(T. D. 3640)

Regulations 65, relating to income tax, revenue act of 1924

PART I

INCOME TAX ON INDIVIDUALS

NORMAL TAX

SEC. 210. (a) In lieu of the tax imposed by section 210 of the Revenue Act of 1921, there shall be levied, collected, and paid for each taxable year upon the net income of every individual (except as provided in subdivision (b) of this section) a normal tax of 6 per centum of the amount of the net income in excess of the credits provided in section 216, except that in the case of a citizen or resident of the United States the rate upon the first $4,000 of such excess amount shall be 2 per centum, and upon the next $4,000 of such excess amount shall be 4 per centum;

(b) In lieu of the tax imposed by subdivision (a), there shall be levied, collected, and paid for each taxable year upon the net income of every nonresident alien individual, a resident of a contiguous country, a normal tax equal to the sum of the following:

(1) 2 per centum of the amount by which the part of the net income attributable to wages, salaries, professional fees, or other amounts received as compensation for personal services actually performed in the United States, exceeds the credits provided in subdivisions (d) and (e) of section 216; but the amount taxable at such 2 per centum rate shall not exceed $4,000;

(2) 4 per centum of the amount by which such part of the net income exceeds the sum of (A) the credits provided in subdivisions (d) and (e) of section 216, plus (B) $4,000; but the amount taxable at such 4 per centum rate shall not exceed $4,000; and

(3) 6 per centum of the amount of the net income in excess of the sum of (A) the amount taxed under paragraphs (1) and (2), plus (B) the credits provided in section 216.

ART. 1. **Income tax on individuals.**—Title II of the statute, which is effective January 1, 1924, imposes an income tax on individuals, including a normal tax (section 210) and a surtax (section 211). The tax is upon net income as defined in the statute, which is determined by subtracting the allowable deductions from gross income as defined in the statute. See sections 212, 213, 214, and 215. In certain cases credits are allowed against net income (section 216) and against the amount of the tax (sections 209 and 222). Special provisions of the statute deal with nonresident alien individuals (section 217), partnerships (section 218), estates and trusts (section 219), and corporations formed or availed of for the purpose of preventing imposition of surtax upon their shareholders (section 220). See section 208 and articles 1651–1654 for special provisions relative to the taxation of capital gains and the deduction of capital losses. The tax is payable upon the basis of returns rendered by persons liable thereto,

except that in some instances it is to be paid at the source of the income. See sections 221 and 223–227. The statute also imposes an income tax on corporations at a fixed rate (section 230). See Part II of these regulations. For administrative provisions and for definitions and general provisions, see Parts III and IV of the regulations.

ART. 2. **Normal tax.**—The normal tax on individual citizens or residents of the United States upon the amount of the net income in excess of the credits provided in section 216 is at the rate of 2 per cent upon the first $4,000, 4 per cent upon the next $4,000, and 6 per cent upon the remainder of the net income. In the case of nonresident alien individuals, residents of countries other than Canada and Mexico, the normal tax is 6 per cent, there being no reduction in the rate upon any part of the net income subject to tax. In the case of nonresident alien individuals, residents of Canada or Mexico, the normal tax is (1) 2 per cent of that part of the net income attributable to compensation for personal services actually performed in the United States in excess of the credits provided in subdivisions (d) and (e) of section 216, but not in excess of $4,000; (2) 4 per cent of the amount by which such part of the net income exceeds the sum of (*a*) the credits provided in subdivisions (d) and (e) of section 216 plus (*b*) $4,000, but the amount taxable at 4 per cent shall not exceed $4,000; (3) 6 per cent of the amount of the net income in excess of the amounts taxed at 2 per cent and 4 per cent plus the credits provided in section 216. In order to determine the income to which the normal tax is applied, the net income, as defined in section 212, is first entitled to the credits and exemptions specified in section 216 and articles 301–306.

The rates of normal tax are shown below in tabular form:

CITIZEN OR RESIDENT OF THE UNITED STATES

Amount of net income	Rate of normal tax
	Per cent
First $4,000 in excess of credits	2
Next $4,000	4
Remainder of net income	6

NONRESIDENT ALIEN—RESIDENT OF CANADA OR MEXICO

Compensation for services rendered in the United States in excess of credits under section 216 (d) and (e) (total not over $4,000)	2
Compensation for services rendered in the United States in excess of credits under section 216 (d) and (e) plus $4,000 (total not over $4,000)	4
Net income in excess of amounts taxed at 2 per cent and 4 per cent plus credits under section 216	6

NONRESIDENT ALIEN—RESIDENT OF FOREIGN COUNTRY OTHER THAN CANADA OR MEXICO

Net income in excess of credits under section 216	6

ART. 3. **Persons liable to tax.**—Citizens of the United States, except those entitled to the benefits of section 262 (see articles 1135–1137), wherever resident, are liable to the tax. It makes no difference that they may own no assets within the United States and may receive no income from sources within the United States. Every resident alien individual is liable to the tax, even though his income is wholly from sources outside the United States. Every nonresident alien individual is liable to the tax on his income from sources within the United States. (See section 213 (c) and articles 92 and 93.) Estates and trusts are also subject to the tax. (See section 219 and articles 341–347.)

ART. 4. **Who is a citizen.**—Every person born or naturalized in the United States, and subject to its jurisdiction, is a citizen. When any naturalized citizen has left the United States and resided for two years in the foreign country from which he came, or for five years in any other foreign country, it is presumed that he has ceased to be an American citizen. This presumption does not apply, however, to residence abroad while the United States was at war, nor does it apply in the case of individuals born in the United States subject to its jurisdiction. For example, if a Swede, after being naturalized in the United States, returned to Sweden and resided there for two years prior to April 6, 1917, he is presumed once more to be an alien. However, even though an individual born in the United States, subject to its jurisdiction, of either citizen or alien parents, resided in a foreign country for a number of years, he would still be a citizen of the United States, unless he had become naturalized in or taken an oath of allegiance to the foreign country of residence or some other foreign state. A foreigner who has filed his declaration of intention of becoming a citizen of the United States, but who has not yet received his final citizenship papers, is an alien. (See articles 311–314 for distinction between a resident alien individual and a nonresident alien individual.)

SURTAX

SEC. 211. (a) In lieu of the tax imposed by section 211 of the Revenue Act of 1921, but in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows:

Upon a net income of $10,000 there shall be no surtax; upon net incomes in excess of $10,000 and not in excess of $14,000, 1 per centum of such excess.

$40 upon net incomes of $14,000; and upon net incomes in excess of $14,000 and not in excess of $16,000, 2 per centum in addition of such excess.

$80 upon net incomes of $16,000; and upon net incomes in excess of $16,000 and not in excess of $18,000, 3 per centum in addition of such excess.

$140 upon net incomes of $18,000; and upon net incomes in excess of $18,000 and not in excess of $20,000, 4 per centum in addition of such excess.

$220 upon net incomes of $20,000; and upon net incomes in excess of $20,000 and not in excess of $22,000, 5 per centum in addition of such excess.

$320 upon net incomes of $22,000; and upon net incomes in excess of $22,000 and not in excess of $24,000, 6 per centum in addition of such excess.

$440 upon net incomes of $24,000; and upon net incomes in excess of $24,000 and not in excess of $26,000, 7 per centum in addition of such excess.

$580 upon net incomes of $26,000; and upon net incomes in excess of $26,000 and not in excess of $28,000, 8 per centum in addition of such excess.

$740 upon net incomes of $28,000; and upon net incomes in excess of $28,000 and not in excess of $30,000, 9 per centum in addition of such excess.

$920 upon net incomes of $30,000; and upon net incomes in excess of $30,000 and not in excess of $34,000, 10 per centum in addition of such excess.

$1,320 upon net incomes of $34,000; and upon net incomes in excess of $34,000 and not in excess of $36,000, 11 per centum in addition of such excess.

$1,540 upon net incomes of $36,000; and upon net incomes in excess of $36,000 and not in excess of $38,000, 12 per centum in addition of such excess.

$1,780 upon net incomes of $38,000; and upon net incomes in excess of $38,000 and not in excess of $42,000, 13 per centum in addition of such excess.

$2,300 upon net incomes of $42,000; and upon net incomes in excess of $42,000 and not in excess of $44,000, 14 per centum in addition of such excess.

$2,580 upon net incomes of $44,000; and upon net incomes in excess of $44,000 and not in excess of $46,000, 15 per centum in addition of such excess.

$2,880 upon net incomes of $46,000; and upon net incomes in excess of $46,000 and not in excess of $48,000, 16 per centum in addition of such excess.

$3,200 upon net incomes of $48,000; and upon net incomes in excess of $48,000 and not in excess of $50,000, 17 per centum in addition of such excess.

$3,540 upon net incomes of $50,000; and upon net incomes in excess of $50,000 and not in excess of $52,000, 18 per centum in addition of such excess.

$3,900 upon net incomes of $52,000; and upon net incomes in excess of $52,000 and not in excess of $56,000, 19 per centum in addition of such excess.

$4,660 upon net incomes of $56,000; and upon net incomes in excess of $56,000 and not in excess of $58,000, 20 per centum in addition of such excess.

$5,060 upon net incomes of $58,000; and upon net incomes in excess of $58,000 and not in excess of $62,000, 21 per centum in addition of such excess.

$5,900 upon net incomes of $62,000; and upon net incomes in excess of $62,000 and not in excess of $64,000, 22 per centum in addition of such excess.

$6,340 upon net incomes of $64,000; and upon net incomes in excess of $64,000 and not in excess of $66,000, 23 per centum in addition of such excess.

$6,800 upon net incomes of $66,000; and upon net incomes in excess of $66,000 and not in excess of $68,000, 24 per centum in addition of such excess.

$7,280 upon net incomes of $68,000; and upon net incomes in excess of $68,000 and not in excess of $70,000, 25 per centum in addition of such excess.

$7,780 upon net incomes of $70,000; and upon net incomes in excess of $70,000 and not in excess of $74,000, 26 per centum in addition of such excess.

$8,820 upon net incomes of $74,000; and upon net incomes in excess of $74,000 and not in excess of $76,000, 27 per centum in addition of such excess.

$9,360 upon net incomes of $76,000; and upon net incomes in excess of $76,000 and not in excess of $80,000, 28 per centum in addition of such excess.

$10,480 upon net incomes of $80,000; and upon net incomes in excess of $80,000 and not in excess of $82,000, 29 per centum in addition of such excess.

$11,060 upon net incomes of $82,000; and upon net incomes in excess of $82,000 and not in excess of $84,000, 30 per centum in addition of such excess.

$11,660 upon net incomes of $84,000; and upon net incomes in excess of $84,000 and not in excess of $88,000, 31 per centum in addition of such excess.

$12,900 upon net incomes of $88,000; and upon net incomes in excess of $88,000 and not in excess of $90,000, 32 per centum in addition of such excess.

$13,540 upon net incomes of $90,000; and upon net incomes in excess of $90,000 and not in excess of $92,000, 33 per centum in addition of such excess.

$14,200 upon net incomes of $92,000; and upon net incomes in excess of $92,000 and not in excess of $94,000, 34 per centum in addition of such excess.

$14,880 upon net incomes of $94,000; and upon net incomes in excess of $94,000 and not in excess of $96,000, 35 per centum in addition of such excess.

$15,580 upon net incomes of $96,000; and upon net incomes in excess of $96,000 and not in excess of $100,000, 36 per centum in addition of such excess.

$17,020 upon net incomes of $100,000; and upon net incomes in excess of $100,000 and not in excess of $200,000, 37 per centum in addition of such excess.

$54,020 upon net incomes of $200,000; and upon net incomes in excess of $200,000 and not in excess of $300,000, 38 per centum in addition of such excess.

$92,020 upon net incomes of $300,000; and upon net incomes in excess of $300,000 and not in excess of $500,000, 39 per centum in addition of such excess.

$170,020 upon net incomes of $500,000; and upon net incomes in excess of $500,000, in addition 40 per centum of such excess.

(b) In the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this section attributable to such sale shall not exceed 16 per centum of the selling price of such property or interest.

ART. 11. **Surtax.**—In addition to the normal tax imposed by section 210 a surtax is imposed at the rates specified in the statute upon the net income of every individual, resident or nonresident. See articles 2–4. In determining the taxable net income, for the purpose of the surtax, the credits provided by section 216 of the statute in the case of the normal tax are not applicable. (See section 208 and articles 1651–1654 for special rates of tax in cases of capital gains or losses.)

ART. 12. ***Computation of surtax.***—*The following table shows the* surtax due for 1924 and subsequent years upon certain specified amounts of net income. In each instance the first figure of the net income in the net income column is to be excluded and the second figure included. The percentage given opposite applies to the excess of income over the first figure in the net income column, and the sum in the next column is the surtax on the entire difference between the first figure and the second figure in the net income column. The final column gives the total surtax on a net income equal to the second figure in the net income column.

Net income	Per cent	Surtax	Total surtax
$0 to $10,000			
$10,000 to $14,000	1	$40	$40
$14,000 to $16,000	2	40	80
$16,000 to $18,000	3	60	140
$18,000 to $20,000	4	80	220
$20,000 to $22,000	5	100	320
$22,000 to $24,000	6	120	440
$24,000 to $26,000	7	140	580
$26,000 to $28,000	8	160	740
$28,000 to $30,000	9	180	920
$30,000 to $34,000	10	400	1, 320
$34,000 to $36,000	11	220	1, 540
$36,000 to $38,000	12	240	1, 780
$38,000 to $42,000	13	520	2, 300
$42,000 to $44,000	14	280	2, 580
$44,000 to $46,000	15	300	2, 880
$46,000 to $48,000	16	320	3, 200
$48,000 to $50,000	17	340	3, 540
$50,000 to $52,000	18	360	3, 900
$52,000 to $56,000	19	760	4, 660
$56,000 to $58,000	20	400	5, 060
$58,000 to $62,000	21	840	5, 900
$62,000 to $64,000	22	440	6, 340
$64,000 to $66,000	23	460	6, 800
$66,000 to $68,000	24	480	7, 280
$68,000 to $70,000	25	500	7, 780
$70,000 to $74,000	26	1, 040	8, 820
$74,000 to $76,000	27	540	9, 360
$76,000 to $80,000	28	1, 120	10, 480
$80,000 to $82,000	29	580	11, 060
$82,000 to $84,000	30	600	11, 660
$84,000 to $88,000	31	1, 240	12, 900
$88,000 to $90,000	32	640	13, 540
$90,000 to $92,000	33	660	14, 200
$92,000 to $94,000	34	680	14, 880
$94,000 to $96,000	35	700	15, 580
$96,000 to $100,000	36	1, 440	17, 020
$100,000 to $200,000	37	37, 000	54, 020
$200,000 to $300,000	38	38, 000	92, 020
$300,000 to $500,000	39	78, 000	170, 020
$500,000 up	40		

The surtax for any amount of net income not shown in the table is computed by adding to the surtax for the largest amount shown which is less than the income, the surtax upon the excess over that amount at the rate indicated in the table. Accordingly, the surtax upon a net income of $63,128 would be $6,148.16, computed as follows:

Surtax on $62,000 from table	$5, 900. 00
Surtax on $1,128 at 22 per cent	248. 16
Total	$6, 148. 16

ART. 13. **Surtax on sale of mineral deposits.**—Where the taxpayer by prospecting and locating claims, or by exploring and discovering undeveloped claims, has demonstrated the principal value of mines,

oil or gas wells, which prior to his efforts had a relatively minor value, the portion of the surtax attributable to a sale of such property or of the taxpayer's interest therein shall not exceed 16 per cent of the selling price. Exploration work alone without discovery is not sufficient to bring a case within this provision. Shares of stock in a corporation owning mines, oil or gas wells, do not constitute an interest in such property. To determine the application of this provision to a particular case the taxpayer should first compute the surtax in the ordinary way upon his net income, including his net income from any such sale. The proportion of the surtax indicated by the ratio which the taxpayer's net income from the sale of the property, or his interest therein, bears to his total net income is the portion of the surtax attributable to such sale, and if it exceeds 16 per cent of the selling price of the property or interest, such portion of the surtax shall be reduced to that amount. (See articles 220–223.)

NET INCOME OF INDIVIDUALS DEFINED

SEC. 212. (a) In the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(c) If a taxpayer changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with the approval of the Commissioner, be computed on the basis of such new accounting period, subject to the provisions of section 226.

ART. 21. **Meaning of net 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. Income can not be determined merely by reckoning cash receipts, 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 202–206, 208, 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 71–91. (*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 206, 214 and 215 and the articles thereunder. (*d*) Net income less credits. See section 216 and articles 301–306. The surtax is imposed upon net income; the normal tax upon net income less credits. Although taxable net income is a statutory conception, it follows, subject to certain modifications as to exemptions and as to deductions for partial losses in some cases, 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. As to the net income of corporations see section 232 and article 531.

