracket.—Eighty per cent of the amount of the net income derived from contracting in excess of the war profits credit (i. e., 80 per cent of the amount by which $30,000 exceeds $17,300 or 80 per cent of $12,700) is $10,160. The amount of the tax computed under the first and second brackets ($2,616 plus $8,970) is $11,586. There is no tax under this bracket, as $10,160 does not exceed $11,586.

Tax.—The tax upon the first portion of the net income (i. e., $30,000 derived from contracting) is the sum of the taxes computed under the three brackets (i. e., $2,616 plus $8,970 plus nothing) or $11,586. This is 38.62 per cent of $30,000 of the net income from contracting.

(2) The tax upon the second or personal service part of the net income (i. e., $60,000 derived from engineering) is the same percentage of such part of the net income (i. e., 38.62 per cent of $60,000) or $23,172.

(3) The total tax is the sum of $11,586 (the tax upon the first part of the net income derived from contracting) and $23,172 (the tax upon the second part of the net income derived from engineering) or $34,758.

§ 309. Tax Computed for Part of Year

Apportionment of specific exemption.—The specific exemption of $3,000 is apportioned only in the case where a return is made covering a period of less than twelve months. In such a case the specific exemption is the same proportion of $3,000 as the number of months in the period is of twelve months, any fractional part of a month being counted as the number of days in such part of a month divided by 30. Thus, in the case of a corporation organized May 12, 1918, and making a return for the period ending December 31, 1918, the exemption is $1,916.67, that is, the same proportion of $3,000 as $7^{20}/_{30}$ months is of 12 months. On return form 1120 this apportionment is taken care of by prorating items 3 and 8 of schedule III. This provision is inapplicable where the return is made for a full fiscal year beginning prior to January 1, 1918, and ending after that date, even though the income for such fiscal year is not subject to full taxation under the present statute. (Regulations No. 45, art. 761.)

§ 310. Meaning of "Prewar Period"

The prewar period in the case of each corporation covers so many of the calendar years 1911, 1912 and 1913 during the whole of which it, or a predecessor trade or business, was in existence. See section 330 of the statute and articles 931–934. If a new enterprise was launched in corporate form in June, 1912, its prewar period would accordingly be the calendar year 1913. The prewar period when mentioned without reference to any particular corporation means the calendar years 1911, 1912 and 1913. (Regulations No. 45, art. 771.)

§ 311. War Profits Credit

The regulations of the Treasury Department on this subject (Regulations No. 45, arts. 781–785) are as follows:

ART. 781. *War profits credit.*—Ordinarily the war profits credit consists of the sum of the specific exemption of $3,000 and an amount equal to the average net income of the corporation for the prewar period, plus 10 per cent of the excess of the invested capital for the taxable year over the average invested capital for the prewar period, or minus 10 per cent of the excess of the average invested capital for the prewar period over the invested capital for the taxable year. If a return is made for a period of less than twelve months, the amount equal to the average net income for the prewar period plus or minus 10 per cent of the difference between the average invested capital for the prewar period, and the invested capital for the taxable year shall be reduced to the same proportion thereof as the number of months in the period is of twelve months. See section 305 of the statute. The same result is reached in schedule IV of return form 1120 by computing the war profits credit for a full year and taking a fractional part of the result. If at the time a return is made the net income for the prewar period or the difference between the average invested capital for the prewar period and the invested capital for the taxable year can not be determined, the war profits credit shall be computed in the first instance as provided in the following article. If either of these amounts can not eventually be determined, the war profits credit shall be finally determined as provided in the following article.

ART. 782. *War profits credit where meager prewar net income.*—If a corporation had no net income for the prewar period, or if the war profits credit as ordinarily computed (exclusive of the specific exemption of $3,000) is less than 10 per cent of its invested capital for the taxable year, then the war profits credit consists of the sum of the specific exemption of $3,000 and an amount equal to 10 per cent of the corporation's invested capital for the taxable year.

ART. 783. *War profits credit where no prewar period.*—If a corporation had no prewar period, then the war profits credit consists of the sum of the specific exemption of $3,000 and an amount equal to the same percentage of the invested capital for the taxable year as the average percentage of net income to invested capital for the prewar period of corporations engaged in a trade or business of the same general class as that conducted by the taxpayer, but not less than 10 per cent of its invested capital for the taxable year. The war profits credit shall be computed in the first instance on the basis of 10 per cent of the invested capital, and when the average percentage of corporations engaged in the same general class of trade or business has been determined the amount of the tax will if necessary be recomputed. See section 250 of the statute.

ART. 784. *War profits credit where no prewar period in special circumstances.*—If a corporation had no prewar period, but (*a*) if a majority of its stock at any time during the taxable year was owned or controlled by a corporation which was in existence during the whole of at least one calendar year during the prewar period, or (*b*) if 50 per cent or more of its gross income consisted of income derived from Government contracts made after April 5, 1917, and before November 12, 1918, then the war profits credit is to be determined as provided in article 782 instead of in the manner provided in article 783.

ART. 785. *War profits credit in the case of affiliated corporations.*—In the case of affiliated corporations making a consolidated return only one specific exemption of $3,000 is allowed.

§ 313. Examples of Computation of Tax

The following official illustrations of the method of computing the tax are given in Regulations No. 45, arts. 716–720:

ART. 716. *Illustration of computation of tax.*—A corporation has an average prewar invested capital of $50,000, an average prewar net income of $10,000, an invested capital for 1918 of $100,000, a net income for 1918 of $40,000, an invested capital for 1919 of $110,-000, and a net income of $50,000.

(1) For 1918 the excess profits credit is a specific exemption of $3,000, plus 8 per cent of the invested capital (i. e., 8 per cent of $100,000) or $8,000, making a total of $11,000. See section 312 of the statute and article 791. The war profits credit is a specific exemption of $3,000, plus the average prewar net income of $10,000, plus or minus 10 per cent of the difference between the average prewar invested capital and the invested capital for 1918. In this case it is plus, because the invested capital for 1918 is greater than the average prewar invested capital. The amount added is 10 per cent of the difference between $100,000 and $50,000, i. e., 10 per cent of $50,000, or $5,000, making a total war profits credit of $18,000. See section 311 and article 781.

First bracket.—The amount or portion of the net income ($40,000) in excess of the excess profits credit ($11,000) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of $100,000) or $20,000 is $9,000. The tax computed under this bracket is 30 per cent of this amount (i. e., 30 per cent of $9,000) or $2,700.

Second bracket.—The amount or portion of the net income ($40,-000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of $100,000) or $20,000 is $20,000. The tax computed under this bracket is 65 per cent of this amount (i. e., 65 per cent of $20,000) or $13,000.

Third bracket.—Eighty per cent of the amount or portion of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which $40,000 exceeds $18,000, or $22,000) is $17,600. The amount of the tax computed under the first and second brackets ($2,700 plus $13,000) is $15,700. The tax computed under this bracket is the amount by which $17,600 exceeds $15,700, or $1,900.

Total tax.—The total tax for 1918 is the sum of the taxes computed under the three brackets (i. e., $2,700 plus $13,000 plus $1,900) or $17,600.

(2) For 1919 the excess profits credit is a specific exemption of $3,000 plus 8 per cent of the invested capital (i. e., 8 per cent of $110,000) or $8,800, a total of $11,800. See section 312 and article 791.

First bracket.—The amount or portion of the net income ($50,000) in excess of the excess profits credit ($11,800) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of $110,000) or $22,000 is $10,200. The tax computed under this bracket is 20 per cent of this amount (i. e., 20 per cent of $10,200) or $2,040.

Second bracket.—The amount or portion of the net income ($50,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of $110,000) or $22,000 is $28,000. The tax computed under this bracket is 40 per cent of this amount (i. e., 40 per cent of $28,000) or $11,200.

Total tax.—The total tax for 1919 is the sum of the taxes computed under the two brackets (i. e., $2,040 plus $11,200) or $13,240.

ART. 717. *Illustration of computation where no tax under third bracket.*—If the corporation used as an illustration in article 716 had an average prewar net income of $20,000 instead of $10,000, the excess profits credit and the tax for 1918 computed under the first and second brackets would be the same, but the war profits credit and the tax computed under the third bracket would not be the same. The war profits credit would be a specific exemption of $3,000 plus the average prewar net income or $20,000, plus 10 per cent of $50,000 (the difference in invested capital) or $5,000, making a total war profits credit of $28,000.

Third bracket.—Eighty per cent of the amount of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which $40,000 exceeds $28,000 or 80 per cent of $12,000) is $9,600. The amount of the tax computed under the first and second brackets ($2,700 plus $13,000) is $15,700. There is accordingly no tax under the third bracket, as $9,600 does not exceed $15,700.

Total tax.—The total tax for 1918 is the sum of the taxes computed under the three brackets (i. e., $2,700 plus $13,000 plus nothing) or $15,700. The total tax for 1919 would, of course, be the same as in article 716.

Art. 718. *Illustration of computation where excess profits credit not exhausted under first bracket.*—A corporation has an average prewar invested capital of $20,000, an average prewar net income of $7,000, and invested capital and net income for 1918 of the same amounts, respectively. The excess profits credit is a specific exemption of $3,000 plus 8 per cent of the invested capital (i. e., 8 per cent of $20,000) or $1,600, a total of $4,600. The war profits credit is a specific exemption of $3,000 plus the average prewar net income of $7,000, a total of $10,000. There is nothing further to be added or deducted in this case, as there is no difference between the average invested capital for the prewar period and the invested capital for the taxable year.

First bracket.—The excess profits credit ($4,600) exceeds 20 per cent of the invested capital (20 per cent of $20,000) or $4,000, and there is no amount taxable under this bracket.

Second bracket.—The portion of the net income ($7,000) in excess of 20 per cent of the invested capital (20 per cent of $20,000) or $4,000 is $3,000. In this case, however, the full amount of the excess profits credit could not be allowed under the first bracket, so that the $3,000 which would ordinarily be taxable under this bracket is reduced by the amount of the excess profits credit not allowed under the first bracket ($600), leaving only $2,400 taxable under this bracket. The tax computed under this bracket is 65 per cent of this amount (i. e., 65 per cent of $2,400) or $1,560.

Third bracket.—The war profits credit ($10,000) exceeds the net income ($7,000), so that there is no tax under this bracket.

Total tax.—The total tax for 1918 would be the sum of the taxes computed under the three brackets (i. e., nothing plus $1,560 plus nothing) or $1,560, were it not that section 302 provides that the maximum tax shall not in this case exceed $1,200. See articles 731–733. The total tax for 1918 is therefore $1,200.

Art. 719. *Illustration of computation where net income derived from Government contract.*—If in the case of the corporation used as an illustration in article 716 the $50,000 net income for 1919 includes $20,000 of net income from Government contracts, the tax for that year would be the sum of the amounts computed under clauses (1) and (2) of section 301(c) of the statute.

(1) Under clause (1) the excess profits credit is $11,800, the same as under clause (2). The war profits credit is a specific exemption of $3,000, plus the average prewar net income, or $10,000, plus 10 per cent of $60,000 (the difference in invested capital) or $6,000, making a total war profits credit of $19,000.

First bracket.—The amount or portion of the net income ($50,000) in excess of the excess profits credit ($11,800) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of $110,000), or $22,000, is $10,200. The tax computed under this bracket is 30 per cent of this amount (i. e., 30 per cent of $10,200) or $3,060.

Second bracket.—The amount or portion of the net income ($50,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of $110,000) or $22,000, is $28,000. The tax computed under this bracket is 65 per cent of this amount (65 per cent of $28,000) or $18,200.

Third bracket.—Eighty per cent of the amount of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which $50,000 exceeds $19,000, or $31,000) is $24,800. The amount of the tax computed under the first and second brackets ($3,060 plus $18,200) is $21,260. The tax computed under this bracket is the amount by which $24,800 exceeds $21,260, or $3,540.