ART. 22. **Computation of net income.**—Net income must be computed with respect to a fixed period. Usually that period is twelve months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. See article 51. If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 23. **Bases of computation.**—(1) Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 200 of the statute for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as

of a different period. See section 213 (a). For instance, in any case in which it is necessary to use an inventory, no accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. See article 52. On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property. (But see section 205.)

(2) The true income, computed under the Revenue Act of 1924 and, where the taxpayer keeps books of account, in accordance with the method of accounting regularly employed in keeping such books (provided the method so used is properly applicable in determining the net income of the taxpayer for purposes of taxation), shall in all cases be entered in the return. If for any reason the basis of reporting income subject to tax is changed, the taxpayer shall attach to his return a separate statement setting forth for the taxable year and for the preceding year the classes of items differently treated under the two systems, specifying in particular all amounts duplicated or entirely omitted as the result of such change.

(3) A taxpayer who changes the method of accounting employed in keeping his books for the taxable year 1924 or thereafter should, before computing his income upon such new basis for purposes of taxation, secure the consent of the Commissioner. Application for permission to change the basis of the return shall be made at least 30 days before the close of the period to be covered by the return and shall be accompanied by a statement specifying the classes of items differently treated under the two systems and specifying all amounts which would be duplicated or entirely omitted as a result of the proposed change.

ART. 24. **Methods of accounting.**—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. (See section 1002 of the statute and article 1321.) Among the essentials are the following:

(1) In all cases in which the production, purchase, or sale of merchandise of any kind is an income-producing factor, inventories of the merchandise on hand (including finished goods, work in process, raw materials, and supplies) should be taken at the beginning and end of the year and used in computing the net income of the year (see arts. 1611–1618);

(2) Expenditures made during the year should be properly classified as between capital and income; that is to say, expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account; and

(3) In any case in which the cost of capital assets is being recovered through deductions for wear and tear, depletion, or obsolescence any expenditure (other than ordinary repairs) made to restore the property or prolong its useful life should be added to the property account or charged against the appropriate reserve and not to current expenses. But see article 224.

ART. 25. **Accounting period.**—The return of a taxpayer is made and his income computed for his taxable year, which means his fiscal year, or the calendar year if he has not established a fiscal year. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. No fiscal year will, however, be recognized unless before its close it was definitely established as an accounting period by the taxpayer and the books of such taxpayer were kept in accordance therewith. The taxable year 1924 is the calendar year 1924 or any fiscal year ending during the calendar year 1924. (See section 200(a) of the statute.) A person having no such fiscal year must make return on the basis of the calendar year. Except in the case of a first return for income tax a taxpayer shall make his return on the basis (fiscal or calendar year) upon which he made his return for the taxable year immediately preceding unless, with the approval of the Commissioner, he has changed his accounting period.

ART. 26. **Change in accounting period.**—If a taxpayer changes his accounting period he shall at least 30 days before the close of the proposed period for which a return would be required to effect the change, furnish to the collector, for transmission to the Commissioner, the information required on Form 1128. The due date of the separate return for such period is the fifteenth day of the third month following the close of that period. If the change in the basis of computing the net income of the taxpayer is approved by the Commissioner, the taxpayer shall thereafter make his returns and compute his net income upon the basis of the new accounting period. See article 431.

GROSS INCOME DEFINED: INCLUSIONS

SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees,

whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

ART. 31. **What included in gross income.**—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. See section 213(b). In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. Profits of citizens, residents, or domestic corporations derived from sales in foreign commerce must be included in their gross income; but special provisions are made for nonresident aliens by section 217 and for citizens and domestic corporations deriving at least 80 per cent of their gross income from sources within possessions of the United States by section 262. Income may be in the form of cash or of property.

A husband and wife domiciled in Arizona, Idaho, Louisiana, Nevada, New Mexico, Texas, or Washington, in rendering separate income tax returns, may each report as gross income one-half of the income which, under the laws of the respective States, becomes simultaneously with its receipt community property.

As to dividends, whether in cash or in property, see section 201 and articles 1541–1549.

Where property is sold by a corporation to a shareholder, or by an employer to an employee, for an amount substantially less than its fair market value, such shareholder of the corporation or such employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value. In computing the gain or loss from the subsequent sale of such property its cost shall be deemed to be its fair market value at the date of acquisition. This paragraph does not apply, however, to the issuance by a corporation to its shareholders of the right to subscribe to its stock, as to which see article 39.

The amount of income tax paid for a bondholder by the obligor pursuant to a so-called tax-free covenant in its bonds shall not be

included in the gross income of the bondholder. See section 234(a) (3) of the statute. The amount of the tax so paid may nevertheless be claimed as a credit against the total amount of tax due in accordance with section 221(d) and article 376. As to the determination of gain or loss from sale or disposition of property, see sections 202–204 and articles 1561–1603. As to the gross income of corporations, see section 233 and articles 541–550.

ART. 32. **Compensation for personal services.**—Where no determination of compensation is had until the completion of the services, the amount received is ordinarily income for the taxable year of its determination, if the return is rendered on the accrual basis; or, for the taxable year in which received, if the return is rendered on a receipts and disbursements basis. Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, pay of persons in the military or naval forces of the United States, retired pay of Federal and other officers, and pensions or retiring allowances paid by private persons or by the United States (except pensions exempted by paragraph (9) of subdivision (b) of section 213), are income to the recipients; as are also marriage fees, baptismal offerings, sums paid for saying masses for the dead, and other contributions received by a clergyman, evangelist, or religious worker for services rendered. However, so-called pensions awarded by one to whom no services have been rendered are mere gifts or gratuities and are not taxable. The salaries of Federal officers and employees are subject to tax. (See section 209 and articles 1661 and 1662 for special provisions relative to earned income and article 88 as to compensation of State officers and employees.)

ART. 33. **Compensation paid other than in cash.**—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 employees, 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. But see section 213(b)(11). Premiums paid by an employer on policies of group life insurance covering the lives of his employees, the beneficiaries of which are designated by the employees, are not income to the employees. See article 293.

ART. 34. **Compensation paid in notes.**—Notes or other evidences of indebtedness 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, shall 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 6 per cent basis, the recipient shall 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.

ART. 35. **Gross income from business.**—In the case of a manufacturing, merchandising or mining business "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. In determining the gross income subtractions should not be made for depreciation, depletion, selling expenses or losses, or for items not ordinarily used in computing the cost of goods sold.

ART. 36. **Long-term contracts.**—Income from long-term contracts is taxable for the period in which the income is determined, such determination depending upon the nature and terms of the particular contract. As used herein the term "long-term contracts" means building, installation, or construction contracts covering a period in excess of one year. Persons whose income is derived in whole or in part from such contracts may, as to such income, prepare their returns upon the following bases:

(*a*) Gross income derived from such contracts may be reported upon the basis of percentage of completion. In such case there should accompany the return certificates of architects or engineers showing the percentage of completion during the taxable year of the entire work to be performed under the contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied. If, upon completion of a contract, it is found that the taxable net income arising thereunder has not been clearly reflected for any year or years, the Commissioner may permit or require an amended return.

(*b*) Gross income may be reported in the taxable year in which the contract is finally completed and accepted if the taxpayer elects as a consistent practice so to treat such income, provided such method

clearly reflects the net income. If this method is adopted there should be deducted from gross income all expenditures during the life of the contract which are properly allocated thereto, taking into consideration any material and supplies charged to the work under the contract but remaining on hand at the time of completion.

Where a taxpayer has filed his return in accordance with the method of accounting regularly employed by him in keeping his books and such method clearly reflects the income, he will not be required to change to either of the methods above set forth. If a taxpayer desires to change his method of accounting in accordance with paragraphs (*a*) and (*b*) above, a statement showing the composition of all items appearing upon his balance sheet and used in connection with the method of accounting formerly employed by him, should accompany his return.

ART. 37. **State contracts.**—The profit of an independent contractor from a contract with a State or political subdivision thereof must be included in gross income. Where warrants are issued by a city, town, or other political subdivision of a State, and are accepted by the contractor in payment for public work done, the fair market value of such warrants should be returned as income. If for any reason the contractor upon conversion of the warrants into cash does not receive and can not recover the full value of the warrants so returned, he may deduct from gross income for the year in which the warrants are converted into cash any loss sustained, and if he realizes more than the value of the warrants so returned he should include such amount in his gross income of the year in which realized.

ART. 38. **Gross income of farmers.**—A farmer reporting on the basis of receipts and disbursements (in which no inventory to determine profits is used) shall include in his gross income for the taxable year (1) the amount of cash or the value of merchandise or other property received from the sale of live stock and produce which were raised during the taxable year or prior years, (2) the profits from the sale of any live stock or other items which were purchased, and (3) gross income from all other sources. The profit from the sale of live stock or other items which were purchased is to be ascertained by deducting the cost from the sales price in the year in which the sale occurs, except that in the case of the sale of animals purchased as draft or work animals or solely for breeding or dairy purposes and not for resale, the profit shall be the amount of any excess of the sales price over the amount representing the difference between the cost and the depreciation theretofore sustained and allowed as a deduction in computing net income.

In the case of a farmer reporting on the accrual basis (in which an inventory is used to determine profits), his gross profits are ascer-

tained by adding to the inventory value of live stock and products on hand at the end of the year the amount received from the sale of live stock and products, and miscellaneous receipts for hire of teams, machinery, and the like, during the year, and deducting from this sum the inventory value of live stock and products on hand at the beginning of the year and the cost of live stock and products purchased during the year. In such cases all live stock raised or purchased for sale shall be included in the inventory at their proper valuation determined in accordance with the method authorized and adopted for the purpose. Also live stock acquired for draft, breeding, or dairy purposes and not for sale may be included in the inventory, instead of being treated as capital assets subject to depreciation, provided such practice is followed consistently by the taxpayer. In case of the sale of any live stock included in an inventory their cost must not be taken as an additional deduction in the return of income, as such deduction will be reflected in the inventory. See article 1616.

In every case of the sale of machinery, farm equipment, or other capital assets (which are not to be included in an inventory if one is used to determine profits) any excess over the cost thereof less the amount of depreciation theretofore sustained and allowed as a deduction in computing net income, shall be included as gross income. Where farm produce is exchanged for merchandise, groceries, or the like, the market value of the article received in exchange is to be included in gross income. Rents received in crop shares shall be returned as of the year in which the crop shares are reduced to money or a money equivalent. Proceeds of insurance, such as hail and fire insurance on growing crops, should be included in gross income to the amount received in cash or its equivalent for the crop injured or destroyed. If a farmer is engaged in producing crops which take more than a year from the time of planting to the time of gathering and disposing, the income therefrom may be computed upon the crop basis; but in any such cases the entire cost of producing the crop must be taken as a deduction in the year in which the gross income from the crop is realized.

As herein used the term "farm" embraces the farm in the ordinarily accepted sense, and includes stock, dairy, poultry, fruit, and truck farms, also plantations, ranches, and all land used for farming operations. All individuals, partnerships, or corporations that cultivate, operate, or manage farms for gain or profit, either as owners or tenants, are designated farmers. A person cultivating or operating a farm for recreation or pleasure, the result of which is a continual loss from year to year, is not regarded as a farmer.

Form 1040 F should be filled in and attached to his income tax return by every farmer who either keeps no records or only records of cash receipts and disbursements; its use is optional with other farmers. See further articles 111, 145, and 171.

ART. 39. **Sale of stock and rights.**—When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots can not be determined, the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost or other basis of the stock will constitute gain. In the case of stock in respect of which any stock dividend was paid, the basis for determining gain or loss from a sale of a share of such stock shall be ascertained as specified in article 1599. 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 such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, 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.

Where a corporation issues to its shareholders the right to subscribe to its stock, the value of the right does not constitute taxable income to the shareholder, but gain may be derived or loss sustained by the shareholder from the sale of such right.

Where the right to subscribe relates to new stock of substantially the same character or preference as the stock with respect to which the right is issued—

(1) If the shareholder exercises his right to subscribe, the basis for determining gain or loss from a subsequent sale of any one of the old or new shares will be the cost or other basis of the old shares, plus the subscription price of the new shares, divided by the total number of the old and new shares.

(2) If the shareholder sells the right to subscribe or the stock with respect to which the right is issued, the gain or loss from the sale will be determined by comparing the sum of the sale price of the right and the subscription price with the basis of the shares as determined in (1) above. The gain computed under the provisions of this article shall not exceed the amount for which the right is sold. If, however, this limitation has been applied, the gain or loss from the subsequent sale of the stock with respect to which the right was issued, shall be determined as if no right to subscribe had been issued with respect to it.

If the right issued deals with stock in whole or in part of a character or preference materially different from the stock with respect to which the right is issued, or if the stock with respect to which the right is issued was purchased at different times and at different prices, and the identity of the lots can not be determined, or if the stock with respect to which the right is issued was purchased at different times and at different prices and the stock right issued with respect to such stock can not be identified as having been issued with respect to any particular lot of such stock, the computation of the gain from the sale of the old shares or the right in cases where the right is sold or from the sale of the old or new shares in cases where the right is exercised shall be made in accordance with the principles laid down in article 1599 with respect to the computation of the gain or loss from the sale of stock received as a stock dividend.

ART. 40. **Sale of patents and copyrights.**—A taxpayer disposing of patents or copyrights by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the cost, or other basis, as provided in article 1591. The profit or loss thus ascertained should be increased or decreased, as the case may be, by the amounts deducted on account of depreciation of such patents or copyrights since February 28, 1913, or since the date of acquisition if subsequent thereto. See article 167.

ART. 41. **Sale of good will.**—Any profit or loss resulting from a sale of good will can be taken only when the business, or a part of it, to which the good will attaches is sold, in which case the profit or loss will be determined by comparing the sale price with the cost or other basis of the assets, including good will. (See article 1591.) If specific payment was not made for good will acquired after February 28, 1913, there can be no deductible loss with respect thereto, but profit may be realized from the sale of good will built up through expenditures which have been currently deducted. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof is on the taxpayer to establish the cost or fair market value on March 1, 1913, of the good will sold. See article 163.

ART. 42. **Sale of personal property on installment plan.**—Dealers in personal property ordinarily sell either for cash or on the personal credit of the buyer or on the installment plan. Occasionally a fourth type of sale is met with, in which the buyer makes an initial payment of such a substantial nature (for example, a payment of more than 25 per cent) that the sale, though involving deferred payments, is not one on the installment plan. Dealers in personal property who sell on the installment plan usually adopt one of four ways of protecting themselves in case of default: (*a*) By an agreement that

title is to remain in the seller until the buyer has completely performed his part of the transaction; (*b*) by a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the purchase price; (*c*) by a present transfer of title to the purchaser, who at the same time executes a reconveyance in the form of a chattel mortgage to the seller; or (*d*) by conveyance to a trustee pending performance of the contract and subject to its provisions. The general purpose and effect being the same in all of these plans, it is desirable that a uniformly applicable rule be established.

The rule prescribed is that in the sale or contract for sale of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for, the income to be returned by the vendor will be that proportion of each installment payment which the gross profit to be realized when the property is paid for bears to the gross contract price. Such income may be ascertained by taking as profit that proportion of the total cash collections received in the taxable year from installment sales (such collections being allocated to the year against the sales of which they apply), which the annual gross profit to be realized on the total installment sales made during each year bears to the gross contract price of all such sales made during that respective year. In any case where the gross profit to be realized on a sale or contract for sale of personal property has been reported as income for the year in which the transaction occurred, and a change is made to the installment plan of computing net income, no part of any installment payment received subsequent to the change, representing income previously reported on account of such transaction, should be reported as income for the year in which the installment payment is received. The intent and purpose of this provision is that where the entire profit from installment sales has been included in gross income for the year in which the sale was made, no part of the installment payments received subsequently on account of such previous sales shall again be subject to tax for the year or years in which received. Where the taxpayer makes a change to this method of computing net income his balance sheet should be adjusted conformably. If for any reason the vendee defaults in any of his installment payments and the vendor repossesses the property, the entire amount received on installment payments, less the profits already returned, will be income of the vendor 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 proper allowance for damage and use, if any.

If the vendor chooses as a matter of consistent practice to treat the obligations of purchasers as the equivalent of cash, such a course is permissible.

ART. 43. **Sale of real estate in lots.**—Where a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such the cost shall be equitably apportioned to the several lots or parcels and made a matter of record on the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels which constitutes taxable income may be returned as income for the year in which the sale was made. This rule contemplates that there will be a measure of gain or loss on every lot or parcel sold, and not that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain or loss will be accounted for as provided in article 1591.

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 having a fair market value, 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 having a fair market value 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 article 44 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. If these obligations have a fair market value, they are to be considered as the equivalent of cash and the profit realized from the transaction is taxable income for the year in which the initial payment was made and the obligation 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). If the obligations have no fair market value, the amount of the initial payment shall be applied against and reduce the basis, as provided in section 204 and articles 1591–1603, of the property sold and if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the basis as provided above and the amount realized therefor. See articles 153 and 1591.