The portion of the tax computed under clause (1) is the same proportion of the total amount computed under the above brackets at the rates for 1918 (i. e., $3,060 plus $18,200 plus $3,540) or $24,800, as the part of the net income attributable to Government contracts ($20,000) is of the entire net income ($50,000). This portion of the tax is therefore 2/5 of $24,800 or $9,920.

(2) The portion of the tax computed under clause (2) is the same proportion of the total amount computed at the rates for 1919 or $13,240 (for the details see illustration for 1919 under article 716) as the part of the net income not attributable to Government contracts ($30,000) is of the entire net income ($50,000). This portion of the tax is therefore 3/5 of $13,240 or $7,944.

(3) The total tax for the year 1919 is the sum of the amounts computed under paragraphs (1) and (2) above ($9,920 plus $7,944) or $17,864.

ART. 720. *Illustration of computation where return for period of less than 12 months.*—A corporation which has reported on the basis of the fiscal year ending March 31, 1918, later changes to a calendar year basis and files a return covering the 9 months from April 1, 1918, to December 31, 1918. It had an average prewar capital of $50,000, an average prewar net income of $3,500, an invested capital for the 9 months ending December 31, 1918, of $120,000, and a net income for such period of $50,000. The computation in this illustration follows the directions contained in return form 1120 and proportionately reduces items 3 and 8 of schedule III and items 1 and 2 of column 2 of schedule IV. It should be noted that this is a somewhat different method of arriving at the same result which would be reached under a literal application of sections 305, 311(a) (2) and 326 (d) of the statute. The excess profits credit is computed by adding the specific exemption of $3,000 to 8 per cent of the full invested capital of $120,000, or $9,600, a total of $12,600, and taking 9/12 of this result, or $9,450, as the excess profits credit. See item 3 of schedule III of form 1120. The war profits credit is computed by adding the specific exemption of $3,000 to 10 per cent of the full invested capital of $120,000, or $12,000, a total of $15,000, and taking 9/12 of this result, or $11,250, as the war profits credit. See item 8, of schedule III of form 1120. The war profits credit is computed in this case under section 311 (b), because the amount computed under section 311 (a) (2) is less than 10 per cent of the invested capital. The amount computed under section 311 (a) (2) would be the sum of the average prewar net income, or $3,500, plus 10 per cent of the amount by which the full invested capital of $120,000 actually used during the taxable period exceeds the average prewar invested capital of $50,000 (i. e., 10 per cent of $70,000), or $7,000, a total of $10,500. See items 4 and 5 of schedule III of form 1120. This amount is less than 10 per cent of the full invested capital for the taxable year as computed under section 311 (b). See item 6 of schedule III of form 1120.

First bracket.—The amount or portion of the net income ($50,000) in excess of the excess profits credit ($9,450) and not in excess of 9/12 of 20 per cent of the invested capital (i. e., 9/12 of 20 per cent of $120,000), or $18,000, is $8,550. The tax computed under this bracket is 30 per cent of this amount (i. e., 30 per cent of $8,550), or $2,565.

Second bracket.—The amount or portion of the net income ($50,000) in excess of 9/12 of 20 per cent of the invested capital (i. e., 9/12 of 20 per cent of $120,000), or $18,000, is $32,000. The tax computed under this bracket is 65 per cent of this amount (i. e., 65 per cent of $32,000), or $20,800.

Third bracket.—80 per cent of the amount or portion of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which $50,000 exceeds $11,250, or $38,750), is $31,000. The amount of the tax computed under the first and second brackets ($2,565 plus $20,800) is $23,365. The tax computed under this bracket is the amount by which $31,000 exceeds $23,365, or $7,635.

Total tax.—The total tax will be the sum of the taxes computed under the three brackets (i. e., $2,565 plus $20,800 plus $7,635) or $31,000.

§ 314. Determination of Net Income

Prewar net income of affiliated corporations.—The consolidated net income of affiliated corporations for the prewar period shall be the average consolidated net income for the prewar years of such of the several corporations included in the consolidation for the taxable year as were affiliated during the prewar period, plus the aggregate of the average net income for each of the corporations not affiliated during the prewar period which were in existence during all of the prewar period or during at least one full year within the prewar period. The net income of a subsidiary corporation organized during the prewar period by an existing corporation shall also be included. (Regulations No. 45, art. 802.)

§ 315. Determination of Invested Capital; Definitions

The rules prescribed by the Treasury Department (in Regulations No. 45, arts. 811–818) on this subject are as follows:

ART. 811. *Intangible and tangible property.*—Intangible property includes patents and good will and other like property. Tangible property includes all property other than intangible property. Most contracts are intangible property and in the absence of a specific ruling by the Commissioner to the contrary should be so regarded for the purpose of making returns. A contract may be treated as tangible property only after the submission of a full statement as to its exact nature showing to the satisfaction of the Commissioner that it relates to rights in tangible property to such an extent that its value arises chiefly therefrom. Associated Press, United Press and similar franchises, and subscription lists and mailing lists, are intangible property.

ART. 812. *Borrowed capital; securities.*—Any interest in a corporation represented by bonds, debentures or other securities, by whatever name called, including so-called preferred stock, if with respect to the payment of either interest or principal it ranks with or prior to the interest of the general creditors, is borrowed capital and cannot be included in computing invested capital. Any such preferred stock may, however, be so included if it is deferred with respect to the payment of both interest and principal to the interest of the general creditors.

ART. 813. *Borrowed capital; amounts left in business.*—Whether a given amount paid into or left in the business of a corporation constitutes borrowed capital or paid-in surplus is largely a question of fact. Thus, indebtedness to stockholders actually cancelled and left in the business would ordinarily constitute paid-in surplus, while amounts left in the business representing salaries of officers in excess of their actual withdrawals, or deposit accounts in favor of partners in a partnership succeeded by the corporation, will be considered paid-in surplus or borrowed capital according to the facts of the particular case. The general principle is that if interest is paid or is to be paid on any such amount, or if the stockholder's or officer's right to repayment of such amount ranks with or before that of the general creditors, the amount so left with the corporation must be considered as borrowed capital and be so treated in computing invested capital.

ART. 814. *Borrowed capital; other illustrations.*—Items such as deposits or amounts due to other banks shown in the balance sheet of a bank, unexpired subscriptions shown in the balance sheet of a publishing concern, etc., are deemed liabilities and cannot be included in computing invested capital.

ART. 815. *Inadmissible assets.*—Stocks, bonds and other obligations (other than obligations of the United States), the dividends or interest from which are not required to be included in computing net income, are inadmissible assets even though no such dividends or interest have been actually paid or received during the taxable year. The failure to pay or to receive dividends or interest does not change the status of such securities as inadmissible assets. A corporation cannot by including the income from inadmissible assets as taxable income create the right to have such assets considered admissible assets.

ART. 816. *Inadmissible assets; government bonds.*—Obligations of a State or Territory or any municipal or other political subdivision thereof, of the District of Columbia, or of any possession of the United States, and federal farm loan bonds, not being obligations of the United States within the meaning of the statute, are inadmissible assets.

ART. 817. *Inadmissible assets; partial exception.*—(*a*) Where the income derived from inadmissible assets consists in part of profit from the disposition thereof, or (*b*) where all or a part of the interest derived from such assets is in effect included in net income because the interest paid on indebtedness incurred or continued to purchase or carry such assets may not be deducted from gross income, in either case a corresponding part of the capital invested in such assets shall be deemed an admissible asset. This article applies separately to each issue or class of inadmissible securities held by a corporation. For example, it may hold A company stock costing $100,000 and B company stock costing $200,000. During the year it receives $8,000 in dividends from A company and $5,000 from B company, and on September 30 sells part of its B company stock at a profit of $3,000. For the period from January 1 to September 30, $75,000 of its holdings of B company stock become admissible. After September 30 its remaining holdings of B company stock are inadmissible, but the proceeds of the sale are admissible unless invested in inadmissibles. See articles 852 and 854.

ART. 818. *Admissible assets.*—Admissible assets include all assets other than inadmissible assets. Organization expenses and deferred charges against future income are admissible assets. For all purposes of computing invested capital admissible assets must be valued in accordance with the provisions of sections 326, 330 and 331 of the statute and the articles thereunder. Thus, for example, intangible property paid in for stock or shares is an admissible asset, but it cannot be valued at an amount in excess of that at which it may be included in computing invested capital under paragraphs (4) and (5) of section 326 (a).

§ 316. How Invested Capital Determined

The regulations prescribed by the Treasury Department on this subject are contained in Regulations No. 45, arts. 831–871, and are as follows:

ART. 831. *Meaning of invested capital.*—Invested capital within the meaning of the statute is the capital actually paid in to the corporation by the stockholders, including the surplus and undivided profits, and is not based upon the present net worth of the assets, as shown by an appraisal or in any other manner. The basis or starting point in the computation of invested capital is found in the amount of cash and other property paid in, the valuation at which such other property may be included being determined in accordance with the statute and the regulations. The computation does not stop, however, with such original entries or amounts, but also takes into account the surplus and undivided profits of prior years left in the business. The invested capital of a corporation includes, generally speaking, (*a*) the cash paid in for stock, (*b*) the tangible property paid in for stock, (*c*) the surplus and undivided profits, and (*d*) the intangible property paid in for stock (to a limited amount), less, however, the same proportion of such aggregate sum as the amount of inadmissible assets bears to the total assets. Invested capital does not include borrowed capital. The fair market value of the assets as of March 1, 1913, has no bearing on invested capital.

ART. 832. *Cash paid in; bonus stock.*—Capital stock issued as a bonus in connection with the sale of a corporation's bonds may not be included in invested capital unless the corporation proves to the satisfaction of the Commissioner that such stock bonus enabled the corporation to secure a higher price for the bonds than it could otherwise have secured. Wherever this fact is established such stock shall be included in computing invested capital to the extent of the difference between the selling price of the bonds and the price at which they could have been sold if issued without such stock bonus. The excess of the face value of such bonds over the price at which they could have been sold if issued without the stock bonus is deemed discount and is subject to amortization.

ART. 833. *Tangible property paid in; evidences of indebtedness.*—Enforcible notes or other evidences of indebtedness, either interest-bearing or non-interest 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.

ART. 834. *Tangible property paid in: inadmissible assets.*—Stocks, bonds and other obligations (other than obligations of the United States), the dividends or interest from which are not included in computing net income, when bona fide paid in for stock or shares may like other tangible property be included in computing the invested capital of the corporation at their actual cash value when paid in. For the purpose of the reduction required in articles 852 and 854, however, account must be taken of such assets in the same manner as of any other inadmissible assets.

ART. 835. *Tangible property paid in: mixture of tangible and intangible property.*—Where stock or shares and bonds or other obligations have been issued for a mixed aggregate of tangible and intangible property, it will be presumed in the absence of satisfactory evidence to the contrary that the bonds were issued for tangible property and that the stock was issued for the balance of the tangible property, if any, and for the intangible property. Where stock or shares have been issued for a mixed aggregate of tangible and intangible property and certain liabilities have been assumed in connection with the transaction, it will be presumed that such liabilities are to be charged against the tangible property and the intangible property in the order named, unless it is shown by evidence satisfactory to the Commissioner that this presumption is not in accordance with the facts. See further section 327 (c) of the statute.

ART. 836. *Tangible property paid in: value in excess of par valuc of stock.*—Evidence offered to support a claim for a paid-in surplus must be as of the date of the payment, and may consist among other things of (*a*) an appraisal of the property by disinterested authorities made on or about the date of the transaction; (*b*) certification of the assessed value in the case of real estate; and (*c*) proof of a market price in excess of the par value of the stock or shares. The additional value allowed in any case is confined to the value definitely known or accurately ascertainable at the time of the payment. No claim will be allowed for a paid-in surplus in a case in which the additional value has been developed or ascertained subsequently to the date on which the property was paid in to the corporation, or in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as for instance, at a receiver's sale. Generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation, and in all cases the proof of value must be clear and explicit.