ART. 47. **Annuities and insurance policies.**—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 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 gross income the amount of rent paid to the annuitant, and he is not entitled to deduct from his gross in-

come any sums paid to the annuitant. Amounts received by an insured as a return of premiums paid by him under life insurance, endowment, or annuity contracts, such as the so-called "dividends" of a mutual insurance company which may be credited against the current premium, are not subject to tax. See article 72. Distributions on paid-up policies which are made out of earnings of the insurance company subject to tax are in the nature of corporate dividends and are income of an individual only for the purpose of the surtax.

ART. 48. **Improvements by lessees.**—When buildings are erected or improvements made by a lessee in pursuance of an agreement with the lessor, and such buildings or improvements are not subject to removal by the lessee, the lessor may at his option report the income therefrom upon either of the following bases:

(*a*) The lessor may report as income at the time when such buildings or improvements are completed the fair market value of such buildings or improvements subject to the lease. This amount would ordinarily be the difference between the value of the land free from the lease without such improvements and the value of the land subject to the lease with such improvements.

(*b*) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the termination of the lease and report as income for each year of the lease an aliquot part thereof.

If for any other reason than a bona fide purchase from the lessee by the lessor the lease is terminated, so that the lessor comes into possession or control of the property prior to the time originally fixed for the termination of the lease, the lessor receives additional income for the year in which the lease is so terminated to the extent that the value of such buildings or improvements when he became entitled to such possession exceeds the amount already reported as income on account of the erection of such buildings or improvements. No appreciation in value due to causes other than the premature termination of the lease shall be included. Conversely, if the buildings or improvements are destroyed prior to the expiration of the lease, the lessor is entitled to deduct as a loss for the year when such destruction takes place the amount previously reported as income because of the erection of such buildings or improvements, less any salvage value subject to the lease to the extent that such loss was not compensated for by insurance. If the buildings or improvements destroyed were acquired prior to March 1, 1913, the deduction shall be based on the cost or the value subject to the lease as of that date, whichever is higher, less any salvage value subject to the lease to the extent that such loss was not compensated for by insurance. See articles 110 and 164.

ART. 49. **Forgiveness of indebtedness.**—The cancellation and forgiveness of indebtedness may amount to a payment of income, to a gift, or to a capital transaction, dependent upon the circumstances. 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 shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation.

ART. 50. **When included in gross income.**—Gains, profits and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included when they accrue to him in accordance with the approved method of accounting followed by him. See articles 21–24. If a person sues in one year on a pecuniary claim or for property, and money or property is recovered on a judgment therefor in a later year, income is realized in that year, assuming that the money or property would have been income in the earlier year if then received. This is true of a recovery for patent infringement. Bad debts or accounts charged off subsequent to March 1, 1913, because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. (See articles 112 and 151.) Such items as claims for compensation under canceled Government contracts constitute income for the year in which they are allowed or their value is otherwise definitely determined.

ART. 51. **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 some future date, the mere crediting on the books of the corporation does not constitute receipt.

ART. 52. **Examples of constructive receipt.**—When interest coupons have matured and are payable, 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 true if the coupons are exchanged for other property instead of eventually being cashed. Defaulted coupons are income for the year in which paid. Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the stockholder. The distributive share of the profits of a partner in a partnership is regarded as received by him, although not distributed. See section 218 of the statute and articles 335–338. Interest credited on savings bank deposits, even though the bank nominally has 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. (But see section 213(b) (10) and article 89.)

GROSS INCOME DEFINED: EXCLUSIONS

[SEC. 213. For the purposes of this title, except as otherwise provided in section 233.]

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

(1) The proceeds of life insurance policies paid upon the death of the insured;

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

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income);

(4) Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions. Every person owning any of the obligations or securities enumerated in clause (A), (B), or (C) shall, in the return required by this title, submit a statement showing the number and amount of such obligations and securities owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), the interest shall be exempt only if and to the extent pro-

vided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income taxes;

(5) The income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments, or from interest on deposits in banks in the United States of moneys belonging to such foreign governments, or from any other source within the United States;

(6) Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness;

(7) Income derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, or income accruing to the Government of any possession of the United States, or any political subdivision thereof.

Whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, prior to September 8, 1916, entered in good faith into a contract with any person, the object and purpose of which is to acquire, construct, operate, or maintain a public utility—

(A) If by the terms of such contract the tax imposed by this title is to be paid out of the proceeds from the operation of such public utility, prior to any division of such proceeds between the person and the State, Territory, political subdivision, or the District of Columbia, and if, but for the imposition of the tax imposed by this title, a part of such proceeds for the taxable year would accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then a tax upon the net income from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this title, but there shall be refunded to such State, Territory, political subdivision, or the District of Columbia, (under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this title) would have accrued directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, bears to the amount of the net income from the operation of such public utility for such taxable year.

(B) If by the terms of such contract no part of the proceeds from the operation of the public utility for the taxable year would, irrespective of the tax imposed by this title, accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then the tax upon the net income of such person from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this title;

(8) The income of a nonresident alien or foreign corporation which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States;

(9) Amounts received as compensation, family allotments and allowances under the provisions of the War Risk Insurance and the Vocational Rehabilitation Acts or the World War Veterans' Act, 1924, or as pensions from the

United States for service of the beneficiary or another in the military or naval forces of the United States in time of war, or as a State pension for services rendered by the beneficiary or another for which the State is paying a pension;

(10) The amount received by an individual before January 1, 1927, as dividends or interest from domestic building and loan associations, substantially all the business of which is confined to making loans to members, but the amount excluded from gross income under this paragraph in any taxable year shall not exceed $300;

(11) The rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation;

(12) The receipts of shipowners' mutual protection and indemnity associations, not organized for profit, and no part of the net earnings of which inures to the benefit of any private shareholder; but such corporations shall be subject as other persons to the tax upon their net income from interest, dividends, and rents;

(13) In the case of an individual, amounts distributed as dividends to or for his benefit by a corporation organized under the China Trade Act, 1922, if, at the time of such distribution, he is a citizen of China, resident therein, and the equitable right to the income of the shares of stock of the corporation is in good faith vested in him.

ART. 71. **Exclusions from gross income.**—The term "gross income" as used in the Act does not include those items of income exempted by statute or by fundamental law. The exemption of such income should not be confused with the reduction of taxable income by the application of allowable deductions. Every person owning (1) obligations of a State, Territory, any political subdivision thereof, or the District of Columbia, or (2) securities issued under the provisions of the Federal Farm Loan Act or of such Act as amended, or (3) obligations of the United States or its possessions, must, however, submit in his income tax return a statement showing the number and amount of such obligations and securities owned and the income received therefrom.

ART. 72. **Proceeds of insurance—Compensation—Pensions.**—The proceeds of life insurance policies, paid upon the death of an insured to his estate or to any beneficiary (individual, partnership, or corporation), directly or in trust, are excluded from the gross income of the beneficiary. See article 541. The amount received by an insured under life insurance, endowment, or annuity contracts as a return, without interest, of premiums paid by him therefor is excluded from his gross income. See article 47. 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. See further article 293. 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, 1914, as amended, even though the benefit accrued before that date. In addition to this exemption from all Federal taxes, the Revenue Act of 1924 exempts from income tax amounts received as compensation, family allotments, and allowances under the provisions of the War Risk Insurance, the Vocational Rehabilitation Acts, or the World War Veterans' Act, 1924, or as pensions from the United States for service of the beneficiary or another in the military or naval forces of the United States in time of war, or as a State pension for services rendered by the beneficiary or another for which the State is paying a pension. As to meaning of " military and naval forces of the United States," see section 2 of the statute.

ART. 73. **Gifts and bequests.**—Property received as a gift, or received under a will or under statutes of descent and distribution, is exempt from the income tax, although the income therefrom derived from investment, sale, or otherwise is not. An amount of principal paid under a marriage settlement is a gift. Neither alimony nor an allowance based on a separation agreement is taxable income. See article 291.

ART. 74. **Interest upon State obligations.**—Interest upon the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia is exempt from the income tax. Obligations issued for a public purpose by or on behalf of the State or Territory or a duly organized political subdivision acting by constituted authorities empowered to issue such obligations, are the obligations of a State or Territory or a political subdivision thereof. The term " political subdivision " denotes any division of the State or Territory made by the proper authorities thereof acting within their constitutional powers for the purpose of carrying out a portion of those functions of the State or Territory which by long usage and the inherent necessities of government have always been regarded as public. Political subdivisions of a State or Territory, within the meaning of the exemption, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of a State or Territory. The purchase by a State of property subject to a mortgage executed to secure an issue of bonds does not render the bonds obligations of the State, and the interest upon them does not become exempt from taxation whether or not the State assumes the payment of the bonds.

ART. 75. **Dividends and interest from Federal land banks, Federal intermediate credit banks, and national farm loan associations.**—As section 26 of the Federal Farm Loan Act of July 17, 1916 (39 Stat. 360), as amended by an act approved March 4, 1923 (42 Stat. 1454), provides that Federal land banks, Federal intermediate credit banks, and national farm loan associations, 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 first mortgages executed to Federal land banks, Federal intermediate credit banks, or to joint stock land banks, farm loan bonds, and debentures issued by intermediate credit banks, with the income therefrom, shall be exempt from taxation, the income derived from dividends on stock of Federal land banks, Federal intermediate credit banks and national farm loan associations and from interest on promissory notes secured by such first mortgages, or from such farm loan bonds or debentures, is not subject to the income tax. See also section 231 (13) of the statute.

ART. 76. **Dividends from Federal reserve bank.**—Section 7 of the Federal Reserve Act of December 23, 1913, provides that Federal reserve banks, including the capital stock and surplus therein and the income derived therefrom, shall be exempt from taxation, except taxes upon real estate. This exemption attaches to and follows the income derived from dividends on stock of Federal reserve banks in the hands of the stockholders, so that the dividends received on the stock of Federal reserve banks are not subject to the income tax. Dividends paid by member banks, however, are treated like dividends of ordinary corporations.

ART. 77. **Interest upon United States obligations.**—Although interest upon the obligations of the United States and its possessions is generally exempt from tax, in the case of obligations issued by the United States after September 1, 1917, which include Treasury certificates of indebtedness, Treasury bonds, Treasury notes, Treasury (war) savings certificates, the Liberty bond issues (except the first Liberty loan 3½ per cent bonds and Victory Liberty loan 3¾ per cent convertible notes), and Victory Liberty loan 4¾ per cent convertible notes, the interest is exempt from tax only if and to the extent provided in the acts authorizing the issue thereof, as amended and supplemented.

Treasury bonds, Treasury notes, Treasury certificates of indebtedness, and Treasury (war) savings certificates have the exemptions described in paragraph (2) of article 82 and all of these certificates and bonds (but not the notes) also have the exemptions from surtaxes and profits taxes described in paragraph (3) of article 82. Interest credited to postal savings accounts upon moneys deposited in postal savings banks is exempt from income tax. Interest on the first

Liberty loan 3½ per cent bonds is entirely exempt from Federal, State, and local taxation, except estate or inheritance taxes, but this absolute exemption does not extend to the bonds of the first Liberty loan converted.

ART. 78. **Liberty bond exemptions, as amended and supplemented by the Revenue Act of 1924.**—The Liberty bond exemptions from surtaxes, war-profits and excess-profits taxes under the Second Liberty Bond Act of September 24, 1917 (as amended by the Third Liberty Bond Act of April 4, 1918, by the Supplement to the Second Liberty Bond Act approved September 24, 1918, the Fourth Liberty Bond Act of July 9, 1918), the Victory Liberty Loan Act of March 3, 1919, and the Revenue Act of 1921, have been amended and supplemented by section 1028 of the Revenue Act of 1924, which provides as follows:

CONSOLIDATION OF LIBERTY BOND TAX EXEMPTIONS

SEC. 1028. The various Acts authorizing the issues of Liberty bonds are amended and supplemented as follows:

(a) On and after January 1, 1921, 4 per centum and 4¼ per centum Liberty bonds shall be exempt 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, corporations, or associations, in respect to the interest on aggregate principal amounts thereof as follows:

Until the expiration of two years after the date of the termination of the war between the United States and the German Government, as fixed by proclamation of the President, on $125,000 aggregate principal amount; and for three years more on $50,000 aggregate principal amount.

(b) The exemptions provided in subdivision (a) shall be in addition to the exemptions provided in section 7 of the Second Liberty Bond Act, and in addition to the exemption provided in subdivision (3) of section 1 of the Supplement to the Second Liberty Bond Act in respect to bonds issued upon conversion of 3½ per centum bonds, but shall be in lieu of the exemptions provided and free from the conditions and limitations imposed in subdivisions (1) and (2) of section 1 of the Supplement to the Second Liberty Bond Act and in section 2 of the Victory Liberty Loan Act.

Accordingly, in addition to the exemptions provided in section 7 of the Second Liberty Bond Act and in subdivision (3) of section 1 of the supplement to the Second Liberty Bond Act, but in lieu of the exemptions provided and free from the conditions and limitations imposed in subdivisions (1) and (2) of section 1 of the Supplement to the Second Liberty Bond Act and in section 2 of the Victory Liberty Loan Act, the interest on the 4 per cent and 4¼ per cent Liberty bonds shall be exempt on an aggregate principal amount of $125,000 of such bonds until the expiration of two years after July 2, 1921, the

date of the termination of the war between the United States and the German Government as fixed by proclamation of the President, and for three years more (from July 3, 1923, to July 2, 1926) on an aggregate principal amount of $50,000 of such bonds. Since none of the Liberty or Victory issues is subject to normal income tax, and since the Revenue Act of 1921 repealed the excess-profits and war-profits taxes as of January 1, 1922, from that date the question of exemption from such taxes is immaterial and the only important question is the surtax exemption.

ART. 79. **Liberty bond exemption under Second, Third, and Fourth Liberty Bond Acts.**—Under the Revenue Act of 1924 the exemption provided by section 7 of the Second Liberty Bond Act of September 24, 1917, has not been changed. Section 7 of the Second Liberty Bond Act of September 24, 1917, as amended by the Third Liberty Bond Act of April 4, 1918, and by the Fourth Liberty Bond Act of July 9, 1918, provides that in addition to the entire exemption of interest on first Liberty loan 3½ per cent bonds, there shall be exempt from normal income tax all interest on first Liberty loan converted 4 per cent bonds, first Liberty loan converted 4¼ per cent bonds, first Liberty loan second converted 4¼ per cent bonds, second Liberty loan 4 per cent bonds, second Liberty loan converted 4¼ per cent bonds, third Liberty loan 4¼ per cent bonds, and fourth Liberty loan 4¼ per cent bonds, Treasury bonds, Treasury certificates of indebtedness, Treasury notes, and Treasury (war) savings certificates. Interest on an aggregate of not exceeding $5,000 principal amount of bonds included in such later issues, bonds of the first Liberty loan converted, Treasury certificates of indebtedness, and Treasury (war) savings certificates (but not the notes) is exempt from the surtax as well as the normal tax. Interest in excess of the interest on not exceeding $5,000 principal amount of such bonds and certificates may, however, be subject to surtaxes and may accordingly be required to be included in gross income.

ART. 80. **Exemption of Treasury (war) savings certificates.**—Treasury (war) savings certificates are issued under the Second Liberty Bond Act of September 24, 1917, as amended, and include war savings certificates and Treasury savings certificates. Such certificates are not transferable, nor is it lawful for any one person at any one time to hold more than $5,000, maturity value, of any one series thereof. The principal amount of such certificates for the purpose of computing the exemption is their issue price.

In the case of a taxpayer reporting income on a basis of cash receipts and disbursements, the difference between the issue price of the savings certificates and the amount received upon their redemption is deemed to be income to the holder in the taxable year when received. The amount thus received is exempt from all State and

local taxation (except estate and inheritance taxes) and from the normal Federal income tax and the corporation income tax. It is not exempt from surtaxes, except to the extent that it falls within the above-described exemption in respect of the interest on an aggregate principal amount of 4 and 4¼ per cent Liberty bonds, Treasury certificates of indebtedness and savings certificates, not exceeding $5,000. For the purpose of computing this limited exemption, savings certificates are to be taken at issue price, and if the exemption is claimed with respect to any holdings of savings certificates it will be deemed to cover the period during which the taxpayer holds the savings certificates in respect of which the exemption is claimed, and not merely the taxable year in which the certificates are redeemed. In other words, if the taxpayer holds and claims exemption upon $4,000 (issue price) of savings certificates of the Series of 1922, for the full period of 5 years to maturity, he will not be able to claim any exemption with respect to any other holdings in excess of $1,000 of Liberty bonds, Treasury certificates of indebtedness or savings certificates under the $5,000 limited exemption above described, for any part of the five-year period. If, on the other hand, the holder of $4,000 (issue price) of savings certificates, Series of 1922, has during the prior four years taken the full benefit of the $5,000 limited exemption with respect to other holdings of bonds or certificates, he will not be able to claim exemption in the fifth year for more than the amount by which the maturity value of the savings certificates exceeds the published redemption price at the beginning of that year.