ART. 837. *Surplus and undivided profits: paid-in surplus.*—Where it is shown by evidence satisfactory to the Commissioner that tangible property has been paid in by a stockholder to a corporation as a gift or at a value definitely known or accurately ascertainable as of the date of such payment clearly and substantially in excess of the cash or other consideration paid by the corporation therefor, then the amount of the excess shall be deemed to be paid-in surplus. Substantially the same kind of evidence will be required under this article as under article 836.

ART. 838. *Surplus and undivided profits: earned surplus.*—Only true earned surplus and undivided profits can be included in the computation of invested capital, and if for any reason the books do not properly reflect the true surplus such adjustments must be made as are necessary in order to arrive at the correct amount. In the computation of earned surplus and undivided profits full recognition must first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowances for depreciation, obsolescence or depletion of property (irrespective of the manner in which such property was originally acquired), and for the amortization of any discount on its bonds. There can of course be no earned surplus or undivided profits until any deficit or impairment of paid-in capital due to depletion, depreciation, expense, losses or any other cause has been made good. Where adequate evidence is presented that the amounts written off or deducted in previous returns of net income are in the aggregate incorrect or unreasonable, adjustments must be made, and the taxpayer will be allowed a refund in respect of any taxes overpaid in prior years, or in the case of an underpayment of taxes will be additionally assessed.

ART. 839. *Surplus and undivided profits: allowance for depletion and depreciation.*—Depletion, like depreciation, must be recognized in all cases in which it occurs. Depletion attaches to each unit of mineral or other property removed, and the denial of a deduction in computing net income under the Act of August 5, 1909, or the limitation upon the amount of the deduction allowed under the Act of October 3, 1913, does not relieve the corporation of its obligation to make proper provision for depletion of its property in computing its surplus and undivided profits. Adjustments in respect of depreciation or depletion in prior years will be made or permitted only upon the basis of affirmative evidence that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years was insufficient or excessive, as the case may be. Where deductions for depreciation or depletion have either on the books of the corporation or in its returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return.

ART. 840. *Surplus and undivided profits: additions to surplus account.*—A corporation's books of accounts will be presumed to show the facts. If it claims that its capital or surplus account is understated the burden of proof will rest upon it. Additions to such accounts will be accepted to the following extent:

(1) Excessive depreciation heretofore charged off on property still owned and in use, if it is now shown by satisfactory proof to have been excessive and such excess is substantial in amount, whether or not disallowed by the Commissioner as a deduction from net income, may be restored to the surplus account. No such amount shall be restored, however, unless it is shown that adequate depreciation has been deducted upon all other property of the corporation still in use, nor in any case in which such amount has been allowed as a deduction for amortization under section 234 (a) (8) of the statute, or in which the cost of the property has been recovered through being included in the price of goods or services, as for example, in the case of patterns, dies, plates, special tools, etc., or under a munition contract with a foreign government.

(2) Amounts which have been expended before January 1, 1917, for the acquisition of plant, equipment, tools, patterns, furniture, fixtures, or like tangible property, having a useful life extending substantially beyond the year in which the expenditure was made, and which have been charged as current expense, may (less proper deductions for depreciation or obsolescence) be added to the surplus account when such assets are still owned and in active use by the corporation during the taxable year. Special tools, patterns, and similar assets shall not be assigned any value if their cost has been recovered through having been included in the price of goods. If their cost has not been so recovered and they are held for only occasional use, they shall not be assigned a value in excess of the fair value based upon the earnings actually arising from their current use, and in no case shall such value be more than the cost less depreciation. Assets of this kind not in current use shall not be valued at more than their nominal or scrap value.

(3) Amounts which have been expended in the past for intangible property of any kind can be restored to capital or surplus account only to the extent that the corporation specifically paid such amounts for the intangible property as such. For provisions relating to patents see article 843.

(4) Adjustments necessary to correct other errors found in the books of account may be made. But see the following article.

ART. 841. *Surplus and undivided profits; limitation of additions to surplus account.*—Additions to surplus which a corporation may desire to make under the preceding article fall broadly into two classes:

(1) To correct returns of net income for prior years in which actual errors have been made, as for example where excessive depreciation has been deducted, additions to plant and equipment or other capital charges have been charged off as an expense, inventories have been taken upon a wrong basis of valuation, etc.

(2) To reinstate in surplus deductions from income which are as a matter of good accounting to some extent optional, such as experimental expenses, patent litigation, development of good will through advertising or otherwise, etc.

Adjustments falling in class (1) will be permitted for all years whether before or after March 1, 1913, provided amended returns of net income are filed for each year in which an erroneous return has been made. Due consideration will be given to the assessment of penalties in any case in which a fraudulent return has been made. Adjustments falling in class (2) cannot be permitted, as in such cases it is considered that the corporation has exercised a binding option in deducting such expenses from income. An election of this sort which was made concurrently with the transaction cannot now be revised, and amended returns in respect thereof cannot be accepted. The corporation shall submit with its return a statement of the additions proposed, specifying the kinds and amounts of property involved, the years in which the expenditures were made, and the method followed in distinguishing between capital outlays and current expenses, and showing that adequate provision has been made for depreciation, obsolescence and depletion of such of the assets affected by the additions as are subject to recognized depreciation, obsolescence or depletion. In any case in which there is an operating deficit amounts restored must first be set off against the deficit and only the excess can be actually included in the computation of invested capital.

ART. 842. *Surplus and undivided profits; property paid in and subsequently written off.*—Where tangible or intangible property has been paid in to a corporation for stock or shares or as paid-in surplus, and has subsequently been in whole or in part written off the books, the amount so written off may upon evidence satisfactory to the Commissioner be restored to the capital or surplus account subject to the following limitations:

(1) The amount restored must be reduced by a proper deduction for any depreciation, obsolescence or depletion; and

(2) The aggregate amount included in computing invested capital on account of such property shall not exceed the amount which might have been included if such property had not been written off.

ART. 843. *Surplus and undivided profits; patents.*—From the standpoint of assets a patent, or more particularly a group of patents, is closely analogous to good will. Their value is contingent upon and measured by their earning power. While patents have a definite life, there is a common tendency to extend that life by improvements upon the original, and in a successful business the patent value merges more or less completely into a trade name or other form of good will. Therefore, while deductions in respect to the depreciation of patents based upon a normal life period of seventeen years are allowable in computing net income for the purpose of the income tax, such deductions are not obligatory, but are optional with each taxpayer. Where since January 1, 1909, a corporation has exercised that option to its own benefit in computing its taxable net income the amount so deducted can not now be restored in computing invested capital. Where, however, the cost of patents has been charged against surplus or otherwise disposed of in such a manner as not to benefit the corporation in computing its taxable net income since January 1, 1909, any amount so written off may be restored in computing invested capital, if it be shown to the satisfaction of the Commissioner that the amount so written off represented a mere book entry ascribable to a conservative policy of management or accounting and did not represent a realized shrinkage in the value of such assets. Any amount so restored may not be written off by way of deductions from taxable net income in any subsequent year or years. Where a corporation has charged to current expenses the cost of developing or protecting patents, no amount in respect thereof expended since January 1, 1909, can be restored in computing invested capital. In respect of expenditures made before January 1, 1909, a corporation now seeking to restore them must be prepared to show to the satisfaction of the Commissioner that all such items are proper capital expenditures. It can not be said that the correct computation of surplus and undivided profits necessarily requires a deduction in respect of the expiration of patents. It follows, therefore, that where a corporation in the exercise of its option has not written down the cost of patents, it is not ordinarily necessary to reduce the surplus and undivided profits in computing invested capital, whether the patents have been acquired for stock or shares or for cash or other tangible property. Due consideration will be given to the facts in any case in which this rule seems obviously unreasonable.

ART. 844. *Surplus and undivided profits; reserve for depreciation or depletion.*—If any reserves for depreciation or for depletion are included in the surplus account it should be analyzed so as to separate such reserves and leave only real surplus. Reserves for depreciation or depletion can not be included in the computation of invested capital, except to the following extent:

(1) Excessive depletion or depreciation included therein and which if charged off could be restored under article 840 may be included in the computation of invested capital; and

(2) Where depreciation or depletion is computed on the value as of March 1, 1913, or as of any subsequent date, the proportion of depreciation or depletion representing the realization of appreciation of value at March 1, 1913, or such subsequent date, may if undistributed and used or employed in the business be treated as surplus and included in the computation of invested capital.

For the purpose of computing invested capital depreciation or depletion computed on the value as of March 1, 1913, or as of any subsequent date shall, if such value exceeded cost, be deemed a pro rata realization of cost and appreciation and be apportioned accordingly. Except as above provided value appreciation (even though evidenced by an appraisal) which has not been actually realized and in respect of amounts accrued since March 1, 1913, reported as income for the purpose of the income tax, can not be included in the computation of invested capital, and if already reflected in the surplus account it must be deducted therefrom.

ART. 845. *Surplus and undivided profits; reserve for income and excess profits taxes.*—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 the installment is due and payable. Where as a result of an audit by the Commissioner, or the acceptance of an amended return, or for any other reason, the amount of any such tax for the preceding year is subsequently changed, a corresponding adjustment will be made in the invested capital for the taxable year upon the same basis as if the corrected amount of the tax for the preceding year had been used in the original computation of the invested capital for the taxable year.

ART. 846. *Surplus and undivided profits; insurance on officers.*—Where insurance is carried by the corporation on the life of an officer or employee, the policy may be included as an admissible asset and reflected in the surplus account at the cash surrender value as of the beginning of the taxable year. The whole amount of premiums paid on such insurance cannot be included in surplus, but the surplus will be considered as increased as of the beginning of each taxable year by the amount added to the cash surrender value of the policy.

ART. 847. *Surplus and undivided profits; property taken for debt or in exchange.*—Real or personal property taken by a corporation in payment or satisfaction of a debt, or property received in exchange for other property, will be an admissible asset at its fair market value upon receipt. The profit or loss, if any, resulting from the transaction will not be reflected in invested capital until the succeeding taxable year.

ART. 848. *Surplus and undivided profits; discount on sale of bonds.*—Discount allowed on the sale of bonds is in effect an advance on account of interest, so that the effective rate of interest in such a case is equal to the sum of the nominal rate plus the rate necessary to amortize the discount over the life of the bonds. Where, under incorrect accounting practices, the discount on bonds has been charged to a property account or otherwise carried as an asset, and is so reflected in the surplus account, it is necessary in computing invested capital to make an adjustment in respect of such discount.

ART. 849. *Surplus and undivided profits; miscellaneous.*—Only the amount of discount which has actually been reported by a bank in a prior year as taxable income and credited to surplus account may be included in surplus as of the beginning of the taxable year. For the treatment of surplus arising out of sales on the installment plan see articles 42–46, and from compensation for property lost, damaged or condemned see articles 49 and 50.

ART. 850. *Surplus and undivided profits; current profits.*—Profits earned during any year can not be included in the computation of invested capital for that year, even though during the year such profits are set up as surplus on the books or assumed to be distributed in the form of stock dividends. If a dividend is declared and paid during any year out of the profits of that year and the stockholders pay back into the corporation all or a substantial part of the amount of such dividends, the amount so paid back can not be included in the computation of invested capital unless the corporation shows by evidence satisfactory to the Commissioner that the dividends were paid in good faith and without any understanding, express or implied, that they were to be paid back.