In the case of a taxpayer reporting on an accrual basis, the interest to be reported for each year is the excess of the published redemption price of the certificates at the end of his accounting year, or of the amount received upon redemption, if redeemed during the year, over the corresponding published price for the beginning of that year; and the interest exempt from taxation, if any, is the proportion of the interest accrued that the portion of the issue price includable in the exemption for each year is of the total issue price.

ART. 81. **Liberty bond exemption under Supplement to Second Liberty Bond Act, as amended and supplemented by the Revenue Act of 1924.**— The Revenue Act of 1924, in effect repeals subdivisions (1) and (2), but retains subdivision (3) of section 1 of the Supplement to the Second Liberty Bond Act, approved September 24, 1918. Subdivision (3) provides:

> The interest on an amount of bonds, the principal of which does not exceed $30,000, owned by any individual, partnership, association, or corporation, issued upon conversion of 3½ per centum bonds of the first Liberty loan in the exercise of any privilege arising as a consequence of the issue of bonds of the fourth Liberty loan, shall be exempt from such taxes.

This exemption from surtaxes and profits taxes expired July 2, 1923, and was in addition to the exemption provided in section 7 of the Second Liberty Bond Act (see article 79) in respect to the interest on an amount of bonds and certificates, authorized by such Act and amendments thereto, the principal of which does not exceed in the aggregate $5,000.

ART. 82. **Summary of tax exemptions of Liberty bonds, Treasury bonds, Treasury notes, Treasury certificates of indebtedness, and Treasury (war) savings certificates.**—Liberty bonds, Treasury bonds, Treasury notes, Treasury certificates of indebtedness, and Treasury (war) savings certificates issued under the authority of the Acts of Congress approved April 24, 1917, September 24, 1917, April 4, 1918, July 9, 1918, September 24, 1918, March 3, 1919, and the Revenue Act of 1921, are entitled to the following exemptions on and after January 1, 1921:

(1) 3½ per cent bonds of the first Liberty loan are exempt from all Federal, State, and local taxation, except estate or inheritance taxes.

(2) 4 per cent and 4¼ per cent Liberty bonds, Treasury bonds, Treasury notes, Treasury certificates of indebtedness, and Treasury (war) savings certificates 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*) 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.

(3) 4 per cent and 4¼ per cent Liberty bonds, Treasury bonds, Treasury certificates of indebtedness, and Treasury (war) savings certificates are entitled to certain limited exemptions from surtaxes and excess-profits taxes now or hereafter imposed by the United States. For the period from July 3, 1923, to July 2, 1926, the total possible exemption from surtax amounts to $55,000, as follows:

Period July 3, 1923, to July 2, 1926:

$5,000 in the aggregate of First 4s, First 4¼s, First-second 4¼s, Second 4s and 4¼s, Third 4¼s, Fourth 4¼s, Treasury bonds, Treasury certificates of indebtedness, and Treasury (war) savings certificates.

50,000 in the aggregate of First 4s, First 4¼s, First-second 4¼s, Second 4s and 4¼s, Third 4¼s, and Fourth 4¼s.

$55,000 total possible exemptions for this period.

ART. 83. **Liberty bond exemption in the case of trusts or partnerships.**—(*a*) When income is taxable to beneficiaries, as in the case of a trust

the income of which is to be distributed to the beneficiaries periodically, each beneficiary is regarded as the owner of a proportionate part of the bonds held in trust and is entitled to exemption on account of such ownership as if he owned such proportionate part of the bonds directly. When, on the other hand, income is taxable to the trustee, as in the case of a trust the income of which is accumulated for the benefit of unborn or unascertained persons, the trustee is regarded as the owner of all the bonds held in trust and the trust is entitled to exemption on account of such ownership.

(*b*) As the income of a partnership is taxable to the individual partners, each partner is treated as the owner of a proportionate part of the bonds held by the partnership and is entitled to exemption on account of such ownership as if he owned such proportionate part of the bonds directly. See section 218.

ART. 84. **Liberty bond exemption in the case of nonresident aliens.**—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 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 income taxes.

ART. 85. **Return for fiscal year ending in 1924.**—In the case of a return rendered for a fiscal year beginning in 1923 and ending in 1924, the interest received from obligations of the United States issued after September 1, 1917, is, in respect to the amount received prior to January 1, 1924, exempt only if and to the extent provided in the acts authorizing the issue thereof, as amended and supplemented by section 1328 of the Revenue Act of 1921. See article 80, Regulations 62. The interest received on and after January 1, 1924, is exempt in accordance with the acts authorizing the issue thereof as amended and supplemented by section 1028 of the Revenue Act of 1924. See article 78. The provisions of the two statutes being identical in this respect, it follows that the same exemptions apply to interest on obligations of the United States whether received before, or on or after January 1, 1924, except on such interest received before July 3, 1923, as to which see article 83 of Regulations 62. Since the basis of the exemptions is the principal amount of bonds held rather than the amount of interest received, where the holdings are not constant during the taxable period, if at any time the holdings of any issue or issues are less than the maximum exempted principal, then the exempted interest for such time shall be only the amount of interest received or accrued upon the principal actually held.

ART. 86. **Income of foreign governments, ambassadors, and consuls.**—The exemption of the 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.

Ambassadors and ministers accredited to the United States and the members of their households (including secretaries, attachés, and servants) who are not citizens of the United States, are exempt from the payment of Federal income tax upon their salaries, fees, or wages. The income from investments in the United States in bonds and stocks and from interest on bank balances received by ambassadors and ministers accredited to the United States, who are not citizens of the United States, is exempt from tax, but income from any business carried on by them in the United States is taxable. These provisions are also applicable to the wives and minor children of foreign ambassadors and ministers and the members of their households, including secretaries, attachés, and servants.

All foreign consular officers and employees in foreign consulates in the United States who are nationals of the States appointing them are exempt from Federal income tax with respect to the wages, fees, and salaries received by them in compensation for their consular services, provided the appointing State grants a similar exemption to citizens of the United States who are American consular officers or employees of the American consulates in such State. The income received by foreign consular officers and employees of foreign consulates from investments in the United States in bonds and stocks and from interest on bank balances as well as income from any business carried on by them in the United States is subject to Federal income tax.

The compensation of citizens of the United States who are officers or employees of a foreign government is not exempt from income tax.

ART. 87. **Income of States.**—Income derived from any public utility or from the exercise of any essential governmental function and accruing to any State or Territory of the United States, to any political subdivision thereof, or to the District of Columbia, or income accruing to the government of any possession of the United States, or any political subdivision thereof, is exempt from tax. See article 74. The income of State workmen's compensation insurance funds established by State statutes is not taxable.

ART. 88. **Compensation of State officers and employees.**—Compensation paid its officers and employees by a State or political subdivision thereof, including fees received by notaries public commissioned by

States and the commissions of receivers appointed by State courts, is not taxable. Compensation received for services rendered to a State or a political subdivision thereof is included in gross income unless the person receives such compensation as an officer or employee of a State or political subdivision. An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects, and whose services are continuous, not occasional or temporary. Employees of universities receiving salaries paid in part or in whole from funds available under the Smith-Lever Act of May 8, 1914, who are officers or employees of a State, are not required to return as taxable income the salaries so received. This is also true with respect to the Act of August 30, 1890, relating to colleges for the benefit of agriculture and the mechanic arts, and to the Act of March 2, 1887, relating to agricultural experiment stations in such colleges. As to State contracts, see article 37.

ART. 89. **Additional exclusions from gross income.**—The following additional exclusions from gross income are allowed by the Revenue Act of 1924:

(1) So much of the income from sources within the United States of a nonresident alien individual or of a foreign corporation as consists of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States nonresident in such foreign country and to corporations organized in the United States. (*a*) The following is an incomplete list of the foreign countries which either impose no income tax, or, in imposing such tax, exempt from taxation so much of the income of a citizen of the United States nonresident in such foreign country and of a corporation organized in the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of the United States: Argentine Republic; Bulgaria; Denmark; Egypt; Iceland; Norway; Paraguay; Persia; St. Lucia; Siam; Sweden; Venezuela. (*b*) The following is an incomplete list of the foreign countries which, in imposing an income tax upon the income of citizens of the United States nonresident in such countries or of corporations organized in the United States, do not exempt from taxation the earnings derived from the operation of a ship or ships documented under the laws of the United States: Antigua; Belgium; British Honduras; Costa Rica; Dominica; Fiji; Finland; Great Britain; Greece; Grenada; India; Jamaica; Japan; New Zealand; Peru; St. Vincent; Spain; Trinidad; Union of South

Africa. So much of the income from sources within the United States of a nonresident alien individual or of a foreign corporation as consists of earnings derived from the operation of a ship or ships documented under the laws of any of the countries in the first list is not required to be included in the gross income of such nonresident alien individual or foreign corporation for the purpose of Federal income tax. The income from sources within the United States of a nonresident alien individual or of a foreign corporation from earnings derived from the operation of a ship or ships documented under the laws of any of the countries in the second list is required to be included in the gross income of such nonresident alien individual or foreign corporation and is subject to Federal income tax. If a nonresident alien individual or a foreign corporation receives income from sources within the United States consisting of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which is in neither list, the amount so received must be included in gross income unless satisfactory proof is furnished either (*a*) that such foreign country imposes no income tax, or (*b*) if an income tax is imposed that the foreign statute grants an equivalent exemption to citizens of the United States nonresident in such country and to corporations organized in the United States;

(2) Dividends or interest received by an individual before January 1, 1927, from domestic building and loan associations, substantially all the business of which is confined to making loans to members, but the amount excluded from gross income under this paragraph shall not exceed $300 in any taxable year;

(3) Rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation;

(4) Receipts of shipowners' mutual protection and indemnity associations not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder. Such corporations, however, shall be subject as other taxpayers to the tax upon their net income from interest, dividends, and rents. In other words, they are subject to the taxes imposed by section 230, but only upon net income from interest, dividends, and rents;

(5) Under section 234 (a) (3) any tax paid by a corporation pursuant to a tax-free covenant clause need not be included in the gross income of the bondholder. See article 565;

(6) Amounts distributed as dividends by a corporation organized under the China Trade Act, 1922, to or for the benefit of an individual, if at the time of such distribution he is a citizen of China, resident therein, and the equitable right to the income of the shares of stock of the corporation is in good faith vested in him. See section 263.

Art. 90. Income accrued prior to March 1, 1913.—Any claim existing unconditionally on March 1, 1913, whether presently payable or not and held by a taxpayer prior to March 1, 1913, whether evidenced by writing or not, and all interest which had accrued thereon before that date, do not constitute taxable income, although actually recovered or received subsequent to such date. Interest accruing on or after that date is taxable income. Where an interest-bearing claim held on February 28, 1913, is paid in whole or in part after that date, any gain derived from the payment of the claim is taxable. The amount of such gain is the excess of the proceeds of the claim (both principal and interest) exclusive of any interest accrued since February 28, 1913, already returned as income, over the cost thereof (both principal and interest then accrued). However, the gain to be included in gross income where the fair market value of the claim as of March 1, 1913, is greater than the cost thereof, is the excess of the amount received over such value. In the case of an insurance policy its surrender value as of March 1, 1913, may be used as a basis for the purpose of ascertaining the gain derived from its sale or other disposition. Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued.

Art. 91. Subtraction for redemption of trading stamps.—Where a taxpayer, for the purpose of promoting his business, issues with sales trading stamps or premium coupons redeemable in merchandise or cash, he should in computing the income from such sales subtract only the amount received or receivable which will be required for the redemption of such part of the total issue of trading stamps or premium coupons issued during the taxable year as will eventually be presented for redemption. This amount will be determined in the light of the experience of the taxpayer in his particular business and of other users engaged in similar businesses. The taxpayer shall file for each of the five preceding years, or such number of these years as stamps or coupons have been issued by him, a statement showing (*a*) the total issue of stamps during each year, (*b*) the total stamps redeemed in each year, and (*c*) the percentage for each year of the stamps redeemed to the stamps issued in such year. A similar statement shall also be presented showing the experience of other users of stamps or coupons whose experience is relied upon by the taxpayer to determine the amount to be subtracted from the proceeds of sales. The Commissioner will examine the basis used in each return, and in any case in which the amount subtracted in respect of such stamps or coupons is found to be excessive an amended return or amended returns will be required.

GROSS INCOME DEFINED: NONRESIDENT ALIEN INDIVIDUAL

[SEC. 213.] (c) In the case of a nonresident alien individual, gross income means only the gross income from sources within the United States, determined under the provisions of section 217.

ART. 92. **Gross income of nonresident alien individuals.**—In the case of nonresident alien individuals " gross income " means only the gross income from sources within the United States, determined under the provisions of section 217. See articles 317–331. As to the gross income of foreign corporations see section 233 (b) of the statute and article 550; also section 217 and articles 317–331. The items of gross income from sources without the United States and therefore not taxable to nonresident aliens or foreign corporations are described in section 217 (c) and article 323. As to who are nonresident alien individuals, see articles 311–315.

ART. 93. **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 sources derived, nonresident alien seamen are taxable only on income from sources within the United States. 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. See further article 320. 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 312.

DEDUCTIONS ALLOWED INDIVIDUALS: BUSINESS EXPENSES

SEC. 214. (a) In computing net income there shall be allowed as deductions:
(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity;

ART. 101. **Business expenses.**—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 121–251. The cost of goods purchased for resale,

with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See article 35.) Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see article 102), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. But see article 293. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source. See section 215 of the statute and articles 291–294. As to deductions by corporations see section 234 and articles 561–572.

ART. 102. **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 solely on business, the reasonable and necessary traveling expenses, including railroad fares, meals, and lodging, become business instead of personal expenses. (*a*) If, then, an individual, whose business requires him to travel, receives a salary as full compensation for his services, without reimbursement for traveling expenses, or is employed on a commission basis with no expense allowance, his traveling expenses, including the entire amount expended for meals and lodging, are deductible from gross income. (*b*) If an individual receives a salary and is also repaid his actual traveling expenses, he shall include in gross income the amount so repaid and may deduct such expenses. (*c*) If an individual receives a salary and also an allowance for meals and lodging, as, for example, a per diem allowance in lieu of subsistence, the amount of the allowance should be included in gross income and the cost of such meals and lodging may be deducted therefrom. A payment for the use of a sample room at a hotel for the display of goods is a business expense. Only such expenses as are reasonable and necessary in the conduct of the business and directly attributable to it may be deducted. A taxpayer claiming the benefit of the deductions referred to herein must attach to his return a statement showing (1) the nature of the business in which engaged; (2) number of days away from home during the taxable year on account of business; (3) total amount of expenses incident to meals and lodging while absent from home on business during the taxable year; (4) total amount of other expenses incident to travel and claimed as a deduction.

Claim for the deductions referred to herein must be substantiated, when required by the Commissioner, by records showing in detail the amount and nature of the expenses incurred.

Commuters' fares are not considered as traveling expenses and are not deductible.

ART. 103. **Cost of materials.**—Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only to the amount that they are actually consumed and used in operation during the year for which the return is made, provided that the cost of such material and supplies has not been deducted in determining the net income for any previous year. If a taxpayer carries incidental materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and deduct from gross income the total cost of such supplies and materials as were purchased during the year for which the return is made, provided the net income is clearly reflected by this method.

ART. 104. **Repairs.**—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 if such account is kept. See articles 161–171.

ART. 105. **Professional expenses.**—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 currently expended for books, furniture, and professional instruments and equipment, the useful life of which is short, may be deducted. See section 215 and articles 291–294.

ART. 106. **Compensation for personal services.**—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. (*a*) An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few stockholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stockholdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. (*b*) An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable in all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises in like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned. See article 32.

ART. 107. **Treatment of excessive compensation.**—The income tax liability of the recipient in respect of an amount ostensibly paid to him as compensation, but not allowed to be deducted as such by the payor, will depend upon the circumstances of each case. Thus, in the case of excessive payments by corporations, if such payments correspond or bear a close relationship to stockholding, and are found to be a distribution of earnings or profits, the amount of the excess will be treated as a dividend, and will thus be exempt from the normal tax

in the hands of the recipient. If such payments constitute, in part, payment for property, the amount of the excess should be treated by the payor as a capital expenditure and by the recipient as part of the purchase price.

ART. 108. **Bonuses to employees.**—Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are not deductible from gross income.

ART. 109. **Pensions—Compensations for injuries.**—Amounts paid for pensions to retired employees or to their families or others dependent upon them, or on account of injuries received by employees, and lump-sum amounts paid or accrued as compensation for injuries, are proper deductions as ordinary and necessary expenses. Such deductions are limited to the amount not compensated for by insurance or otherwise. No deduction shall be made for contributions to a pension fund held by the corporation, the amount deductible in such case being the amount actually paid to the employee. When the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs, in recognition of the services rendered by the individual, such payments may be deducted. Salaries paid by employers to employees who are absent in the military, naval, or other service of the Government, but who intend to return at the conclusion of such service, are allowable deductions.