ART. 851. *Intangible property paid in.*—The actual cash value of intangible property paid in for stock or shares must be determined in the light of the facts in each case. Among the factors to be considered are (*a*) the earnings attributable to such intangible assets while in the hands of the predecessor owner; (*b*) the earnings of the corporation attributable to the intangible assets after the date of their acquisition; (*c*) representative sales of the stock of the corporation at or about the date of the acquisition of the intangible assets; and (*d*) any cash offers for the purchase of the business, including the intangible property, at or about the time of its acquisition. A corporation claiming a value for intangible property paid in for stock or shares should file with its return a full statement of the facts relating to such valuation. See also article 835.

ART. 852. *Percentage of inadmissible assets.*—For the purpose of ascertaining the deductible percentage the amount of inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount held at the end of the year. The total amount of admissible and inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount at the end of the year. If at any time a substantial change has taken place either in the amount of inadmissible assets or in the total amount of admissible and inadmissible assets, the effect of such change shall be averaged exactly from the date on which it occurred. In any case where the Commissioner finds that either amount determined as above provided does not substantially reflect the average situation throughout the year, and that the amount of each kind of assets held on a given day of each month throughout the year or at more frequent regular intervals can be determined, the amount of inadmissible assets and the amount of both kinds of assets held during the year shall be determined by averaging the amounts held at such several times. In making the computations under this article the valuation at which each asset is carried shall be adjusted in accordance with the provisions of the statute and of the regulations relating to the valuation of assets for the purpose of computing invested capital, including in such adjustment the amount of reserves for depreciation, depletion, amortization and other reserves which represent the valuation of assets. It is immaterial whether any asset was acquired out of invested capital or out of profits earned during the year or borrowed capital.

ART. 853. *Changes in invested capital during year.*—The invested capital as of the beginning of any period of one year or less should be adjusted by an appropriate addition or deduction for each change in invested capital during the period. The amount so added or deducted in each case is the amount of the change averaged for the time remaining in the period during which it is in effect. The fraction used in finding such average is the number of days remaining in the period (including the day on which the change occurs) over the number of days in the period. Thus if a return is made for the calendar year ending December 31, 1918, and if $100,000 of additional capital was paid in on February 17, 1918, this addition to invested capital is in effect for 318 days, and the amount to be added to the invested capital as of the beginning of the year would be $^{318}/_{365}$ of $100,000, or $87,-123.29. If $50,000 of this amount was withdrawn on October 31, 1918, the amount to be deducted would be $^{62}/_{365}$ of $50,000, or $8,-493.15.

ART. 854. *Computation of average invested capital.*—For the purpose of computing invested capital for any period of one year or less each corporation shall add together its paid-in capital and its paid-in or earned surplus and undivided profits (under whatever name it may be called) as shown by its books at the beginning of the period. The total so obtained shall be adjusted (*a*) for any property paid in, or for any asset reflected in surplus and undivided profits, which is not carried on the books at the valuation prescribed by the statute or by the regulations, and (*b*) for any changes in paid-in capital or in paid-in or earned surplus and undivided profits (not including surplus and undivided profits earned during the period) occurring during the period, averaged for the time for which such changes are effective. See article 853. The total so obtained and adjusted is the average invested capital for the period, unless the corporation at any time during the period held any inadmissible assets, in which case such total must be reduced by a percentage thereof equal to the percentage which the amount of inadmissible assets held during the period is of the total amount of admissible and inadmissible assets held during the period. See article 852. The invested capital for any year during the prewar period is determined in the same manner as for the taxable year. The invested capital can not be determined by adding the amounts of the assets of a corporation.

ART. 855. *Invested capital for full year or less.*—In the case of a corporation making a return for a full year of 12 months, its invested capital for the year is the average invested capital for the year. In the case of a corporation making a return for a fractional part of a year, its invested capital for such period is the same fractional part of the average invested capital for such period, except that for the purpose of section 311 (a) (2) of the statute it is the full average invested capital for the period. In computing the tax under a return for a fractional part of a period the same purpose may sometimes be more readily effected by using the full average invested capital and taking a fractional part of the result, as in schedule III of form 1120. In schedule IV of the same form, however, the fractional part of the full average invested capital for the period should be used.

ART. 856. *Illustration of invested capital for fractional part of year.*—A corporation was organized July 1, 1918, and makes a return for the six months ending December 31, 1918. The invested capital consists of $100,000 paid in on July 1 and $100,000 paid in on October 1. The average invested capital for such period would be $100,000 plus 92/184 (not 92/365) of $100,000, or $50,000, a total of $150,000. The invested capital for the period for the purpose of the tax would, however, be 6/12 of $150,000, or $75,000. But see section 311 (a) (2) of the statute.

ART. 857. *Method of determining available net income.*—Whether at the time of any payment made during the taxable year there is sufficient income of the taxable year available for such payment, or whether the surplus or undivided profits as of the beginning of the taxable year must be reduced by the amount of such payment, shall be determined according to the following principles:

(1) The aggregate amount of earnings of the taxable year available for all purposes up to any given date will be determined upon the basis of the same proportion of the net income for the taxable year (as finally determined for the purpose of income and war profits and excess profits taxes) as the part of the year already elapsed is of the entire year (determined in the manner provided in article 853), unless the corporation shows from its books or other records that a greater proportion of its earnings for the year was available on such date.

(2) The aggregate amount available will be deemed to be applied for the following purposes in the order in which they are stated: (*a*) accrued federal income and war profits and excess profits taxes for the taxable year (see article 845), and (*b*) dividends paid after the expiration of the first sixty days of the taxable year (see section 201 of the statute and article 1541) and other corporate purposes, including the purchase of outstanding stock of the corporation previously issued (see article 862). In any case where the above computation would be indeterminate because of the effect of the provisions of this article upon the invested capital for the year, the amount of such invested capital for the purpose of this computation may be deemed to be the invested capital as of the beginning of the taxable year, plus any additional capital paid in during such year and minus any specific withdrawal or liquidation of capital during such year.

ART. 858. *Effect of ordinary dividend.*—A dividend other than a stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment the date when declared will be considered also the date when payable for the purpose of this article. For the purpose of computing invested capital a dividend paid after the expiration of the first sixty days of the taxable year will be deemed to be paid out of the net income of the taxable year to the extent of the net income available for such purpose on the date when it is payable. See article 857. The surplus and undivided profits as of the beginning of the taxable year will be reduced as of the date when the dividend is payable by the entire amount of any dividend paid during the first sixty days of the taxable year and by the amount of any other dividend in excess of the current net income available for its payment. In the case of a dividend paid during the first sixty days of a taxable year which exceeds in amount the surplus and undivided profits as of the beginning of the taxable year the excess will be deemed to be paid out of earnings of the taxable year available at the date when the dividend is payable, and to the extent that such earnings are insufficient it will be deemed to be a liquidation of paid in capital or surplus. From the date when any dividend is payable the amount which the several stockholders are entitled to receive will be treated as if actually paid to them, whether or not it is so paid in fact, and the surplus and undivided profits, either of the taxable year or of the preceding years, will in accordance with the foregoing provisions be deemed to be reduced as of that date by the full amount of the dividend. Amounts paid to stockholders in anticipation of dividends, or amounts withdrawn by stockholders in excess of dividends declared, will in computing invested capital have the same effect as if actually paid as dividends.

ART. 859. *Effect of stock dividend.*—The payment of a stock dividend has no effect upon the amount of invested capital. Such items as appraised value of good will, appreciation in value of real estate or other tangible property, etc., although carried to surplus and distributed as stock dividends, can not in this manner be capitalized and included in computing invested capital. If a corporation has paid a stock dividend in excess of its true surplus, it can not be deemed to have any greater invested capital than could have been computed had no such stock dividend been paid.

ART. 860. *Impairment of capital.*—Capital or surplus actually paid in is not required to be reduced because of an impairment of capital in the nature of an operating deficit, except where there has been directly or indirectly a liquidation or return of their investment to the stockholders, in which case full effect must be given to any liquidation of the original capital.

ART. 861. *Surrender of stock.*—Where stock which has originally been issued or exchanged by the corporation for property (tangible or intangible) is returned to the corporation as a gift or for a consideration substantially less than its par value, the stock so returned shall not be treated as a part of the stock issued or exchanged for such property. The proceeds derived in cash or its equivalent from the resale of the stock so returned shall, however, be included in computing invested capital.

ART. 862. *Purchase of stock.*—Where a corporation either directly or indirectly, as for example through a trustee, has prior to the taxable year bought its own stock, either for the purpose of retirement or of holding it in the treasury or for other purposes, the entire cost of such stock must be deducted from the aggregate invested capital as of the beginning of the taxable year, if such deduction has not already been made. Where such stock is purchased during the taxable year a deduction from the invested capital as of the beginning of the taxable year and effective from the date of such purchase is required only to the extent that such stock has not been purchased out of the undivided profits of the taxable year. See article 857. The full amount derived in cash or its equivalent from the resale of such stock may be included in the invested capital from the date of such resale, unless such stock had been purchased out of earnings of the taxable year.

ART. 863. *Invested capital and other measures of capital.*—(*a*) The invested capital as here defined may differ from the capital as shown on the books of the corporation. In such event no changes should be made in the books themselves. The corporation should, however, in all cases keep a permanent record of the adjustments which are made in computing invested capital. (*b*) Section 1000 of the statute imposes a tax on the fair value of the capital stock of corporations. As in the case of the war profits and excess profits tax the invested capital is based upon the actual investment of the stockholders in the corporation, irrespective of the present value of its assets, and in the case of the capital stock tax the fair value looks to the present value of the corporation's assets, irrespective of the amount of the investment of the stockholders therein, the amount determined as the fair value of the capital stock for the purpose of the capital stock tax can have no bearing upon the determination of invested capital.

ART. 864. *Affiliated corporations; invested capital.*—The invested capital of affiliated corporations, as defined in section 240 (b) of the statute and article 633, for the taxable year is the invested capital of the entire group treated as one unit operated under a common control. As a first step in the computation a consolidated balance sheet should be prepared in accordance with standard accounting practices, which will reflect the actual assets and liabilities of the affiliated group. In preparing such a balance sheet all intercompany items, such as intercompany notes and accounts receivable and payable, should be eliminated from the assets and the liabilities, respectively, and proper adjustments should be made in respect of intercompany profits or losses reflected in inventories which at the beginning or end of the taxable year contain merchandise exchanged between the corporations included in the affiliated group at prices above or below cost to the producing or original owner corporation. Such consolidated balance sheet will then show (*a*) the capital stock of the parent or principal company in the hands of the public; (*b*) the consolidated surplus belonging the the stockholders of the parent or principal company; and (*c*) the capital stock, if any, of subsidiary companies not owned by the parent or principal company, together with the surplus, if any, belonging to such minority interest. In computing consolidated invested capital the starting point is furnished by the total of the amounts shown under (*a*), (*b*) and (*c*) above. This total must be increased or diminished by any adjustments required to be made under the provisions of sections 325, 326, 330 and 331 of the statute and articles 811–818, 831–869, 931–934 and 941 of the regulations, except as otherwise provided in articles 865–868.

ART. 865. *Affiliated corporations; intangible property paid in.*—(1) In respect of corporations whose affiliation is in the nature of parent and subsidiary companies: (*a*) in the case of intangible property bona fide paid in for stock or shares prior to March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares of the consolidation outstanding on March 3, 1917 (determined as indicated in items (*a*) and (*c*) in article 864), or in the aggregate 25 per cent of the par value of the total stock or shares shown on the consolidated balance sheet, being the amount of the capital stock included in items (*a*) and (*c*) in article 864 at the beginning of the taxable year, whichever is lowest; and (*b*) in the case of intangible property bona fide paid in for stock or shares on or after March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares shown by the consolidated balance sheet, being the amount of the capital stock included in items (*a*) and (*c*) in article 864 outstanding at the beginning of the taxable year, whichever is lowest. (*c*) When intangible property has been acquired in part before and in part after March 3, 1917, the amounts shall be ascertained, respectively, under (*a*) and (*b*) above and in the aggregate shall in no case exceed 25 per cent of the par value of the total stock or shares outstanding at the beginning of the taxable year shown in the consolidated balance sheet, being the amount of the capital stock included in items (*a*) and (*c*) in article 864.