ART. 110. **Rentals.**—Where a leasehold is acquired for business purposes 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 borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease, and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the

probable life of the buildings erected, or of the improvement made, this deduction shall take the form of an allowance for depreciation. See article 48.

ART. 111. **Expenses of farmers.**—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. The cost of farm machinery, equipment, 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. Amounts expended in purchasing work, breeding, or dairy animals are regarded as investments of capital, and may be depreciated unless such animals are included in an inventory in accordance with article 38. The purchase price of an automobile, even when wholly used in carrying on farming operations, is not deductible, but 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. 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. See articles 38, 145, and 171.

ART. 112. **When charges deductible.**—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a

correct return. See articles 21–24 and 50. The expenses, liabilities, or deficit of one year can not be used to reduce the income of a subsequent year. But see section 206 and articles 1621–1626. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he can not deduct them from the income of the next or any succeeding year. It is recognized, however, that particularly in a going business of any magnitude there are certain overlapping items both of income and deduction, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts. Judgments or other binding adjudication, such as decisions of referees and boards of review under workmen's compensation laws, on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. If subsequently to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from gross income, he may render an amended return for such preceding taxable year including such amount of loss in the deductions from gross income and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return. See section 281. A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained.

DEDUCTIONS ALLOWED INDIVIDUALS: INTEREST

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

(2) All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

ART. 121. **Interest.**—Interest paid or accrued within the year on indebtedness may be deducted from gross income, except that interest on indebtedness incurred or continued to purchase or carry securities, such as municipal bonds and first Liberty loan 3½ per cent bonds, the interest upon which is wholly exempt from tax, is not deductible. Since other obligations of the United States issued after September 24, 1917, are not wholly exempt from taxation under this title, interest paid on indebtedness incurred or continued to purchase such

obligations (whether or not originally subscribed for by the taxpayer) is deductible in accordance with the general rule. 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 but may, under proper circumstances, be deducted as rent.

Interest calculated for cost-keeping or other purposes on account of capital or surplus invested in the business but which does not represent a charge arising under an interest-bearing obligation, is not an allowable deduction from gross income.

DEDUCTIONS ALLOWED INDIVIDUALS: TAXES

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

(3) Taxes paid or accrued within the taxable year except (A) income, war-profits, and excess-profits taxes imposed by the authority of the United States, (B) so much of the income, war-profits and excess-profits taxes, imposed by the authority of any foreign country or possession of the United States, as is allowed as a credit under section 222, (C) taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and (D) taxes imposed upon the taxpayer upon his interest as shareholder of a corporation, which are paid by the corporation without reimbursement from the taxpayer. For the purpose of this paragraph, estate, inheritance, legacy, and succession taxes accrue on the due date thereof except as otherwise provided by the law of the jurisdiction imposing such taxes;

ART. 131. **Taxes.**—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. See section 222 of the statute and articles 381–387 as to tax credits. 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. The gift tax imposed by section 319 of the statute is deductible from the gross income of the donor.

Taxes are deductible as such only by the person upon whom they are imposed. Thus the taxes imposed by section 600 of the Act upon sales by the manufacturer are not deductible by the individual purchaser, even though such taxes are actually billed to him as separate items.

ART. 132. **Federal duties and excise 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 de-

ductible 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.

ART. 133. **Taxes for local benefits.**—So-called taxes, more properly assessments, paid for local benefits, such as street, sidewalk, and other like improvements, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied, do not constitute an allowable deduction from gross income. A tax is considered assessed against local benefits when the property subject to the tax is limited to 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.

ART. 134. **Federal estate and State inheritance taxes.**—Federal estate taxes, paid or accrued during the taxable year, are an allowable deduction from the gross income of the estate in computing the net income thereof subject to tax. The whole amount of such taxes, irrespective of when paid, is deemed to have accrued on the due date thereof, namely, one year after the decedent's death (sec. 305, Title III, Revenue Act of 1924), and, if the accounts of the estate are kept on an accrual basis, are deductible from gross income of the taxable year in which such due date falls, or for the taxable year in which paid, if paid before the due date. If the accounts are kept on the basis of cash receipts and disbursements, deduction may be taken from gross income of the taxable year or years in which the payment or payments may have been made.

Estate, succession, legacy, or inheritance taxes, imposed by any State, Territory, or possession of the United States, or foreign country, are deductible by the estate, subject to the provisions of section 214, where, by the laws of the jurisdiction exacting them, they are imposed upon the right or privilege to transmit rather than upon the right or privilege of the heir, devisee, legatee, or distributee, to receive or to succeed to the property of the decedent passing to him. Where such taxes are imposed upon the right or privilege of the heir, devisee, legatee, or distributee, so to receive or to succeed to the property, they constitute, subject to the provisions of section 214, an allowable deduction from his gross income.

Where, in accordance with a direction contained in the testator's will, the taxes upon the right to receive any particular devise or devises, legacy or legacies are so payable as to relieve the particular devisee or devisees, legatee or legatees from the burden thereof, then the person or persons entitled to the fund or other property out of which payment is made may not take deduction of the taxes so paid, but deduction thereof is available only to such devisee or devisees, legatee or legatees; each, if there be more than one, being authorized to deduct such part of the taxes so paid as he would otherwise have been entitled to do had there been no such testamentary direction.

Where there is a life estate and a remainder, and, by the laws of the jurisdiction imposing them, the taxes in respect to both interests are payable out of the remainder interest, with no legal obligation imposed whereby the remainderman is entitled to reimbursement, then deduction of the taxes so paid may be taken only by the remainderman. Where, in the case of an annuity, the taxes in respect thereto are, by the laws of the jurisdiction imposing them, payable in the first instance out of the fund set aside for creating the annuity, but are to be repaid or restored to such fund from the annuity, then deduction thereof may be taken only by the annuitant.

The accrual dates of such taxes shall be the due date thereof except as otherwise provided by the law of the jurisdiction imposing them. Where deduction is claimed of any such taxes, the amount thereof and the name of the State, Territory, or possession of the United States, or foreign country, by which they have been imposed shall be stated in the return.

ART. 135. **Tax on stock.**—In computing the net income of an individual no deduction is allowed for the taxes imposed upon his interest as shareholder of a bank or other corporation, which are paid by the corporation without reimbursement from the taxpayer. The amount so paid should not be included in the income of the shareholder.

DEDUCTIONS ALLOWED INDIVIDUALS: LOSSES

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

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only if the profit, if such transaction had resulted in a profit, would be taxable under this title. No deduction shall be allowed under this paragraph for any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities where it appears that within thirty days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) or has entered into a contract or option to acquire substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition. If such acquisition or the contract or option to acquire is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed;

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a nonresident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise. The basis for determining the amount of the deduction under this paragraph, or paragraph (4) or (5), shall be the same as is provided in section 204 for determining the gain or loss from the sale or other disposition of property;

ART. 141. **Losses.**—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 a 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 theft. They must usually be evidenced by closed and completed transactions. The basis for determining the amount of the deduction for losses is the same as is provided in section 204 for determining the gain or loss from the sale or other disposition of property. See articles 1591–1603. Proper adjustment must be made in each case for expenditures properly chargeable to capital account, and for items of loss, depreciation, obsolescence, amortization, or depletion, previously allowed with respect to the property. Moreover, the amount of the loss must be reduced by the amount of any insurance or other compensation received, and by the salvage value, if any, of the property. See articles 1579 and 1580. A loss on the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. No loss is realized by the transfer of property by gift or by death. See section 208(c) and articles 1651–1654 as to capital losses.

ART. 142. **Voluntary removal of buildings.**—Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income. When a taxpayer buys real estate upon which is located a building, which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building.

ART. 143. **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 such business, he may claim as a loss for the year in which he takes such action the difference between the basis and the salvage value of the property. In determining the amount of the loss, adjustment must be made, however, for improvements and for depreciation. 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 has been prematurely discarded, as, for example, where an increase in the cost or 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.

ART. 144. **Shrinkage in value of stocks.**—A person possessing stock of a corporation can not deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. See, however, article 154. If stock of a corporation be-

comes worthless, its cost or other basis determined under section 204 may be deducted by the owner in the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness be made, as in the case of bad debts. Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders or general policy of such supervisory officers charge off stock as worthless or write it down to a nominal value, such stock shall, in the absence of affirmative evidence clearly establishing the contrary, be presumed for income tax purposes to be worthless. See article 151. For dealers in securities, see article 1615.

ART. 145. **Losses of farmers.**—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, except as such shrinkage may be reflected in an inventory if used to determine profits. The total loss by frost, storm, flood, or fire of a prospective crop 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, except as such loss is reflected in an inventory if used. 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 allowed as a deduction in computing net income, 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 allowed as a deduction in computing net income), which is 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. The cost of any feed, pasturage, or care which has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of a deductible loss. 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. See articles 38, 111, and 171.

ART. 146. **Losses from the sale and repurchase of securities.**—A taxpayer, other than one in the trade or business of buying and selling securities, can not deduct any loss claimed to have been sustained from the sale or other disposition of stock or securities, if within 30 days before or after the date of such sale or other disposition he has acquired (otherwise than by bequest or inheritance), or has entered into a contract or option to acquire substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition. If such acquisition or the contract or option to acquire is to the extent of part only of substantially identical property, only a proportionate part of the loss shall be disallowed. See article 1601 for the basis for determining gain or loss from the subsequent sale or other disposition of such securities. This provision is designed to prevent a taxpayer who owns securities, other than one in the trade or business of buying and selling securities, from claiming as a deduction in computing net income the so-called "loss" sustained from a sale of securities which is immediately followed or immediately preceded by a purchase of substantially identical securities. Gain or loss, however, is realized in the case of the "short sale." Under this article a taxpayer owning a hundred shares of stock in the X company, who purchases another hundred shares of stock in the X company and within 30 days thereafter sells the first purchased stock of the X company, can not deduct in computing net income any loss claimed to have been sustained from the transaction; if he sells the entire 200 shares of stock, a gain or loss from both transactions is realized at that time; and if he sells the stock of the X company included within the second purchase a gain or loss is realized thereby.

DEDUCTIONS ALLOWED INDIVIDUALS: BAD DEBTS

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

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

ART. 151. **Bad debts.**—Bad debts may be treated in either of two ways—(1) by a deduction from income in respect of debts ascertained to be worthless in whole or in part, or (2) by a deduction

from income of an addition to a reserve for bad debts. Taxpayers were given an option for 1921 to select either of the methods mentioned for treating such debts. See article 151, Regulations 62. The method used in the return for 1921 must be used in returns for subsequent years and for returns under the Revenue Act of 1924 unless permission is granted by the Commissioner to change to the other method. A taxpayer filing a first return of income may select either of the two methods subject to approval by the Commissioner upon examination of the return. If the method selected is approved, it must be followed in returns for subsequent years, except as permission may be granted by the Commissioner to change to another method. See also article 155.

Where all the surrounding and attending circumstances indicate that a debt is worthless, either wholly or in part, the amount which is worthless and charged off or written down to a nominal amount on the books of the taxpayer shall be allowed as a deduction in computing net income. There should accompany the return a statement showing the propriety of any deduction claimed for bad debts. No deduction shall be allowed for the part of a debt ascertained to be worthless and charged off prior to January 1, 1921, unless and until the debt is ascertained to be totally worthless and is finally charged off or is charged down to a nominal amount, or the loss is determined in some other manner by a closed and completed transaction. Before a taxpayer may charge off and deduct a debt in part, he must ascertain and be able to demonstrate, with a reasonable degree of certainty, the amount thereof which is uncollectible. Any amount subsequently received on account of a bad debt or on account of a part of such debt previously charged off, and allowed as a deduction for income tax purposes, must be included in gross income for the taxable year in which received. In determining whether a debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. Partial deductions will be allowed with respect to specific debts only.

Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. Actual determination of worthlessness in bankruptcy cases is sometimes possible before and at other times only when a settlement in

bankruptcy shall have been had. Where a taxpayer ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later year. If a taxpayer computes his income upon the basis of valuing his notes or accounts receivable at their fair market value when received, which may be less than their face value, the amount deductible for bad debts in any case is limited to such original valuation.

Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders, or in accordance with the general policy of such supervisory officers, charge off debts in whole or in part such debts shall, in the absence of affirmative evidence clearly establishing the contrary, be presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be.

ART. 152. **Examples of bad debts.**—Worthless debts arising from unpaid wages, salaries, rents, and similar items of taxable income will not be allowed as a deduction unless the income such items represent has been included in the return of income for the year in which the deduction as a bad debt is sought to be made or in a previous year. 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 can not 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.

ART. 153. **Uncollectible deficiency upon sale of mortgaged or pledged property.**—Where mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the mortgagee or pledgee ascertains that the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible, and charges it off, he may deduct such amount as a bad debt for the taxable year in which it is ascertained to be wholly or partially worthless and charged off. Where a taxpayer buys in mortgaged or pledged property for the amount of the debt, no deduction shall be allowed for any part of the debt. Gain or loss is realized when the property bought in is sold or disposed of.

Accrued interest may be included as part of the deduction only when it has previously been returned as income.

ART. 154. **Worthless securities.**—Where bonds purchased before March 1, 1913, depreciated in value between the date of purchase and that date, and were in a later year ascertained to be worthless and charged off, the owner is entitled to a deduction in that year equal to the cost of the bonds. Bonds purchased since February 28, 1913, when ascertained to be worthless, may be treated as bad debts to the amount actually paid for them. 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. A deduction for a bad debt based upon the value of the debt on March 1, 1913, is allowable only when such value is established to the satisfaction of the Commissioner.

A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations can not deduct from gross income any amount merely on account of market fluctuation. Where a taxpayer ascertains, however, that due, for instance, to the financial condition of the debtor, or conditions other than market fluctuation, he will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations and is able to so demonstrate to the satisfaction of the Commissioner, he may deduct in computing net income the uncollectible part of the debt evidenced by the bonds or other similar obligations.

ART. 155. **Reserve for bad debts.**—Taxpayers who have, prior to 1924, established the reserve method of treating bad debts and maintained proper reserve accounts for bad debts, may deduct from gross income a reasonable addition to such reserves in lieu of a deduction for specific bad debt items. A taxpayer who, in accordance with article 151, or upon securing permission from the Commissioner, adopts the reserve method of treating bad debts, shall determine the amount of the reserve that should reasonably have been set up at the close of the preceding taxable year (which shall not be deducted in computing net income) and for the current and subsequent taxable years may add a reasonable addition to such reserve and deduct the amount so added from gross income in computing taxable net income. Where a reserve account is maintained, debts ascertained during the taxable year to be worthless in whole or in part, (*a*) if such debts were outstanding at December 31, 1920, or (if the taxpayer properly changed to the reserve method) prior to the taxable year in which the change of method takes place, should be charged against the reserve and may be deducted from income, in accordance with article 151; (*b*) if such debts arose after December 31, 1920, or after the beginning of the taxable year in which the change of method took place, should be charged against the reserve, and not deducted from income. What

constitutes a reasonable addition to a reserve for bad debts must be determined in the light of the facts, and will vary as between classes of business and with conditions of business prosperity. A taxpayer using the reserve method should make a statement in his return showing the volume of his charge sales (or other business transactions) for the year and the percentage of the reserve to such amount, the total amount of notes and accounts receivable at the beginning and close of the taxable year, and the amount of the debts which have been ascertained to be wholly or partially worthless and charged against the reserve account during the taxable year.

DEDUCTIONS ALLOWED INDIVIDUALS: DEPRECIATION

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

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

ART. 161. **Depreciation.**—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property in the business, equal the basis of the property determined in accordance with section 204 and articles 1591–1603. Due regard must also be given to expenditures for current upkeep.

ART. 162. **Depreciable property.**—The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, nor to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provisions for this being made in the statute. See articles 201–239. Property kept in repair may, nevertheless, be the subject of a depreciation allowance.

See article 104. The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. No such allowance may be made in respect of automobiles or other vehicles used chiefly for pleasure, a building used by the taxpayer solely as his residence, nor in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance.

ART. 163. **Depreciation of intangible property.**—Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses, and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner.

ART. 164. **Capital sum recoverable through depreciation allowances.**—The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. See article 1602. To this amount should be added from time to time the cost of improvements, additions, and betterments, the cost of which is not deducted as an expense in the taxpayer's return, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and nondepreciable property for a lump price, as, for example, buildings and land, the capital sum to be replaced is limited to an amount which bears the same proportion to the lump price as the value of the depreciable property at the time of acquisition bears to the value of entire property at that time. Where the lessee of real property erects buildings, or makes permanent improvements which become part of the realty and income or loss has been returned by the lessor as a result thereof, as provided in article 48, the capital sum to be replaced by depreciation allowances is held to be the same as though no such buildings had been erected or such improvements made. In the case of property which has been the subject of deductions for amortization under sections 214(a) (9) and 234 (a) (8) of the Revenue Acts of 1918 and 1921, depreciation deductions will be allowed after the close of the amortization period upon the basis of

the value of such property after the amortization allowance has been deducted. No depreciation deduction will be allowed in the case of property which has been amortized to its scrap value and is no longer in use. See article 182 of Regulations 45 and 62.

ART. 165. **Method of computing depreciation allowance.**—The capital sum to be replaced should be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. While the burden of proof must rest upon the taxpayer to sustain the deduction taken by him, such deductions must not be disallowed unless shown by clear and convincing evidence to be unreasonable. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made.

ART. 166. **Obsolescence.**—With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost (or other basis) at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation, may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of a taxpayer, the property *may* become obsolete at some later date. This allowance will be confined to such portion of the property on which obsolescence is definitely shown to be sustained and can not be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due.

ART. 167. **Depreciation of patent or copyright.**—In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced is the cost or other basis (not already deducted as current expense) of the patent or copyright. The allowance should be computed by an apportionment of the cost or other basis of the patent or copyright 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. 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 patent became obsolete 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.

ART. 168. **Depreciation of drawings and models.**—A taxpayer who has incurred expenses in his business for designs, drawings, patterns, models, or work of an experimental nature calculated to result in improvement of his facilities or his product, may at his option deduct such expenses from gross income for the taxable year in which they are incurred or treat such articles as capital assets to the extent of the amount so expended. In the latter case, if the period of usefulness of any such asset may be estimated from experience with reasonable accuracy, it may be the subject of depreciation allowances spread over such estimated period of usefulness. The facts must be fully shown in the return or prior thereto to the satisfaction of the Commissioner. Except for such depreciation allowances no deduction shall be made by the taxpayer against any sum so set up as an asset except on the sale or other disposition of such assets at a loss or on proof of a total loss thereof.

ART. 169. **Charging off depreciation.**—A depreciation allowance, in order to constitute an allowable deduction from gross income, must be charged off. The particular manner in which it shall be charged off is not material, except that the amount measuring a reasonable allowance for depreciation must be either deducted directly from the book value of the assets or preferably credited to a depreciation reserve account, which must be reflected in the annual balance sheet. The allowances should be computed and charged off with express reference to specific items, units, or groups of property, each item or unit being considered separately or specifically included in a group with others to which the same factors apply. The taxpayer should keep such records as to each item or unit of depreciable property as will permit the ready verification of the factors used in computing the allowance for each year for each item, unit, or group.

ART. 170. **Closing depreciation account.**—If the use of any property in the business is permanently discontinued, although no sale or other disposition of the property has taken place, a determination of any gain or loss may be made; but any deduction in respect of any loss thereon must be disclosed in the taxpayer's return for the year in which the determination is made and a full statement of the facts and the basis upon which the computation is calculated must be attached to the return. Upon a sale or other disposition of the property, the consideration received shall be compared with the amount of the estimated salvage value used in computing the gain or loss as above provided, and the amount of the difference shall be treated as a gain or loss, as the case may be, of the year in which the sale or other disposition was made. See articles 141–145.

ART. 171. **Depreciation in the 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. A reasonable allowance for depreciation may also be claimed on live stock acquired for work, breeding, or dairy purposes, unless they are included in an inventory used to determine profits in accordance with article 38. Such depreciation should be based on the cost and the estimated life of the live stock. If such live stock be included in an inventory no depreciation thereof will be allowed, as the corresponding reduction in their value will be reflected in the inventory. See also articles 38, 111, and 145.

DEDUCTIONS ALLOWED INDIVIDUALS: DEPLETION

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

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

ART. 201. **Depletion of mines, oil and gas wells; depreciation of improvements.**—Sections 214 (a) (9) and 234 (a) (8) provide that taxpayers shall be allowed as a deduction in computing net income in the case of natural deposits a reasonable allowance for depletion of mineral and for depreciation of improvements. See section 204 (c) and article 1602 with reference to the basis for computing depreciation and depletion.

The essence of these provisions of the statute is that the owner of mineral deposits, whether freehold or leasehold, shall, within the limitations prescribed, secure through an aggregate of annual deple-

tion and depreciation deductions the return of either (*a*) the cost of his property, or (*b*) the value of his property on the basic date plus, in either case, subsequent allowable capital additions (see article 224), but not including land values for purposes other than the extraction of minerals. See section 204 (c) and article 1602.

Operating owners, lessors, and lessees, whether corporations or individuals, are entitled to deduct an allowance for depletion and depreciation, but a shareholder in a mining or oil or gas corporation is not allowed such deductions.

When used in these articles (201–239) covering depletion and depreciation—

(*a*) The term "basic date" indicates the date of valuation, i. e., March 1, 1913, in the case of property acquired prior thereto, if the cost was less than the fair market value on March 1, 1913; the date of acquisition in the case of property acquired on or after March 1, 1913, or in the case of property acquired before March 1, 1913, if the cost of such property was greater than its fair market value on March 1, 1913; or the date of discovery, or a date within 30 days thereafter, in the case of discovery.

(*b*) The "fair market value" of a property is that amount which would induce a willing seller to sell and a willing buyer to purchase.

(*c*) A "mineral property" or "property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface only as is reasonably expected to be underlaid with the mineral. The value of a mineral property is the combined value of its component parts.

(*d*) A "mineral deposit" refers to "minerals only," such as the "ores only" in the case of a mine, to the "oil only" in the case of an oil well, and to the "gas only" in the case of a gas well, and to the "oil and gas" in the case of a well producing both oil and gas. The value of a mineral deposit is its cost, or it is the value of the mineral property, less the value of the plant and equipment, and less the value of the surface of the land for purposes other than mineral production.

(*e*) "Minerals" include ores of the metals, coal, oil, gas, and such nonmetallic substances as abrasives, asbestos, asphaltum, barytes, borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller's earth, graphite, gravel, gypsum, limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, sulphur, and talc.

(*f*) "Operating profit" is the net amount received from mineral production before depletion and depreciation are deducted. It is distinct from net income, as defined in section 212.

(*g*) "Depletion or depreciation sustained": (1) In arriving at the amount returnable through depletion or depreciation, means (except in cases where a discovery has been established, as to which, see (*h*) below), depletion or depreciation actually sustained based on the value as at the basic date; (2) in arriving at profit or loss from sale, means depletion or depreciation allowed based on value as at basic date except where value as at basic date is a discovery value, in which case the depletion sustained is that based on the cost or other basis as prescribed in subdivisions (a), (b), and (c) of section 204. See section 202.

(*h*) Depletion allowance in case of discovery: The deduction for depletion in case of a discovery shall not exceed 50% of the net income, computed without allowance for depletion, from the property upon which the discovery is made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value. The phrase "net income (computed without allowance for depletion)" means the gross income from the sale of all mineral products and any other income incidental to the operation of the property for the production of the mineral products, less operating expenses, including depreciation on equipment and taxes, but excluding any allowance for depletion. If the mineral products are not sold as raw material but are manufactured or converted into a refined product, then the gross income shall be assumed to be equivalent to the market or field price of the raw material before conversion. Operating expenses, depreciation, and taxes on the property upon which the discovery is made, should be applied against the gross income from the same property on the basis of actual expenditures.

ART. 202. **Amount returnable through depletion and depreciation deductions in the case of an operating owner.**—In the case of an operating owner in fee, the amount remaining in any year returnable through depletion and depreciation deductions is (*a*) the cost or value of the property at the basic date plus (*b*) subsequent allowable capital additions and minus (*c*) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year, and minus (*d*) the value of the land at the basic date for other purposes than mineral production and the residual value of other property at the end of operations. The amount returnable through depletion is the total capital remaining less the sum recoverable through depreciation.

ART. 203. **Amount returnable through depletion and depreciation deductions in the case of lessee.**—(*a*) In the case of a lessee, the amount remaining in any year returnable through depletion and depreciation deductions is (1) the value as of the basic date of the lessee's

equity in the property plus (2) subsequent allowable capital additions and minus (3) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year, and minus (4) the residual value of other property at the end of operations. The amount returnable through depletion is the total capital remaining less the sum recoverable through depreciation.

(*b*) The value of the equities of lessor and lessee shall be computed separately, but, when determined as of the same basic date, shall together never exceed the value at that date of the property in fee simple.

(*c*) The value of a lessee's equity, if acquired prior to March 1, 1913, is (1) its cost or (2) the value of his interest in the mineral as of that date, whichever is greater.

(*d*) The value of a lessee's equity in a proven mineral property acquired on or after March 1, 1913, is its cost.

(*e*) The value of a lessee's equity in a discovery after February 28, 1913, is the fair market value at date of discovery or within 30 days thereafter, of his equity in the mineral discovered.

ART. 204. **Amount returnable through depletion and depreciation in case of lessor.**—(*a*) In the case of a lessor, the amount remaining in any year returnable through depletion and depreciation deductions is (1) the value of his equity in the property at the basic date minus (2) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year, plus (3) subsequent allowable capital additions, and minus (4) the value of the land at the basic date for other purposes than mineral production and the residual value of other property at the end of operations. The amount returnable through depletion is the total capital remaining less the sum recoverable through depreciation.

(*b*) The value of the equities of lessor and lessee shall be computed separately, but, when determined as of the same basic date, shall together never exceed the value at that date of the property in fee simple.

(*c*) The value of the lessor's equity in the case of a mineral property not under lease on March 1, 1913, but subsequently leased, is (1) the cost, or (2) the en bloc value of the mineral in the ground on March 1, 1913, whichever is greater, and will, in the absence of satisfactory evidence to the contrary, be presumed not to exceed the value as of March 1, 1913, of the royalties to be expected under the lease.

(*d*) The value of a lessor's equity in a mineral property under lease March 1, 1913, for the entire operating life of the mineral deposits is (1) the cost, or (2) the value as of March 1, 1913, of the royalties and other payments to be expected under the terms of the lease in effect on that date, whichever is greater.

(*e*) The value of a lessor's equity in a mineral property under lease March 1, 1913, for a portion of its operating life is (1) the cost, or (2) the value as of March 1, 1913, of the royalties expected from the mineral to be extracted during the life of the existing lease plus the estimated en bloc value of the mineral remaining at its expiration, which, in the absence of satisfactory evidence to the contrary, will be presumed not to exceed the value as of March 1, 1913, of royalties which could have been expected as at that date from the remaining mineral.

(*f*) The value of a lessor's equity in a mineral property when acquired on or after March 1, 1913, is its cost.

(*g*) The value of a lessor's equity in a discovery after February 28, 1913, is the fair market value at the date of discovery, or within 30 days thereafter, of his equity in the mineral discovered.

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 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 in fact as well as in form to an owner other than 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 mineral property other than oil and gas.**—(*a*) 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 subsequent improvements in methods of extraction and treatment of the mineral product. The value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date. 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 purpose 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 and, in the absence of better evidence, disinterested appraisals by approved methods. Valuations by analytic appraisal methods, such as the present value method, are not entitled to great weight: (1) if the value of a mineral deposit can be determined upon the basis of cost or replacement value, (2) if the knowledge of the presence of the mineral has not greatly enhanced the value of the mineral property, (3) if the removal of the mineral does not materially reduce the value of the property from which it is taken, or (4) if the profits arising from the exploitation of the mineral deposit are wholly or in great part due to the manufacturing or marketing ability of the taxpayer, or to extrinsic causes other than the possession of the mineral itself. Where the fair market value must be ascertained as of a certain date, analytic appraisal methods will not be used if the fair market value can reasonably be determined by any other method.

(*b*) To determine the fair market value of a mineral property by the present value method, the essential factors must be determined for each deposit included in the property. The essential factors are (1) the total operating profit, (2) the rate at which this profit will be obtained, and (3) the rate of interest commensurate with the risk for the particular deposit. In order to estimate the total operating profit it is necessary to determine the quantity, quality, and recoverable mineral content of the developed, probable, and prospective ore reserves in all cases. For mines with a prior operating record the "spread of profit" per unit of recoverable mineral, or the percentage of net profit to gross proceeds from mineral production is the other factor required in estimates of the total expected profit. For mines with no prior operating record the future sales price and future production cost per unit of mineral must be estimated in order to determine the "spread of profit" per unit of recoverable mineral. In the application of factors derived from past experience full allowance should be made for probable future variations in the rate of exhaustion, quality, or grade of the mineral, percentage of recovery, costs of production, and selling price of the product marketed during the expected operating life of the mineral deposit.

(*c*) Mineral deposits for which these factors may not be determined with reasonable accuracy from past operating experience may, with the approval of the Commissioner, be valued in a similar manner; but the factors must be deduced from concurrent evidence such as the general type of the deposit, the characteristics of the district in which it occurs, the habit of the mineral deposits in the

property itself, the intensity of mineralization, the rate at which additional mineral has been disclosed by exploitation, the stage of the operating life of the property, and other evidence tending to establish a reasonable estimate of the required factors.

(*d*) Mineral deposits of different grades, locations, and probable dates of extraction in a mineral property shall be valued separately. The mineral content of a deposit shall be determined in accordance with article 209. In estimating the average grade of the developed and prospective mineral, account should be taken of probable increases or decreases as indicated by the operating history. The rate of exhaustion of a mineral deposit should be determined with due regard to the limitations imposed by plant capacity, by the character of the deposit, by the ability to market the mineral product, by labor conditions, and by the operating program in force or definitely adopted at the basic date for future operations. The operating life of a mineral deposit is that number of years necessary for the exhaustion of both the developed and prospective mineral content at the rate determined as above. The operating cost includes all current expense of producing, preparing, and marketing the mineral product sold (due consideration being given to taxes) exclusive of allowable capital additions as defined in article 224, and deductions for depreciation and depletion, but including cost of repairs and replacements necessary to maintain the plant and equipment at its rated capacity and efficiency. This cost of repairs and replacements is not to be confused with the depreciation deduction by which the cost or value of plant and equipment is returned to the taxpayer free from tax. In general, no estimates of these factors will be approved by the Commissioner which are not supported by the operating experience of the property or which are derived from different and arbitrarily selected periods.

(*e*) The number of units of mineral recoverable in marketable form multiplied by the estimated operating profit per unit gives the total expected operating profit. The value of each mineral deposit is then the total expected operating profit from that deposit reduced to a present value as of the basic date at the rate of interest commensurate with the risk for the operating life, and further reduced by the value at the basic date of the depreciable assets and of the capital additions, if any, necessary to realize the profits. The degree of risk is generally lowest in cases where the factors of valuation are fully supported by the operating record of the mineral property prior to the basic date; relatively higher risks attach to appraisals upon any other basis.

ART. 207. **Determination of fair market value of oil and gas properties.**—(*a*) 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 subsequent improvements in methods of extraction and treatment of the oil and gas product. The value sought should be that established, assuming a transfer between a willing seller and a willing buyer as of that particular date. 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 purpose 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, and, in the absence of better evidence, disinterested appraisals by approved methods. Where the fair market value must be ascertained as of a certain date, analytic appraisal methods, such as the present value method, will not be used if the fair market value can reasonably be determined by any other method.

(*b*) To determine the fair market value of an oil and/or gas property by the present value method, the essential factors must be determined for each deposit included in the property. The factors are: (1) the total quantity of oil and/or gas in terms of the principal or customary unit (or units) paid for in the product marketed; (2) the quantity of oil and/or gas expected to be recovered during each operating period; (3) the average quality or grade of the oil and/or gas reserves; (4) the expected percentage of recovery in each process or operation necessary for the preparation of the oil and gas for market; (5) the probable operating life of the deposit in years; (6) the unit development cost, that is, cost of development exclusive of depreciation and depletion; (7) the unit operating cost, that is, cost of production exclusive of depreciation and depletion; and, (8) the rate of interest commensurate with the risk for the particular deposit. When the deposit has been sufficiently developed these factors may be determined from past operating experience. In the application of factors derived from past experience full allowance should be made for probable future variations in the rate of exhaustion, quality or grade of the oil and/or gas, percentage of recovery, costs of development, production, interest rate and selling price of the product marketed during the expected operating life of the oil and/or gas deposit.

(*c*) Oil and gas deposits for which these factors may not be determined with reasonable accuracy from past operating experience may, with the approval of the Commissioner, be valued in a similar manner; but the factors must be deduced from concurrent evidence, such as the general type of the deposit, the characteristics of the district in which it occurs, the habit of the oil and gas deposits in the property itself, the rate at which additional oil and gas has been disclosed by exploitation, the stage of operating life of the property, and any other evidence tending to establish a reasonable estimate of the required factors.