(2) In respect of corporations affiliated by reason of ownership by the same interests, the limitations set forth in paragraphs (4) and (5) of subdivision (a) of section 326 of the statute shall be applied to each corporation separately and the aggregate of the intangible property, so valued, shall be included in invested capital in the consolidated return. In respect of each of the affiliated corporations the aggregate of the amounts ascertained under the provisions of paragraphs (4) and (5) shall in no case exceed 25 per cent of the outstanding capital stock of such corporation at the beginning of the taxable year.

ART. 866. *Affiliated corporations; inadmissible assets.*—Where adjustment is required in respect of inadmissible assets in accordance with the provisions of subdivision (c) of section 326 of the statute, such adjustment shall be made on the basis of the consolidated balance sheet with due regard to the adjustments and eliminations set forth in articles 864 and 865 and to the provisions of articles 815–818.

ART. 867. *Affiliated corporations; stock of subsidiary acquired for cash.*—When all or substantially all of the stock of a subsidiary corporation was acquired for cash, the cash so paid shall be the basis to be used in determining the value of the property acquired.

ART. 868. *Affiliated corporations; stock of subsidiary acquired for stock.*—Where stock of a subsidiary company was acquired with the stock of the parent company, the amount to be included in the consolidated invested capital in respect of the company acquired shall be computed in the same manner as if the net tangible assets and the intangible assets had been acquired instead of the stock. If in accordance with such acquisition a paid-in surplus is claimed, such claim shall be subject to the provisions of article 837.

ART. 869. *Affiliated corporations; invested capital for prewar period.*—The invested capital of affiliated corporations for the prewar period shall be computed on the same basis as the invested capital for the taxable year, except that where any one or more of the corporations included in the consolidation for the taxable year were in existence during the prewar period, but were not then affiliated as herein defined, then the average consolidated invested capital for the prewar period shall be the average invested capital of the corporations which were affiliated in the prewar period plus the aggregate of the average invested capital for each of the several corporations which were not affiliated during the prewar period. Full recognition, however, must be given to the provisions of section 330 of the statute, particularly the last paragraph thereof, and of articles 931–934.

ART. 870. *Insurance companies.*—The reserve funds of insurance companies, the net additions to which are deductible from gross income under the provisions of section 234 of the statute, cannot be included in computing invested capital.

ART. 871. *Foreign corporations.*—Inasmuch as the war profits and excess profits tax in the case of a foreign corporation is not based on the invested capital of the corporation, but is computed in accordance with section 328 of the statute, the provisions of section 326 and of articles 831–870 have no application to foreign corporations. For the same reason, when rendering a return of income on form 1120 for a foreign corporation, no entry of invested capital should be made thereon.

§ 317. Determination of Tax in Special Cases

In the cases specified in section 327 of the statute the tax will be specially determined under the provisions of section 328, but the tax will not ordinarily be computed under section 328 merely because the corporation's form or manner of organization, or the limitations imposed by section 326, result in a greater tax than would otherwise be payable. A corporation which comes within the provisions of subdivision (*d*) of section 327 may make application for assessment under the provisions of section 328, which application shall be attached to its return in the form of a statement setting forth in full: (*a*) the reasons why the tax should be so determined; (*b*) the facts upon which such reasons are based; (*c*) an exact description of each trade or business or important branch of a trade or business carried on by it; (*d*) a statement of the invested capital and net income for each year since the beginning of the prewar period; and (*e*) a statement showing the amount of gains, profits, commissions or other income derived on a cost plus basis from Government contracts made after April 5, 1917, and before November 12, 1918, and showing the per cent which such income is of the total income of the corporation. (Regulations No. 45, art. 901.)

§ 318. Special Cases; Comparison with Average Tax of Corporations in Same Business

In pursuance of this provision of the statute, the following regulations (Regulations No. 45, arts. 911–914) have been prescribed:

ART. 911. *Computation of tax in special cases.*—In the cases specified in section 327 of the statute the tax is to be computed by comparison with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are engaged in a like or similar trade or business and similarly circumstanced. The provisions of section 328 do not permit the determination of a general average for any trade or business. In each case which comes under the provisions of section 327 the Commissioner will determine, as nearly as may be, the group or class of corporations with which the corporation should be compared and the amount which bears the same ratio to the net income of the corporation (in excess of the specific exemption of $3,000) for the taxable year as the average tax of such representative corporations bears to their average net income (in excess of the specific exemption of $3,000) for such year. The comparison will take account of similarity with respect to gross income, net income, profit 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.

ART. 912. *Determination of first installment of tax in special cases.*—In the case of any corporation, other than a foreign corporation, where absolutely no data are available for the determination of the invested capital for the taxable year, the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax equal to 50% of the net income. In any other case under section 328 of the statute, other than the case of a foreign corporation, but including a case where the invested capital for the taxable year can not be accurately determined, but where a minimum amount of invested capital as to which there is no question can be determined, the installments shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using the minimum invested capital, such tax not to exceed an amount equal to 50% of the net income.

ART. 913. *Determination of first installment of tax in the case of foreign corporation.*—In the case of a foreign corporation the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using its invested capital for the taxable year 1917, such tax not to exceed an amount equal to 50% of the net income. For the purpose of this article the invested capital for 1917 shall be adjusted for any subsequent changes in its amount due to cash or property paid in or withdrawn or to surplus or undivided profits of prior years retained in the business and properly attributable to its business within the United States. If the tax for 1917 was determined under section 210 of the Revenue Act of 1917, the constructive capital which would result in a tax equivalent to the tax determined under that section shall be used.

ART. 914. *Payment of tax in special cases.*—In any case falling under the last two articles the installments shall be paid upon the basis therein provided until the Commissioner notifies the corporation of the amount of tax computed under section 328. The installments shall then be recomputed upon the basis of a war profits and excess profits tax of such amount, and if the amount already paid is less than the amount which would have already become due if the installments had originally been computed upon that basis, the additional amount shall be due and payable ten days after notice and demand from the collector. The provisions hereof supersede any inconsistent instructions in paragraph 10 of page 1 of instructions, or in paragraph 5 of page 2 of instructions, on return form 1120.

§ 319. Reorganizations; Consolidations; Change of Ownership

Regulations No. 45, arts. 931–941, governing this subject, are as follows:

ART. 931. *Scope of reorganizations.*—The first two paragraphs of section 330 of the statute relate only to the prewar period and not to the invested capital or net income for the taxable year. Under their provisions in the case of a reorganization, consolidation or change of ownership, the corporation is regarded as having been in existence prior to the date of such reorganization, consolidation or change in ownership, and the net income and invested capital of the predecessor trade or business for all or any part of the prewar period prior to the organization of the present corporation are deemed to have been the net income and invested capital of such corporation.

ART. 932. *Net income and invested capital of predecessor partnership or individual.*—If the predecessor trade or business was carried on by a partnership or individual, the corporation shall make its return of the net income and invested capital of such trade or business as nearly as may be in the same manner as if such trade or business had been carried on by a corporation. It shall submit with its return a statement setting forth (*a*) the manner in which such trade or business was carried on and (*b*) the points, if any, in which the provisions of the statute and of the regulations are not fully applicable to the determination of the net income or invested capital of the predecessor trade or business for the prewar period. In no case shall the deduction from gross income for salary or compensation for personal services exceed the salaries or compensation customarily paid at that time by corporations or partnerships of similar size and standing engaged in similar trades or businesses for similar services under like responsibilities.

ART. 933. *Election to be taxed as corporation.*—A business enterprise (*a*) which is organized as a corporation before July 1, 1919, (*b*) in which capital is and has been a material income-producing factor, and (*c*) which was previously owned by a partnership or individual, may elect to be taxed as a corporation on its net income from January 1, 1918, to the date of organization of the corporation. In such event the corporation shall be treated as if in existence since January 1, 1918, for the purposes of the income tax, the war profits and excess profits tax, and the capital stock tax. The adoption of any other date than January 1, 1918, for such purpose is not permissible. But this option is not extended to a business enterprise with a net income for the taxable year 1918 less than 20 per cent of its invested capital.

ART. 934. *Adjustment for asset differently valued in prewar invested capital.*—In any case in which as a result of a reorganization or for any other reason any asset in existence both during the taxable year and any prewar year is included in computing the invested capital for the taxable year, but is not included in computing the invested capital for such prewar year, or is valued on a different basis in computing the invested capital for the two years, the difference resulting therefrom shall not be included in determining the difference 10 per cent of which is added to or deducted from the war profits credit under section 311 (a) (2) of the statute. In any such case the corporation shall make the readjustment required by the statute, and shall submit with its return a full statement of the difference in such valuations and of the facts which give rise to such difference. See also section 331 and article 941.

ART. 941. *Valuation of asset upon change of ownership.*—Where a business is reorganized, consolidated or transferred, or property is transferred, after March 3, 1917, and an interest of 50 per cent or greater in such business or property remains in any of the previous owners, then for the purpose of determining invested capital each asset so transferred is valued (*a*) as if still in the possession of the previous owner, if a corporation, or, if not a corporation, (*b*) at its cost to such previous owner, with proper adjustments for losses and improvements. This provision is accordingly concerned with the computation of invested capital for the taxable year, while section 330 of the statute is chiefly concerned with the determination of invested capital for the prewar period.

§ 321. Tax for First Taxable Year

Regulations No. 45, arts. 951–955, applicable to this subject, are as follows:

ART. 951. *Fiscal year with different rates.*—Section 335 of the statute applies to the war profits and excess profits tax. For provisions with respect to the income tax see section 205 of the statute. Subdivision (a), which deals with fiscal years beginning in 1917 and ending in 1918, and subdivision (b), which deals with fiscal years beginning in 1918 and ending in 1919, apply to corporations other than personal service corporations. Subdivision (c), which deals with fiscal years beginning in 1917 and ending in 1918, applies to partnerships and to personal service corporations. Partnerships and personal service corporations having fiscal years beginning in 1918 and ending in 1919 are not subject to the war profits and excess profits tax.

ART. 952. *Fiscal year of corporation ending in 1918.*—The method provided for computing the tax for a fiscal year beginning in 1917 and ending in 1918 is as follows: (*a*) the tax attributable to the calendar year 1917 is found by computing the income of the taxpayer and the tax thereon in accordance with Title II of the Revenue Act of 1917 as if the fiscal year was the calendar year 1917, and determining the proportion of such tax which the number of months falling within the calendar year 1917 is of the number of months in the entire period; (*b*) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the present statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the number of months falling within the calendar year is of the number of months in the entire period; and (*c*) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1917 and the tax attributable to the calendar year 1918.

ART. 953. *Deductions and credits in the case of fiscal year ending in 1918.*—Net losses deductible from net income of the fiscal year under the provisions of section 204 of the statute shall be deductible in computing the tax attributable to the calendar year 1917 as well as in computing the tax attributable to the calendar year 1918. Amounts previously paid by the taxpayer on account of the excess profits tax for its fiscal year ending in 1918 shall be credited towards the payment of the war profits and excess profits tax imposed for such fiscal year by the present statute. Any excess shall be credited or refunded in accordance with the provisions of section 252 of the statute. For credits for foreign taxes see section 238 of the statute.