(*d*) The oil content in the case of oil wells shall be determined in accordance with article 210, and the gas content in the case of gas wells in accordance with articles 212 and 213. The rate of exhaustion of a mineral deposit should be determined by the character of the deposit, by the ability to market the oil and/or gas, by labor conditions, and by the operating program in force or definitely adopted at the basic date for future operations. The operating life of an oil and/or gas property is that number of years necessary for the exhaustion of the property at the rate determined by the actual or estimated rate of decline. The development cost includes all expenditures, such as drilling wells to maintain or increase production; drilling wells to develop additional unproven areas; other improvements necessary to the development of the property, such as roads, warehouses, waterlines, etc. The operating cost includes all current expenditures for producing, preparing, and marketing the oil and/or gas produced, such as pumping oil wells, repairs and renewals of oil or gas wells, cleaning sanded wells, shooting wells, redrilling old wells, labor and supplies for collecting oil, repairs and renewals to separators, pumps, and collecting lines, repairs and renewals to buildings and structures, repairs and renewals to field tools, equipment, fixtures and machinery, superintendence, other field expenditures, extraordinary repairs and renewals, overhead, etc., with due consideration being given to taxes; exclusive of allowable capital additions as defined in article 225 and deductions for depreciation and depletion. The cost of repairs and replacements is not to be confused with the depreciation deduction by which the cost or value of plant and equipment is returnable to the taxpayer free from tax. In general, no estimates of these factors will be approved by the Commissioner which are not supported by the operating experience of the property or which are derived from different and arbitrarily selected periods.

(*e*) The number of units of mineral recoverable in marketable form multiplied by the difference between the selling price and the operating cost per unit gives the total expected operating profit.

The value of each mineral deposit is then the total expected operating profit from that deposit reduced to a present value as of the basic date at the rate of interest commensurate with the risk for the operating life, and further reduced by the value at the basic date of the depreciable assets and of the capital additions, if any, necessary to realize the profits. The degree of risk is generally lowest in cases where the factors of valuation are fully supported by the operating record of the oil and/or gas property prior to the basic date; relatively higher risks attach to appraisals upon any other basis.

ART. 208. **Revaluation of mineral deposits not allowed.**—No revaluation of a property whose value as of the basic date has been determined and approved will be made or allowed during the continuance of the ownership under which the value was so determined and approved except in the case of a subsequent discovery as defined in articles 220–223, or of misrepresentation or fraud or gross error as to any facts determinable on the basic date. Revaluation on account of misrepresentation or fraud or such gross error will be made only with the written approval of the Commissioner. The value as of the basic date may, however, be corrected when a virtual change of ownership of part of the property results as the outcome of litigation, and may be redistributed (*a*) when a revision of the number of units of mineral in the property has been made in accordance with article 209, 210, or 212, and (*b*) in case of the sale of a part of the property, between the part sold and part retained.

ART. 209. **Determination of mineral contents of mine.**—Every taxpayer claiming a deduction for depletion for a given year will be required to estimate or determine with respect to each separate property the total units (acres, tons, pounds, ounces, or other measure) of mineral products reasonably known or on good evidence believed to have existed in the ground on the basic date, according to the method current in the industry and in the light of the most accurate and reliable information obtainable. Preference shall be given in the selection of a unit of estimate to the principal unit (or units) paid for in the product marketed. The estimate of the recoverable units of the mineral products in the property for the purposes of valuation and depletion shall include as to both quantity and grade (*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 the deposit, and (*b*) "probable" or "prospective" ores and minerals (in the corresponding 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 this valuation, (*c*) as to quantity, only in case

they are extensions of known deposits or are new bodies or masses whose existence is indicated by geological or other evidence to a high degree of probability, and (*d*) as to grade, of such richness only as accords with the best indications available. 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. **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, 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. 211. **Computation of deduction for depletion of mineral deposits.**—(*a*) Depletion attaches to the annual production "according to the peculiar conditions of each case," and when the depletion actually sustained, whether legally allowable or not, from the basic date equals the cost or value on the basic date plus subsequent allowable capital additions, no further deduction for depletion will be allowed except in consequence of added value arising through discovery or purchase. See articles 202, 203, 204, and 224.

(*b*) When the value of the property at the basic date has been determined, depletion sustained for the taxable year shall be computed by dividing the value remaining for depletion by the number of units of mineral to which this value is applicable, and by multiplying the unit value for depletion, so determined, by the number of units sold or produced within the taxable year. The depletion deduction for the taxable year is subject, however, to the limitation contained in article 201 (*h*). In the selection of a unit for depletion preference shall be given to the principal or customary unit or units paid for in the product sold.

ART. 212. **Computation of deduction 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 allowance 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, 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 plus the sum of initial pressures of new wells and 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 initial pressures of new wells and less the sum of the pressures at the end of the tax year equals the depletion sustained for the taxable year. The depletion deduction for the taxable year is subject, however, to the limitation contained in article 201 (*h*).

ART. 213. **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 10 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. 214. **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. 215. **Computation of depletion allowance for combined holdings of oil and gas wells.**—The recoverable oil belonging to the taxpayer shall be estimated for each property separately. The capital account for each property shall include the cost or value, as the case may be, of the oil or gas lease or rights plus all incidental costs of development not charged as expense nor returnable through depreciation. The unit value of the recoverable oil and/or gas for each property is the quotient obtained by dividing the amount returnable through depletion for each property by the estimated number of units of recoverable oil and/or gas on that property. This unit for each separate property multiplied by the number of units of oil and/or gas produced within the year by the taxpayer upon such property will determine the amount which may be deducted for depletion from the gross income of that year for that property, subject, however, to the limitation contained in article 201(*h*). The total allowance for depletion of all the oil and/or gas properties of the taxpayer will be the sum of the amounts computed for each property separately. However, in the case of gas properties the depletion sustained for each pool may be computed by using the total amount 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 212. The total allowance for depletion in the gas properties of the taxpayer will be the sum of the amounts computed for each pool.

ART. 216. **Depletion—Adjustments of accounts based on bonus or advanced royalty.**—(*a*) Where a lessor receives a bonus or other sum in addition to royalties, such bonus or other sum shall be regarded as a return of capital to the lessor, but only to the extent of the amount remaining to be recovered through depletion by the lessor at the date of lease. If the bonus exceeds the amount remaining to be recovered, the excess and all the royalties thereafter received will be income and not depletable. If the bonus is less than the amount re-

maining to be recovered by the lessor through depletion, the difference may be recovered through depletion deductions based on the royalties thereafter received to the extent that such deductions are legally allowable. The bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition.

(*b*) Where the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract 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 royalty per unit of such mineral whenever the same shall thereafter be extracted 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 extraction 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 extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(*c*) If for any reason any such mineral lease shall be terminated or abandoned before the mineral which has been paid for in advance has been extracted and removed, and the lessor repossesses the leased property, the lessor shall adjust his capital accounts by restoring to the capital sum of the property the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and his income account shall be adjusted so as to include the amount so restored to capital sum as income of the year such lease is terminated or the property repossessed, and the tax thereon paid.

(*d*) Upon the expiration, termination, or abandonment of a lease, without the removal of any or all of the mineral contemplated by the lease, the lessor shall be required to restore to capital account so much of the bonus received and deducted from the amount returnable through depletion as is in excess of the actual depletion or loss in value sustained as a result of the operations under the lease and the corresponding amount will be income for the year in which the lease expires, terminates, or is abandoned.

Art. 217. **Depletion and depreciation accounts on books.**—Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate accounts in which shall be charged the fair market value as of March 1, 1913, or within thirty days after the date of discovery, or the cost, as the case may be, (*a*) of the mineral deposit and (*b*) of the plant and equip-

ment, together with subsequent allowable capital additions to each account. When the plan or method of depletion and depreciation accounting adopted by the taxpayer has once been approved by the Commissioner, it can not be changed by the taxpayer without the consent of the Commissioner. These accounts shall thereafter be credited annually with the amounts of the depletion and depreciation sustained, whether legally allowable or not; or the amounts of the depletion and depreciation sustained 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 subsequent allowable capital additions, no further deductions for depletion and depreciation with respect to the property shall be allowed.

ART. 218. **Statement to be attached to return when depletion or depreciation of mineral property is claimed.**—(*a*) To the return of every taxpayer claiming a deduction for depletion or depreciation there shall be attached a statement setting forth with respect to each mineral property: (1) Whether taxpayer is a fee owner, lessor, or lessee; (2) the date of acquisition and if under lease, its exact terms and date of expiration; (3) the cost of the property, stating the amount paid to each vendor, with his name and address; (4) the basic date at which the property is valued; (5) the value of the property on the basic date with a statement of the precise method by which it was determined; (6) the value of the surface of the land for purposes other than mineral production; (7) the estimated number of units of mineral at the basic date with an explanation of the method used in the estimation, and an average analysis which will indicate the quality of the mineral valued; (8) the number of units sold during the year for which the return is made; (9) the gross and net income derived from the sale of mineral and in case of discovery the net income from the property upon which the discovery was made; (10) the amounts deducted for depletion; (11) the amounts sustained on account of depletion or on account of depreciation stated separately from the basic date to the taxable year; and (12) any other data which will be helpful in determining the reasonableness of the deductions claimed in the return.

(*b*) To the return of every taxpayer claiming a deduction for depletion in respect of (1) property in which he owns a fractional interest only, or (2) a leasehold, or (3) property subject to lease, there shall also be attached a statement setting forth the name and address and the precise nature of the holding of each person interested in the property, and every lessor shall attach to his return an affidavit stating, as of the date of filing the return, whether the lease involved is still in effect during the year covered by the return, and,

if not still in effect, when it was terminated and for what reason, and whether the lessor has repossessed the property.

(*c*) All statements required to be furnished in connection with the returns of taxpayers claiming depletion or depreciation must be under oath and may be included in a single affidavit.

ART. 219. **Additional statement to be attached to return where depletion of oil or gas is 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 and if such value is greater than the cost; 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 subsequent to February 28, 1913, or if acquired prior to March 1, 1913, and such cost is greater than the value on March 1, 1913, and if not covered by the preceding 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 and/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 and/or gas in the property at the time the value or cost was determined); (*f*) the quantity of oil and/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) and in case of discovery the net income from the property upon which the discovery was made; (*g*) the number of acres of producing and proven oil and/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 lands; (*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. 220. **Discovery of mines.**—(*a*) The discovery must add a new mine to those previously known to exist and can not be made within a proven tract or lease as defined in paragraph (*g*) infra.

(*b*) To entitle a taxpayer to a valuation of his property, for the purpose of depletion allowances, by reason of the discovery of a mine after February 28, 1913, the discovery must be made by the taxpayer after that date, and 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 newly discovered mine contains mineral in such quantity and of such quality as to afford a reasonable expectation of return to the taxpayer of an amount materially in excess of the capital expended in making such discovery plus the cost of future development, equipment, and exploitation.

(*c*) For the purpose of these sections of the Act a mine may be said to be discovered when (1) there is found a natural deposit of mineral, or (2) there is disclosed by drilling or exploration, conducted above or below ground, a mineral deposit not previously known to exist and so improbable that it had not been, and could not have been, included in any previous valuation for the purpose of depletion, and which in either case exists in quantity and grade sufficient to justify commercial exploitation.

(*d*) In determining whether a discovery entitling the taxpayer to a valuation has been made, the Commissioner will take into account the peculiar conditions of each case; but no discovery, for the purposes of valuation, can be allowed, as to ores or minerals, such as extensions of known ore bodies, that have been or should have been included in " probable " or " prospective " ore or mineral, or in any other way comprehended in a prior valuation, nor as of a date subsequent to that when, in fact, discovery was evident, when delay by the taxpayer in making claim therefor has resulted or will result in excessive allowances for depletion.

(*e*) The value of the property claimed as a result of a discovery must be the fair market value, as defined in article 206, based on what is evident within 30 days after the commercially valuable character and extent of the discovered deposits of ore or mineral have with reasonable certainty been established, determined, or proved.

(*f*) After a *bona fide* discovery the taxpayer shall adjust his capital and depletion accounts in accordance with articles 206, 209, and 211, and shall submit such evidence as to establish his right to a revaluation, covering the conditions and circumstances of the discovery and the size, character, and location of the discovered deposit of mineral, the value of the property at the prior basic date, the cost of discovery, and its development, equipment, and exploitation, its value and the particular method used in the determination.

(*g*) In the case of a mine, a " proven tract or lease " includes, but is not necessarily limited to, the mineral deposits known to exist in any known mine at the date as of which such mine was valued for purposes of depletion, and all extensions thereof, including " probable " and " prospective " ores considered as a factor in the determination of the value or cost. A " new mine " is one or more separate new ore-bodies which have not been and could not have been included in any prior valuation. The value of a new mine will be limited to its value to a prospective purchaser who would require mine-openings, plant and equipment, and other facilities independent of those utilized in working other mines in the vicinity, and who would exhaust the new mine at a rate commensurate with such independent facilities.

ART. 221. **Oil and gas wells.**—Section 204(c) provides that taxpayers who discover oil and gas wells after February 28, 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/or gas wells) on the date of discov-

ery 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. 222. Discovery—Proven tract or lease—Value disproportionate to cost.—(1) For the purpose of section 204(c) of the Revenue Act of 1924, 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 returning at least 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 and/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 as 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 areas extends thereunder unless the tract or lease had been acquired before it became so proven. 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 February 28, 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 or other basis, (as prescribed in section 204), of the land or lease, plus the cost of exploration and development work to the time the well was brought in.

ART. 223. **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 of drilling begun, 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.

ART. 224. **Allowable capital additions in case of mines.**—(*a*) All expenditures in excess of net receipts from minerals sold shall be charged to capital account recoverable through depletion while the mine is in the development stage. When the major portion of the mineral production is obtained from workings other than those

opened for the purpose of development or when the principal activity of the mine becomes the production of developed ore rather than the development of additional ores for mining, the mine will be considered to have passed from a development to a producing status. After a mine has reached the producing stage any expenditure for extraordinary development which increases the ore reserves or the rate of production or which will decrease the future cost of ore production may be charged to capital account as prepaid operating expense and deducted as an operating cost in the years to which it is applicable.

(*b*) All expenditures for plant and equipment shall be charged to capital account recoverable through depreciation, while the mine is in the development stage. Thereafter the cost of major items of plant and equipment shall be capitalized, but the cost of minor items of equipment and plant, necessary to maintain the normal output, and the cost of their replacement may be charged to current expense of operation. See articles 104, 292, and 582.

(*c*) After the plan or method of the taxpayer to charge development, minor equipment, etc., either to capital account or to operating expense has been approved by the Commissioner, such plan or method can not be changed without the consent of the Commissioner.

ART. 225. **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 a development 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 a development 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 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 in accordance with article 1612. 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. 226. **Depreciation in the case of mines.**—(*a*) The Act provides that deductions for depreciation of improvements "according to the peculiar conditions in each case" may be taken by a taxpayer owning or leasing mining property. This is deemed to include exhaustion and wear and tear of the property used in mining of deposits, including a reasonable allowance for obsolescence. See articles 161–171.

(*b*) It shall be optional with the taxpayer, subject to the approval of the Commissioner, (1) whether the value of the mining property plus allowable capital additions but minus estimated salvage value shall be recovered at a rate established by current exhaustion of mineral, or (2) whether the value of the mineral deposit on the basic date plus allowable capital additions shall be recovered through depletion and the cost of plant and equipment less the estimated salvage value shall be recovered by reasonable charges for depreciation (see art. 161) at the rate determined by its physical life or its economic life, or, according to the peculiar conditions of the case, by a method satisfactory to the Commissioner.

(*c*) The estimated physical life of a plant or unit thereof (including buildings, machinery, apparatus, roads, railroads, and other equipment and improvements whose principal use is in connection with the mining or treatment or other necessary handling of mineral products) may be defined as the estimated time such plant, or unit, when given proper care and repair, can be continued in use despite physical deterioration, decay, wear, and tear.

(*d*) The estimated economic life of a plant or unit thereof is the estimated time during which the plant or unit may be utilized effectively and economically for its intended purposes and may be limited by the life of the property or of that portion of the mineral deposits which it serves but can never exceed the physical life.

(*e*) Any difference between the salvage value of plant and equipment and the depreciated value remaining at the termination of mining operations shall be returned as profit or loss in the year in which it is realized.

(*f*) Nothing in these regulations shall be interpreted as meaning (1) that the value of a mining plant and equipment may be reduced by depreciation 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 (2) that proper deductions for depreciation on account of obsolescence and decay shall not be made during periods when the mine is idle or is producing at a rate below its normal capacity. In estimating the salvage value of the equipment at the end of its estimated economic life due consideration may be given to its specialized character and the cost of dismounting and dismantling and transporting it to market.

(*g*) Nothing in these regulations shall be interpreted to permit expenditures charged to expense in any taxable year or any part of the value of land for purposes other than mining to be recovered through depletion or depreciation.

ART. 227. **Depreciation of improvements in the case of oil and gas wells.**—Both owners and lessees operating oil and/or gas properties will, in addition to and apart from the deduction allowable for depletion as hereinbefore provided, be permitted to deduct a reasonable allowance for depreciation of physical property, such as machinery, tools, equipment, pipes, etc., so far as not in conflict with the option exercised by the taxpayer under article 225. The amount deductible on this account shall be such an amount based upon its cost or other basis, equitably distributed over its useful life as will bring such property to its true salvage value when no longer useful for the purpose for which such property was acquired. 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 161–171.