ART. 954. *Fiscal year of corporation ending in 1919.*—The method provided for computing the tax for a fiscal year beginning in 1918 and ending in 1919 is as follows: (*a*) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the number of months falling within the calendar year 1918 is of the number of months in the entire period; (*b*) the tax attributable to the calendar year 1919 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1919, and determining the proportion of such tax which the number of months falling within the calendar year 1919 is of the number of months in the entire period; and (*c*) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1918 and the tax attributable to the calendar year 1919. For credits for foreign taxes see section 238 of the statute.

ART. 955. *Illustration of computation of tax for fiscal year.*—A corporation makes its return on the basis of a fiscal year ending March 31. It had an average prewar invested capital of $50,000 and an average prewar net income of $3,500. For the fiscal year ending March

31, 1918, its invested capital and net income are $100,000 and $75,-000, respectively, as computed under Title II of the Revenue Act of 1917, and $125,000 and $70,000, respectively, as computed under the present statute. Such a difference in these amounts as computed under the two acts may readily occur where, for example, a corporation is allowed under the present statute a deduction for interest, amortization, etc., which it was not allowed under the Revenue Act of 1917, or where, under the present statute, it is allowed a greater amount of invested capital on account of intangible property paid in for stock or shares than allowed under the Revenue Act of 1917. For the fiscal year ending March 31, 1919, its invested capital and net income are $125,000 and $60,000, respectively.

(1) A war excess profits tax for the year ending March 31, 1918, as computed under the provisions of Title II of the Revenue Act of 1917, and upon the basis of an invested capital of $100,000 and a net income of $75,000 as computed under that Act, is $32,800. For the details of this computation see illustration (1) under article 16 of Regulations 41. A war profits and excess profits tax for the entire period as computed under subdivision (a) of section 301 of the present statute, and upon the basis of an invested capital of $125,000 and a net income of $70,000 as computed under the statute, is $43,600. Section 335 provides that the tax for this period is the sum of 9/12 of the tax of $32,-800 as computed under the Revenue Act of 1917, or $24,600, plus 3/12 of the tax of $43,600 as computed under the present statute, or $10,900, making a total war excess profits tax for the fiscal year ending March 31, 1918, of $35,500.

(2) A war profits and excess profits tax for the year ending March 31, 1919, as computed under subdivision (a) of section 301 of the statute is $35,600. A war profits and excess profits tax for the entire period as computed under subdivision (b) of section 301 is $16,400. Section 335 provides that the tax for this period is the sum of 9/12 of the tax of $35,600, as computed under subdivision (a) of section 301, or $26,700, plus 3/12 of the tax of $16,400, as computed under subdivision (b) of section 301, or $4,100, making a total war profits and excess profits tax for the fiscal year ending March 31, 1919, of $30,-800.

§ 322. Returns

Every corporation, domestic or foreign, not exempt under § 304 of the statute, shall make a return for the purpose of the war profits and excess profits tax on form 1120. The return shall be made and the tax shall be paid as provided in the case of a return for and payment of the income tax by corporations. (Regulations No. 45, art. 961.)

Returns in special cases.—Where a corporation computes its war profits credit upon the basis of the sum of (*a*) the specific exemption and (*b*) an amount equal to 10 per cent of the invested capital for the taxable year, the items on form 1120 which relate solely to the net income or to the invested capital for the prewar period need not be filled in. Where a corporation enters on its return a war profits and excess profits tax equal to the amount of the maximum tax determined under section 302 of the statute, the items on form 1120 which relate solely to the net income for the prewar period and the items which relate to the invested capital for the prewar period and for the taxable year need not be filled in. Likewise in the case of a foreign corporation the same items may be disregarded, except that all of schedule I on form 1120 shall be filled in and balance sheets as of the beginning and the end of the taxable year for the entire business of the corporation both within and without the United States shall be submitted. The Commissioner may at any time specifically call for all or any part of the information which under this article is not required to be entered on the return. In any case, however, where a claim is made under sections 327 and 328 of the statute, other than in the case of a foreign corporation, the corporation should fill out all items of the return so far as possible and submit a statement explaining why it is impracticable to fill out the entire return. (Idem, art. 962.)

§ 323. Provision as to Sale of Mines or Oil or Gas Wells

In the case of a sale of mines, oil or gas wells, or any interest therein, as described in article 13, the portion of the war profits and excess profits tax attributable to such a sale shall not exceed 20 per cent of the selling price. To determine the application of this provision to a particular case the corporation should compute the war profits and excess profits tax in the ordinary way upon its net income, including its net income from any such sale. The proportion of the total tax indicated by the ratio which the taxpayer's net income from the sale of the property, computed as prescribed in article 715, bears to its total net income is the portion of the tax attributable to such sale, and if it exceeds 20 per cent of the selling price of the property such portion of the tax shall be reduced to that amount. (Regulations No. 45, art. 971.)

§ 334. What Constitutes Carrying on or Doing Business

Under section 407 of the act of September 8, 1916, every domestic corporation was required to pay annually a special excise tax with respect to the carrying on or doing business equivalent to 50 cents for each $1,000 of the fair value of its capital stock. The act approved February 24, 1919, increased the tax to $1 for each $1,000 of the fair average value of the capital stock and reduced the exemption from $99,000 to $5,000. Questions have been raised as to the liability to the capital-stock tax of corporations owning railroads controlled and operated by the Federal Government. Such a concern is exempt from liability for a given tax year only in case it does no business during such year. The liability of a concern which actually does do business is not affected by the control exercised by the Government. For the purpose of determining whether or not a corporation owning a railroad operated and controlled by the Federal Government did or did not do business during a given year, the following rules have been laid down:

Organization.—A corporation may perform the acts necessary to maintain an effective organization, offices, and clerical force, pay salaries, elect directors and officers, hold meetings, etc., without being regarded as doing business.

Ownership.—Tax does not attach because of mere naked ownership either of railroad property or other property.

Management.—A corporation which takes any part in the actual management of a railroad or other enterprise, as, for instance, a coal mine, is doing business. A corporation may, however, collect and distribute the income from property which it does not manage without incurring liability.

Maintenance and improvement.—A corporation which directly maintains or improves or enters into wire, siding, conduit, crossing, or other contracts for the maintenance or improvement of railroad or other directly productive property will generally be held liable. However, if the execution of such contracts by the corporation is a mere formality for the accommodation of the United States Railroad Administration and financial responsibility therefor is assumed by the United States, the execution thereof will not be regarded as doing business by the company.

Borrowing.—Borrowing for the purchase of Government bonds or in connection with obligations previously assumed is not regarded as doing business. Borrowing for the purpose of financing new operations will be regarded as the doing of business.

Purchase.—A corporation may purchase stocks and bonds of other concerns and similar intangible property, which would be considered as "maintaining investments," without incurring liability. The purchase of railroad equipment or of real estate or other tangible property, whether for railroad or other productive purposes or for resale, certainly is doing business in any ordinary sense, and such activity is regarded as ground for assessment of the tax.

Sale.—A concern which sells its entire property or a part once used in operating its business and for which it has no further use in the conduct of its business does not thereby incur liability. This, however, would not, presumably, apply to the sale of property not acquired for use in connection with the conduct of the business. The sale of property acquired for speculative purposes or in the course of a business of dealing in such property would cause liability to attach.

Leases.—A concern which makes long-term leases, whereby it parts with the control of the property, which is to be maintained by the lessee, will be regarded as thereby going out of business with respect to such property, and the execution of such leases will accordingly not be treated as doing business. However, the execution of leases whereby the corporations are obligated to maintain the property, or covering property held for renting purposes, will be regarded as doing business. In short, it is concluded that:

(1) A corporation owning a railroad operated by the Federal Government may, without incurring liability to the capital-stock tax, (*a*) maintain its corporate organization; (*b*) own property; (*c*) collect and distribute the income therefrom; (*d*) purchase stocks and bonds of other organizations; (*e*) sell all or part of the property used in the operation of its railroad or other business; (*f*) enter into long-term leases whereby it is divested of control of and is not obligated to maintain the property; and (*g*) borrow money for the purchase of Government bonds or for the financing of obligations previously incurred.

(2) A corporation will incur liability if it (*a*) manages, (*b*) maintains, or (*c*) purchases railroad or other tangible property; (*d*) sells property not used in the conduct of the railroad or other business; (*e*) borrows money for the financing of new operations; or (*f*) makes leases of property held for renting purposes or whereby it is obligated to maintain the property.

The extent of the activity, if it is of a kind causing liability to incur, is unimportant. Von Baumbach v. Sargent Land Co. et al. (242 U. S., 502).

To assist in determining the question of liability under the statute as interpreted in the rules laid down above, each corporation owning a railroad under Federal control and operation and claiming exemption from the tax will be required to file an affidavit supplying certain information. No claim on file, or hereafter filed, will be favorably considered in the absence of such affidavit. A printed form has been prepared. Copies thereof may be secured upon application. (T. D. 2800, March 13, 1919.)

§ 336. Lessor Corporations

Where a railroad company has given a lease of its road, and the same is operated by the lessee company as a lessee, and not as the agent of the lessor company, the latter is not "engaged in business" so as to be subject to taxation under the Corporation Excise Tax Act. Old Colony R. Co. v. Gill (D. C.) 257 Fed. 220.

§ 341. Estimation of Capital, Surplus, and Profits

Stock insurance companies.—Insurance companies having capital stock, as distinguished from mutual insurance companies, are taxable like other corporations, whether domestic or foreign. In ascertaining the fair value of their capital stock for the purpose of the tax, however, such deposits and reserve funds of insurance companies as they are required by law or contract to maintain or hold for the protection of or payment to or apportionment among policyholders, and reserves which represent actually accrued liabilities, the credits to which are deducted from gross income as ordinary and necessary business expenses, are to be omitted from the calculation. But if the fair average value is estimated from the market price of the shares of stock of the company, no deduction for deposits or reserves is proper from the total value so established. (Regulations No. 50, art. 41.)

§ 344. Computation of Tax; Foreign Corporations

The "capital employed in the transaction of its business in the United States" means that portion of the total capital, surplus and undivided profits of the foreign corporation utilized for the purpose of doing business in the United States. A foreign corporation may have income from sources within the United States for the purpose of the income tax and yet not have capital employed in the transaction of business here for the purpose of the capital stock tax. Compare articles 91–93 and 550 of Regulations 45. A foreign corporation actually itself not doing business in the United States is not subject to the tax, and accordingly the investment of a part of its funds in United States stocks and securities would not constitute capital employed in its business in the United States. See articles 17–21 as to doing business. But if a corporation does business here, then, although the mere investment of funds in United States securities is not as such a taxable employment of capital, such investment will constitute capital employed in the transaction of business in the United States if made in a subsidiary corporation which the foreign corporation uses as an instrumentality for the successful conduct of its own business here. Thus funds of a foreign corporation invested in the purchase of facilities, though apparently independent, for the purpose of its business here, or the purchase of stock and securities of a subsidiary corporation for the same purpose, will constitute capital employed in the transaction of business in the United States. A foreign corporation may not escape taxation by organizing or purchasing stock of another corporation to own the facilities which the taxpayer needs in its business. See article 352 of Regulations 45.

A foreign corporation may employ capital in the transaction of its business in the United States in various ways, as, for example, in the investment of funds in property in the United States used in its business, in stocks and securities of subsidiary corporations as explained in preceding article, in bills and accounts receivable representing business done in the United States, in merchandise kept here for sale, in materials manufactured here, and in deposits in United States banks maintained for use in business here. In general, approximately such proportion of the entire capital of a foreign corporation will probably be employed in the transaction of its business in the United States as the gross amount of its business in the United States bears to its total gross business, but this is not always true, for a corporation may conceivably transact a greater or less volume of business in one country than in another on the same amount of capital.

The basis of the tax is the average amount of capital employed in the transaction of business in the United States during the preceding fiscal year. It will usually be sufficient to determine the amount of capital so employed at the beginning of such year and the amount so employed at the end of such year and to divide the sum of such amounts by two. However, where there have been material changes in the amount of capital the average amount should be determined with due regard to the times at which such changes occurred. The foreign corporation may, if desired, compute the average amount of capital employed on a monthly basis. (Regulations No. 50, arts. 33–35.)

§ 387. Tax on Insurance; Foreign Policies

The regulation of the Treasury Department on this subject is as follows: Any policy or other instrument whereby insurance is made or renewed upon property within the United States, issued by any foreign corporation or partnership or any individual not a resident of the United States, if not signed or countersigned by an officer or agent of the insurer in the State, Territory, or district of the United States within which such insurer is authorized to do business, is liable to the stamp tax imposed by subdivision 15 of Schedule A of Title XI. It should be noted that the stamp tax applies only to policies of insurance upon property within the United States issued to or for or in the name of a domestic corporation or partnership or an individual resident of the United States by any foreign corporation or partnership or any individual not a resident of the United States, and that any policy in the nature of life or other nonproperty insurance is taxable under the provisions of section 503 of the act. (T. D. 2938, Oct. 21, 1919.)

§ 423. Bonds of Indebtedness

Mortgage bonds.—Bonds accompanying real estate mortgages are taxable as bonds of indebtedness upon the amount secured, and not as bonds of indemnity. An agreement extending a mortgage upon maturity, where a bond is secured by the mortgage and such agreement operates to renew the bond, subjects the latter to stamp tax as a renewal. An agreement between the holder of a bond and the present owner of a parcel of real estate, extending maturity of a mortgage bond executed by a former owner, operates as a renewal and such renewal is subject to tax. If, in addition, a new bond is given for the same indebtedness, it also is subject to tax. (Regulations No. 55, arts. 3–5.)

Interim certificates and temporary bonds.—Interim certificates or temporary bonds issued in lieu of definitive bonds are taxable, but no additional tax is required upon the issue of the permanent or definitive bonds, which, however, should bear notation of the fact that stamps in the proper amount were duly attached to the interim certificates. (Idem, art. 7.)

Business property investment bond.—A business property investment bond wherein it is certified that the holder thereof is the owner of an interest in certain specified real property, legal title to which has previously been conveyed to a trustee, and whereby the corporation issuing the same agrees to manage the property and distribute the proceeds in a certain manner, is not subject to tax as a bond, debenture, or certificate of indebtedness, but as a certificate of interest in property. (Idem, art. 11.)

Instrument assigning interest in bond.—An instrument which merely represents an assignment of interest in a bond accompanying a mortgage, is not taxable. (Idem, art. 12.)

Various rulings on bonds.—A certificate of indebtedness issued under order of a Federal court by a receiver is subject to tax. (Idem, art. 15.) The tax applies to bonds of indebtedness executed by the obligor and delivered to a bank or trust company as security for the payment of an obligation. (Idem, art. 16.) Bonds executed in Canada by a Canadian corporation, certified to by a trustee in the United States, given for part of the purchase price of timber located in

Canada, and delivered in the United States, are subject to tax. (Idem, art. 17.) Bonds issued by life insurance companies in satisfaction of insurance policies are subject to tax. (Idem, art. 18.) Bonds issued by school districts for school purposes are exempt from tax. (Idem, art. 19.)

Certificates of indebtedness.—The term "certificates of indebtedness," as used in the act, includes only instruments having the general character of investment securities, as distinguished from instruments evidencing debts arising in ordinary transactions between individuals. (T. D. 2919, Sept. 12, 1919.)

Coupons and interest notes.—Coupons attached to bonds, debentures, or certificates of indebtedness issued by any individual, partnership, or corporation, or to instruments, however termed, issued by a corporation and known generally as corporate securities (all of which are subject to tax as bonds of indebtedness), are not subject to tax if they impose no obligation not imposed by the principal instrument. But interest coupons attached to promissory notes taxable under Schedule A6, as distinguished from the securities enumerated above, if they are themselves promissory notes, separable from the principal obligation and negotiable independently of it, are subject to tax even though they impose no obligation not imposed by the principal instrument. (T. D. 2941, October 30, 1919.)

Indemnity bonds to United States.—Whereas claims for insurance under the war risk insurance act are paid by checks, and such checks are sometimes lost or accidentally destroyed before they can be presented for payment, and in such cases bonds of indemnity for the protection of the United States are exacted before a duplicate check will be issued, it is ruled that such bonds are not subject to the stamp tax. (T. D. 2900, July 25, 1919.)

§ 424. Indemnity, Surety, and Other Bonds

The tax imposed by the foregoing provision attaches upon all bonds executed for indemnifying any person who shall have become bound or engaged as surety, and on all bonds executed for the due execution or performance of any contract, obligation, or requirement, or the duties of any office or position, and to account for any money received by virtue thereof, and upon all policies of guaranty and fidelity insurance, including policies guaranteeing titles to real estate and mortgage guarantee policies, and on all other bonds of any description, not otherwise provided for in Schedule A under Title XI of the revenue act of 1918, except such as may be required in legal proceedings, executed or issued on or after April 1, 1919, and also upon premiums charged upon such bonds or policies theretofore issued which are paid for the purpose of renewing or continuing in force such bonds or policies beyond the date of March 31, 1919.

Where a premium is charged upon any bond or policy designated in said subdivision 2 of Schedule A under Title XI of the revenue act of 1918 executed or issued on or after April 1, 1919, a statement must be made on the face of the bond or policy showing the rate and amount of premium charged and bonding companies or other persons executing such bonds or policies must affix thereto the necessary amount of United States internal-revenue stamps, based upon the premium charged, canceling the same.

Where a premium is paid after April 1, 1919, for the issuance or execution after said date or for the renewing or the continuing in force after said date, regardless of the date of original issuance or execution, of any bond or policy designated in said subdivision 2, Schedule A, under Title XI, of the revenue act of 1918, the tax due upon such premium payment must be paid by United States internal-revenue stamps. The renewal or continuance certificates or other papers showing the renewal or continuance of such bonds or policies or the receipts or other papers showing the payment of such premiums must contain on the face thereof a statement showing the rate and amount of the premium charged and collected, and the bonding companies or other persons issuing or executing such certificates, receipts, or papers must affix thereto the necessary amount of United States internal-revenue stamps based upon the premium charged, canceling the same. (T. D. 2825, April 28, 1919.)

§ 425. Bonds Given in Legal Proceedings

Bonds required in legal proceedings are exempt from stamp tax. These include attachment bonds, injunction bonds, bonds to stay proceedings, bonds on appeal or writ of error, bonds for costs, recognizances, supersedeas bonds; also official bonds of trustees, receivers, or referees in bankruptcy and other court receivers, assignees, executors, administrators, and guardians. Regulations No. 55, art. 27. Bonds of depositaries designated by the United States District Court for the keeping of bankruptcy estates' moneys are likewise not taxable. (Idem, art. 29.)

§ 456. Promissory Notes and Similar Instruments

Promissory notes issued directly by foreign governments and placed in this country for sale are exempt from stamp tax. Regulations No. 55, art. 54. Promissory notes secured by United States bonds and obligations issued after April 24, 1917, of a par value of not less than the amount of such notes, are exempt from tax. Idem. art. 55. Promissory notes secured by certificates of indebtedness issued by the

Director General of Railroads are exempt from stamp tax. Promissory notes secured by bonds of the War Finance Corporation are subject to tax. (Idem, art. 56.)

Coupons or interest notes.—The revised ruling of the Treasury Department on this subject is as follows: Interest coupons attached to promissory notes taxable under Schedule A6, as distinguished from bonds, debentures, and other forms of corporate securities, if they are themselves promissory notes, separable from the principal obligation and negotiable independently of it, are subject to tax, even though they impose no obligation not imposed by the principal instrument. (T. D. 2941, Oct. 30, 1919.)

Notes given to and by federal land banks and joint-stock land banks.—Promissory notes given to federal land banks and joint-stock land banks, when secured by first mortgages, are exempt from the stamp tax. Promissory notes issued by federal land banks are exempt from stamp tax; but promissory notes issued by joint-stock land banks are subject to the tax. (T. D. 2954, Nov. 29, 1919.)

§ 460. Drafts, Checks, and Orders for Money

Time drafts.—A time draft directly covering exports to a foreign country and which constitutes an inherent, necessary, and bona fide part of the actual process of exportation is exempt from stamp tax. This exemption does not depend on whether or not the time which the draft has to run will expire before or after the ocean shipment. Time drafts drawn against the proceeds of the foregoing draft are subject to stamp tax. A time draft drawn on a domestic bank for the purpose of securing money to purchase goods to be exported is subject to tax regardless of the fact that a contract for the sale of the goods existed at the time the draft is drawn. Time drafts drawn on domestic banks against export shipments delivered to the first carrier for transportation, covering the period of transit from the interior point to the seaboard, are not subject to tax. Time drafts not covering exports drawn and delivered or accepted in the United States and payable in foreign countries are taxable. (Regulations No. 55, arts. 41–44.)

Post-dated checks.—Post-dated checks are not subject to tax unless expressly payable after their date. (Idem, art. 63.)

§ 461. Deeds and Other Conveyances

A conveyance by defaulting mortgagor to mortgagee in consideration of the cancellation of the mortgage debt is subject to tax calculated on the amount of the mortgage debt plus unpaid accrued interest. (Regulations No. 55, art. 104.)

Where an officer of a corporation purchases real estate from the corporation, conveyance being first made to a third party, and, as part of the same transaction, the property is conveyed by the third party to the officer, the conveyance to the third party is subject to tax, while the conveyance from the third party is not subject to tax. (Idem, art. 110.)

§ 462. Deeds of Sheriffs and Court Officers

Deeds executed by state, county, or municipal officers conveying realty sold for nonpayment of taxes are not subject to stamp tax. (Regulations No. 55, art. 85.)

§ 463. Deeds; Consideration or Value as Measure of Tax

A conveyance of land in consideration of life maintenance is taxable, the tax to be measured by the value of the property or interest conveyed. (Regulations No. 55, art. 79.)

Deeds from an agent to his principal conveying real estate purchased for and with funds of the principal are not taxable. (Idem. art. 92.)

Conveyances of property of a copartnership, in the hands of receivers, back to the owners, after administration of the estate, are not taxable. (Idem, art. 93.)

Deeds by an executor to devisees, conveying specific parcels of real estate, devised to them in common, are not subject to tax unless a consideration passes between the devisees by reason of some of them taking a greater share in the real estate than that to which entitled under the will, in which event tax attaches to the deeds conveying such greater shares, and is calculated upon the amount of value of such consideration. (Idem, art. 102.)

§ 464. Parcel-Post Packages

Parcel-post packages mailed to or from Hawaii and Alaska are taxable. Parcel-post packages mailed to or from Porto Rico, Philippine Islands, Canal Zone, and the Virgin Islands are not taxable Parcel-post packages mailed from one point in Porto Rico to another point in the same island are not taxable. Parcel-post packages mailed to United States naval vessels in foreign waters or to United States Expeditionary Forces abroad are not taxable. (Regulations No. 55, arts. 151–154.)

Parcel-post packages sent by a state, or political subdivision thereof, in the exercise of its governmental functions, are not subject to tax. To relieve a package from the payment of the tax, the postmaster at the point of mailing should, however, require satisfactory evidence that it is sent by an officer or employee of a state or subdivision of a state in the discharge of such functions. (Idem, art. 155.)

§ 465. Custom-House Entry

Custom-house entries made by United States officials traveling as such on government funds are not taxable. Likewise, entries made by all representatives of foreign countries in their official capacity are by comity exempt. (Regulations No. 55, art. 111.)

§ 468. Proxies

The stamp tax on proxies attaches to the instrument and is not measured by the number of grantors and grantees. (Regulations No. 55, art. 121.)

§ 469. Powers of Attorney

An instrument authorizing the secretary to transfer stock on the books of a corporation is not taxable as a power of attorney, but an instrument appointing an attorney in fact to transfer stock on the books of a corporation is taxable. (Regulations No. 55, art. 138.)

A power of attorney to sell, assign, and transfer shares of capital stock is subject to tax unless it is given in connection with a deposit of the stock as security for a loan. (Idem, art. 143.)

A power of attorney by which a person executing the instrument sells, assigns, and transfers shares of stock and appoints the vendee agent for the transfer is not subject to tax. (Idem, art. 144.)

§ 474. Effect of Failure to Stamp

The formalities deemed necessary in the making and recording of a deed to land are matters for state regulation, not federal regulation, so that the requirement of the United States revenue laws that unstamped instruments of writing shall be invalid and not subject to record is inapplicable thereto. Sowell v. Rankin (Miss.) 82 South. 317.

§ 528. Time for Payment of Taxes

The service of a notice and demand by the collector on form 17 is complete upon mailing it, and the time within which the tax must be paid runs from the date of mailing the notice and not of its receipt by the taxpayer. But payment for the tax must actually reach the collector within the ten day period, and merely mailing a remittance before the expiration of the ten days is not sufficient. So, to avoid the prescribed penalties, no more than ten days may elapse after the mailing of the notice before the payment is in the collector's hands. See section 3184 of the Revised Statutes. By reason, however, of absence from their homes or places of business in foreign countries or in the military or other service of the country and the consequent delay in receiving mail, or by reason of the location of the residence of an individual or of the office of a corporation to which the notice was addressed at a distance from the collector's office, it is impossible for many persons to receive a notice and demand and to make payment of the tax so that such payment may be received by the collector within the ten day period following the service of notice and demand, and in all such cases the collector will enter on the notice as the date on which the tax becomes due and payable a date as nearly as possible ten days after the time that the notice should be received in the ordinary course of the mails by the taxpayer. In such cases when it appears that a remittance for the tax was placed in the mails within the ten day period after the date specified in the notice, and in cases where tardiness is occasioned because the notice was not delivered in due time by reason of delay in the mail and satisfactory evidence of that fact is furnished, the penalty and interest will not be collected. (Regulations No. 45, art. 1007.)

§ 529. Demand for Payment of Tax

An unconditional extension of time for filing a return will postpone the date for payment of the first installment, but will not postpone the date of payment of the other installments unless so specified in each case. Upon failure to pay an installment on time, all of the tax remaining unpaid becomes due and payable upon notice and demand. Upon recomputation of the tax, if the amount already paid exceeds the correct amount of the installment or of the whole tax, the excess shall be credited against subsequent installments or other similar taxes then due from the taxpayer or, if there is no such installment or tax, shall be refunded to him; but if the amount already paid is less than the correct amount of the installment or tax then due, the difference shall be paid upon notice and demand with interest. (Regulations No. 45, art. 1001.)

§ 530. Payment and Receipt

Collectors may accept uncertified checks in payment of taxes, except those payable by stamp, provided such checks are collectible at par; that is, for their full amount, without any deduction for exchange or other charges. The collector will stamp on the face of each check before deposit the words "This check is in payment of an obligation to the United States and must be paid at par. No protest," with his name and title. The day on which the collector receives the check will be considered the date of payment so far as the taxpayer is concerned, unless the check is returned dishonored. If one check is remitted to cover two or more persons' taxes, the remittance must be accompanied by a letter of transmittal stating (*a*) the name of the drawer of the check; (*b*) the amount of the check; (*c*) the amount of any cash, money order, or other instrument included in the same remittance; (*d*) the name of each person whose tax is to be paid by the remittance; (*e*) the amount of the payment on account of each person; and (*f*) the kind of tax paid.

If the bank on which any such check is drawn should refuse to pay it at par, the check should be returned through the depositary bank and be treated in the same manner as a bad check. All expenses incident to the attempt to collect such a check and the return of it through the depositary bank must be paid by the drawer of the check to the bank on which it is drawn, since no deduction can be made from amounts received in payment of taxes. If any taxpayer whose check has been returned uncollected by the depositary bank should fail at once to make the check good, the collector should proceed to collect the tax as though no check had been given. A taxpayer who tenders a certified check in payment for taxes is also not released from his obligation until the check has been paid. (T. D. 2851, May 28, 1919.)

§ 531. Receipts for Taxes

The fact that section 251 of the act of February 24, 1919, requires that full written or printed receipts be issued to taxpayers only on request therefor does not limit the collector's mandatory duty to issue them when requested and does not fail to make them documents required to be issued whenever requested, and the receipts are plainly documents required to be issued by such section. U. S. v. Pittaro (D. C., N. D. Ohio) T. D. 2874, June 23, 1919.

Such receipts are documents required by provisions of the internal-revenue laws and by regulations made in pursuance thereof, within the meaning of section 3451 Revised Statutes, making it an offense to simulate or falsely or fraudulently execute or sign any document required by the internal-revenue laws, or any regulation made in pursuance thereof, or to procure the same to be falsely or fraudulently executed, or to advise, aid in, or connive at such execution thereof. Idem.

The offense may be committed either where the receipt itself is a genuine receipt of the kind kept for that purpose in the office of the internal-revenue collector, but signed by the defendant without authority, or where, even if not a blank of the kind required to be kept, the blank itself is simulated or falsely or fraudulently executed and issued by a person who has no power or authority to do so. Idem.

§ 532. Penalty for Delinquency

Interest on tax.—Where the time for the payment of any installment of the tax is postponed at the request of the taxpayer, interest at the rate of 6 per cent per annum is added from the original due date. If an understatement of the tax in the return is due to the negligence of the taxpayer, but without intent to defraud, interest at the rate of 12 per cent per annum is added to the amount of the deficiency of each installment from the time the installment was due. If any tax remains due and unpaid for ten days after notice and demand by the collector, or in the case of the first installment as computed by the taxpayer remains due and unpaid for ten days, interest at the rate of 12 per cent per annum is added from the due date, except that the interest on any amount which is the subject of a bona fide claim for abatement shall be at the rate of 6 per cent per annum, and except that no interest is added in the case of estates of insane, deceased or insolvent persons. But if any part of a claim for abatement on the ground of a loss in inventory under section 214(a) (12) or section 234 (a) (14) of the statute is disallowed, interest from the original due date at the rate of 12 per cent per annum will be added to the tax not abated; and interest is to be added in all cases in which the demand of payment is made of the taxpayer personally, although he subsequently dies, or becomes insane or insolvent, so that collection of the tax is made from his estate in the hands of his representative. (Regulations No. 45, art. 1003.)

Penalty for nonpayment of tax.—If any tax or installment thereof remains due and unpaid for ten days after notice and demand by the collector (the instructions on the return serve as notice and demand in the case of the first installment as computed by the taxpayer), a penalty of 5 per cent is added. When, however, upon an assessment of a tax and demand made for payment, a bona fide claim for its abatement is filed within 10 days after such demand, no penalty is imposed. Upon receipt of a notice of rejection of the claim (or so much thereof as is not allowed), the collector will notify the claimant and demand the payment of the tax. If the tax is not then paid within 10 days, the 5 per cent penalty will be assessed on the amount of tax not abated. If abatement of the entire tax assessed is not demanded in a claim, and the balance of the tax is not paid within the required 10 days, the 5 per cent penalty will immediately accrue on such balance. The estate of a deceased person, regardless of the date of his death, or of an insane or insolvent person, cannot be charged with liability to the 5 per cent penalty on account of his or the fiduciary's delinquency in making payment of taxes. Where a warrant of distraint is served, $5 is added. (Regulations No. 45, art. 1006.)

§ 544. Credit for Taxes Overpaid

In pursuance of this provision of the statute, the following regulations have been prescribed (Regulations No. 45, arts. 1034, 1035):

ART. 1034. *Claims for credit of taxes erroneously collected.*—Any amount of income, war profits or excess profits tax paid in excess of that properly due shall be credited against any such taxes due from the taxpayer under any other return. To obtain such credit the taxpayer should proceed as follows:

(1) Where the credit demanded is equal to or less than any outstanding assessment of tax, a taxpayer desiring to obtain such credit shall file with the collector for the district in which his original return was filed a claim on form 47A, which shall be sworn to and shall contain the following statements: (*a*) business engaged in by claimant; (*b*) character of assessment; (*c*) amount of tax paid and for what taxable year; (*d*) portion of tax under (*c*) claimed as a credit; (*e*) unpaid assessment against which credit is asked and for what taxable year; and (*f*) all facts regarding the overpayment.

(2) Where the amount claimed as a credit is greater than the outstanding assessment of tax, a taxpayer desiring to obtain such credit and the refund to which he is entitled shall file, in addition to the claim for credit required to be made on form 47A for the amount of the outstanding assessment, a claim for refund of the overpayment in excess of the credit. This claim for refund may be attached to the claim for credit or it may be separately filed with the Commissioner. All the facts regarding the total overpayment should be stated in the claim for refund and a reference made to such claim in the claim for credit.

ART. 1035. *Action on claims for credit.*—Upon receipt of a claim for credit on form 47A the collector shall certify thereon the required information concerning all outstanding assessments and payments covered thereby and shall note on his records that a claim for credit has been filed. He shall thereupon transmit the claim to the Commissioner. Due notice will be given the collector and the taxpayer of the action taken on the claim. A schedule of credit claims on form 7220A will be transmitted to the collector once a month and formal credit shall be taken by the collector at that time. If a claim is allowed against additional taxes due for other years, but such other taxes have not yet been assessed, only the amount of the excess of such taxes over the overpayment shall be assessed, or the excess of the overpayment over such other taxes due shall be refunded, as the case may be. A taxpayer desiring to convert a claim for refund previously filed into a claim for credit may file with the collector a claim on form 47A, referring in it to such claim for refund. Upon its receipt by the Commissioner the claim for credit will be attached to the claim for refund and will be adjusted in the same manner as if the taxpayer had originally filed the claim for credit. The effective date of filing of the claim for credit shall be the actual date of filing such claim with the collector. The filing of a claim for credit against a tax due under another return shall be subject to the same rules with respect to the addition of interest and penalties as if the taxpayer had filed a claim for abatement of the tax against which credit is desired.

§ 545. Suit for Recovery of Taxes Paid

Judgment in a suit against a collector of internal revenue to recover a succession tax collected under the act of June 13, 1898, for part of the claim only, certain interests involved being erroneously held to be taxable, which judgment was satisfied by the United States, is not a bar to a suit against the United States in the Court of Claims to recover the unpaid residue. Sage v. United States, 39 Sup. Ct. 415.

§ 546. Parties to Action

Part of an internal revenue tax illegally exacted and paid under protest to a collector of internal revenue may be recovered in a suit against his successor in office. Lumber Mut. Fire Ins. Co. v. Malley (D. C.) 256 Fed. 380.

§ 553. Amount of Recovery; Interest

Where a railroad company, seeking to recover from a collector of internal revenue taxes illegally assessed, delayed in pressing its claim on account of an understanding with the collector that the claim should await the decision of other pending cases, but it became apparent that the question of interest could not be adjusted, and would have to be submitted to the court, the company's conduct did not disentitle it to interest for any lack of diligence in prosecution. Boston & P. R. Corp. v. Gill (D. C.) 257 Fed. 221.

§ 554. Set Off in Favor of United States

Sums due to the United States are a valid offset as against the amount found due the taxpayer in a suit against the collector, although included therein are items which the Commissioner of Internal Revenue did not claim to be due the United States when considering the return for the purpose of assessment. (T. D. 2882, July 3, 1919.)

[END]