ART. 228. **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 at January 1, 1916, and proper allocation between depreciation and depletion must be maintained after that date.

ART. 229. **Depletion of timber.**—A reasonable deduction from gross income for the depletion of timber and for the depreciation of improvements is permitted, based upon the cost or other basis pre-

scribed in section 204. 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, and minus cut-over land values.

ART. 230. **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, 203, and 204. In the case of leases the apportionment of deductions between the lessor and lessee will be made as specified in articles 203 and 204. The cost of timber properties shall be determined in accordance with the principles indicated in article 205. For method of determining fair market value and quantity of timber, see articles 236–238. For depletion purposes the cost of the timber shall not include any part of the cost of the land.

ART. 231. **Computation of allowance for depletion of timber for given year.**—The allowance for depletion of timber in any taxable year shall be based upon the number of units of timber felled during the year and the unit value of the timber in the timber account or accounts pertaining to the timber cut. The unit value of the timber for a given timber account in a given year shall be the quotient obtained by dividing (*a*) the total number of units of timber on hand in the given account at the beginning of the year plus the number of units acquired during the year plus (or minus) the number of units required to be added (or deducted) by way of correcting the estimate of the number of units remaining available in the account into (*b*) the total fair market value as of March 1, 1913, and/or cost of the timber on hand at the beginning of the year, plus the cost of the number of units acquired during the year, plus proper additions to capital (see art. 233). The amount of the deduction for depletion in any taxable year with respect to a given timber account shall be the product of (*a*) the number of units of timber cut from the given account during the year multiplied by (*b*) the unit value of the timber for the given account for the year. Those taxpayers who keep their accounts on a monthly basis may, at their option, keep their depletion accounts on a monthly basis, in which case the amount deductible on account of depletion for a given month will be determined in the manner outlined above for a given year. The total amount of the deduction for depletion in any taxable year shall be the sum of the amounts deductible for the several timber accounts. For description of timber accounts, see articles 237 and 238.

The depletion of timber takes place at the time the timber is felled. Since, however, it is not ordinarily practicable to determine the quantity of timber immediately after felling, depletion for purposes of accounting will be treated as taking place at the time when, in the process of exploitation, the quantity of timber is first definitely determined.

ART. 232. **Revaluation of timber not allowed.**—In the case of timber acquired prior to March 1, 1913, the fair market value as of that date or the cost, whichever is greater, shall, when determined and approved by the Commissioner, 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 timber was fixed, and during such ownership there shall be no redetermination of the fair market value of the timber for such purpose. However, the unit market (or cost) value of the timber will subsequently be changed if from any cause such unit market (or cost) value, if continued as a basis of depletion, shall upon evidence satisfactory to the Commissioner be found inadequate or excessive for the extinguishment of the cost, or fair market value as of March 1, 1913, of the timber.

ART. 233. **Charges to capital and to expenses in the case of timber.**—In the case of a timber property held for future operation by an owner having no substantial income from the property or from other sources, all expenditures for administration, protection, and other carrying charges prior to production on a normal basis shall be charged to capital account; after such a property is on a normal production basis such expenditures shall be treated as current operating expenses. In case a taxpayer, who has a substantial income from other sources, owns a timber property which is not yet on a normal production basis he may, at his option, charge such expenditures with respect to such timber property to capital or treat them as current operating expenses, but whichever system is adopted must be followed until permission to change to the other system is secured from the Commissioner. In the case of timber operations all expenditures prior to production for plants, improvements, and equipment, and thereafter all major items of plant and equipment, shall be charged to capital account for purposes of depreciation. After a timber operation has been developed and equipped and has reached its normal 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 operating expenses (see articles 104, 292, and 582), unless the taxpayer elects to write off such expenditures through charges for depreciation; however, the method adopted must be followed consistently from year to year.

ART. 234. **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. 235. **Information to be furnished by taxpayer claiming depletion of timber.**—To the income tax return of the taxpayer claiming a deduction for depletion or depreciation or both there shall be attached a map and statement (Form T–Timber) for the taxable year covered by the income tax return. Form T–Timber requires the following: (*a*) Map showing timber and land acquired, timber cut, and timber and land sold; (*b*) description of, cost of, and terms of purchase or lease of, timber and land acquired; (*c*) proof of profit or loss from sale of capital assets; (*d*) description of timber with respect to which claim for loss, if any, is made; (*e*) record of timber cut; (*f*) changes in each timber account as the result of purchase, sale, cutting, reestimate, or loss; (*g*) changes in physical property accounts as the result of additions to or deductions from capital and depreciation; (*h*) operation data with respect to raw and finished material handled and inventoried; (*i*) unit production costs; and (*j*) any other data which will be helpful in determining the reasonableness of the depletion and/or depreciation deductions claimed in the return. Similar information is required for certain years prior to the 1919 taxable year from those taxpayers who have not already furnished it. The specific nature of the information required for the earlier years is given in detail in Form T–General forest industries questionnaire for the years prior to 1919.

ART. 236. **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 shall be determined, subject to approval or revision by the Commissioner upon audit, by the owner of the property in the light of the most reliable and accurate information available 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 will be the selling price, assuming a transfer between a willing seller and a willing buyer as of the particular date. Such factors as the following will be given due consideration: (*a*) Character and quality of the timber as determined by species, age, size, condition, etc.; (*b*) the quantity of timber per acre, the total quantity under consideration, and the location of the timber in question with reference to other timber; (*c*) accessibility of the timber (location with reference to distance from a common carrier, the topography and other features of the ground upon which the timber stands and over which it must be transported in process of exploitation, the probable cost of exploitation, and the climate and the state of industrial development of the locality); and (*d*) the freight rates by common carrier to important markets. The timber in question will be valued on its own merits and not on the basis of general averages for regions; however, the value placed upon it, taking into consideration such factors as those mentioned above, will be consistent with that of the other timber in the region. The Commissioner will give due weight and consideration to any and all facts and evidences having a bearing on the market value, such as cost, actual sales and transfers of similar properties, the margin between the cost of production and the price realized for timber products, market value of stock or shares, royalties and rentals, value fixed by the owner for the purpose of the capital-stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property has been involved, the amount at which the property may have been inventoried and/or appraised in probate or similar proceedings, disinterested appraisals by approved methods, and other factors. For depletion purposes the fair market value at a specified date shall not include any part of the value of the land.

ART. 237. **Determination of quantity of timber.**—Each taxpayer claiming or expecting to claim a deduction for depletion is required to estimate with respect to each separate timber account the total units (feet board-measure, log scale, 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. This estimate shall state as nearly as possible 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, as the net result of the growth of the timber, of changes in standards of utilization, of losses not otherwise accounted for, of abandonment of timber, and/or of errors in the original estimates, there are found to remain on the ground, available for utilization, more or less units of timber than remain in the timber account or accounts, a new estimate of the recoverable units of timber (but not of the cost or the fair market value at a specified date) may be made, with the approval of the Commissioner, and when made, shall thereafter constitute a basis for depletion.

ART. 238. **Aggregating timber and land for purposes of valuation and accounting.**—With a view to logical and reasonable valuation of timber, the taxpayer shall include his timber in one or more accounts. In general, each such account shall include all of the taxpayer's timber which is located in one "block," a block being an operation unit which includes all of the taxpayer's timber which would logically go to a single given point of manufacture. In those cases in which the point of manufacture is at a considerable distance, or in which the logs or other products will probably be sold in a log or other market, the block may be a logging unit which includes all of the taxpayer's timber which would logically be removed by a single logging development. In exceptional cases, provided there are good and substantial reasons, and subject to approval or revision by the Commissioner on audit, the taxpayer may divide the timber in a given block into two or more accounts, e. g., timber owned on February 28, 1913, and that purchased subsequently may be kept in separate accounts, or timber owned on February 28, 1913, and the timber purchased since that date in several distinct transactions may be kept in several distinct accounts, or individual tree species or groups of tree species may be carried in distinct accounts, or special timber products may be carried in distinct accounts, or blocks may be divided into two or more accounts based on the character of the timber and/or its accessibility, or scattered tracts may be included in separate accounts. When such a division is made, a proper portion of the total value or cost, as the case may be, shall be allocated to each account.

The timber accounts mentioned in the preceding paragraph shall not include any part of the value or cost, as the case may be, of the

land. In a manner similar to that prescribed in the foregoing part of this article the land in a given " block " may be carried in a single land account or may be divided into two or more accounts on the basis of its character and/or accessibility. When such a division is made, a proper portion of the total value or cost, as the case may be, will be allocated to each account.

The total value or total cost, as the case may be, of land and timber shall be equitably allocated to the timber and land accounts, respectively.

Each of the several land and timber accounts carried on the books of the taxpayer shall be definitely described as to their location on the ground either by maps or by legal descriptions.

For good and substantial reasons to be approved by the Commissioner, or as required by the Commissioner, the timber or the land accounts may be readjusted by dividing individual accounts, by combining two or more accounts, or by dividing and recombining accounts.

ART. 239. **Timber depletion and depreciation accounts on books.**—Every taxpayer claiming or expecting to claim a deduction for depletion and/or depreciation of timber property (including plants, improvements, and equipment used in connection therewith) shall keep accurate ledger accounts in which shall be charged the fair market value as of March 1, 1913, or the cost, as the case may be, of (*a*) the property, and (*b*) the plants, improvements, and equipment, together with such amounts subsequently expended for the administration, protection, and other carrying charges, or development of the property or additions to plant and equipment as are not chargeable to current operating expenses. See articles 233 and 238. In such accounts there shall be set up separately the quantity of timber, the quantity of land, and the quantity of other resources, if any, and a proper part of the total value or cost shall be allocated to each. See article 238. These accounts shall be credited with the amount of the depreciation and depletion deductions allowed each year, or the amount of the depreciation and depletion shall be credited to depreciation and depletion reserve accounts, to the end that when the sum of the credits for depreciation and depletion equals the value or cost of the property, plus the amount added thereto for administration, protection, and other carrying charges, or development or for additional plant and equipment, less salvage value of the physical property, no further deduction for depreciation and depletion will be allowed.

DEDUCTIONS ALLOWED INDIVIDUALS: CONTRIBUTIONS OR GIFTS

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

(10) Contributions or gifts made within the taxable year to or for the use of: (A) The United States, any State, Territory, or any political subdivision

thereof, or the District of Columbia, for exclusively public purposes; (B) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual; (C) the special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act; (D) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or (E) a fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals; to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this paragraph, except that if in the taxable year and in each of the ten preceding taxable years the amount in all the above cases combined exceeds 90 per centum of the taxpayer's net income for each such year, as computed without the benefit of this paragraph, then to the full amount of such contributions and gifts made within the taxable year. In case of a nonresident alien individual this deduction shall be allowed only as to contributions or gifts made to domestic corporations, or to community chests, funds, or foundations, created in the United States, or to such vocational rehabilitation fund. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

ART. 251. **Contributions or gifts.**—Contributions or gifts within the taxable year are deductible to an aggregate amount not in excess of 15 per cent of the taxpayer's net income, (including such payments), if made to or for the use of: (*a*) the United States, the District of Columbia, or any State or Territory or political subdivision thereof, for exclusively public purposes; (*b*) any corporation or trust, or community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, but only if no part of the net earnings inures to the benefit of any private shareholder or individual; (*c*) the special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act of June 27, 1918; (*d*) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or (*e*) a fraternal society, order or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. For a discussion of what corporations and organizations are included within (*b*) see article

517. If, during the taxable year and in each of the ten preceding taxable years the amount contributed in all the above cases combined exceeds 90 per cent of the taxpayer's net income for each such year, as computed without the benefit of this paragraph, the full amount of such contributions and gifts made within the taxable year is deductible.

In connection with claims for deductions under this article, 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 thereof shall be the fair market value of the property at the time of the gift. The proportionate share of contributions made by a partnership may be claimed as deductions in the personal returns of the partners to an amount which, added to the amount of such contributions made by the partner individually, and claimed as a deduction, is not in excess of 15 per cent of the partner's net income computed without the benefit of the deduction for such contributions; but the contributions made by the partnership shall not be deducted from its gross income in ascertaining the amount of its net income to be reported on Form 1065. See article 335. In the case of a nonresident alien individual this deduction shall be allowed (subject to the 15 per cent limitation) only as to contributions or gifts made to domestic corporations or to community chests, funds, or foundations created in the United States and qualifying under clause (B) of the statute, or to the vocational rehabilitation fund. See also article 325. This article does not apply to gifts by estates and trusts or corporations. See section 219 of the statute and articles 561 and 562.

DEDUCTIONS ALLOWED: NONRESIDENT ALIEN INDIVIDUAL

[SEC. 214.] (b) In the case of a nonresident alien individual, the deductions allowed in subdivision (a), except those allowed in paragraphs (5), (6), and (10), shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in section 217 under rules and regulations prescribed by the Commissioner with the approval of the Secretary. In the case of a citizen entitled to the benefits of section 262 the deductions shall be the same and shall be determined in the same manner as in the case of a nonresident alien individual.

ART. 271. **Deductions allowed nonresident alien individuals.**—In the case of a nonresident alien individual the deductions allowed by section 214(a) for business expenses, interest, taxes, losses in trade, bad debts, depreciation, and depletion are allowed only if and to the extent that they are connected with income from sources within the

United States. See section 217 and article 330. As to deductions for losses not connected with the trade or business allowed by paragraphs (5) and (6) of section 214(a) and contributions (par. 10), see articles 251 and 325. As to deductions allowed foreign corporations, see section 234(b) of the statute and article 572.

ITEMS NOT DEDUCTIBLE

SEC. 215. (a) In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made; or

(4) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

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

ART. 291. **Personal and family expenses.**—Insurance paid on a dwelling owned and occupied by a taxpayer is a personal expense and not deductible. 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. Where the father is legally entitled to the services of his minor children, any 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. See article 73. 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.

ART. 292. **Capital expenditures.**—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. See section 214(a) (8) of the statute and article 161. Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architect's services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price. Expenses of the administration of an estate, such as court costs, attorney's fees, and executor's commissions, are chargeable against the corpus of the estate and are not allowable deductions. Amounts to be assessed and paid under an agreement between bondholders or stockholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. See article 543. An assessment paid by a stockholder of a national bank on account of his statutory liability is ordinarily not deductible but, subject to the provisions of the statute, may in certain cases represent a loss. As to items not deductible by corporations, see section 235 and articles 581 and 582.

ART. 293. **Premiums on business insurance.**—Premiums paid by a taxpayer on an insurance policy on the life of an officer, employee, or other individual financially interested in the taxpayer's business, for the purpose of protecting the taxpayer from loss in the event of the death of the officer or employee insured are not deductible from the taxpayer's gross income. If, however, the taxpayer is in no sense a beneficiary under such a policy, except as he may derive benefit from the increased efficiency of the officer or employee, premiums so paid are allowable deductions. See articles 33 and 106–109. In either case the proceeds of such policies paid upon the death of the insured may be excluded from gross income whether the beneficiary is an individual or a corporation.. See section 213(b) (1) and articles 72 and 541.

ART. 294. **Life or terminable interests.**—Amounts paid to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be subject to any deduction for shrinkage (whether called depreciation or any other name) in the value of such interest due to the lapse of time. In other words, the holder of such an interest so acquired may not set up the value of the expected future payments as corpus or principal and claim deductions for shrinkage or exhaustion thereof due to the passage of time.

No deduction shall be allowed in the case of a life or terminable interest acquired by gift, bequest, or inheritance, where the estate or trust is entitled to a deduction under the statute but there is no reduction of the income of the life or terminable interest. For example, an estate or a trust in a certain State sells securities at a loss; if, under the laws of that State, the beneficiary suffers no actual loss, then even though the estate or trust is permitted to deduct such loss in making its return, the beneficiary whose income has not been diminished thereby is not entitled to a deduction on account of such loss, but must include in his return the full amount distributed or distributable. See articles 341–347.

CREDITS ALLOWED INDIVIDUALS

SEC. 216. For the purpose of the normal tax only there shall be allowed the following credits:

(a) The amount received as dividends (1) from a domestic corporation other than a corporation entitled to the benefits of section 262, and other than a corporation organized under the China Trade Act, 1922, or (2) from a foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 217;

(b) The amount received as interest upon obligations of the United States which is included in gross income under section 213;

(c) In the case of a single person, a personal exemption of $1,000; or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $2,500. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be $2,500. If such husband and wife make separate returns, the personal exemption may be taken by either or divided between them.

(d) $400 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective.

(e) In the case of a nonresident alien individual or of a citizen entitled to the benefits of section 262, the personal exemption shall be only $1,000. The credit provided in subdivision (d) shall not be allowed in the case of a nonresident alien individual unless he is a resident of a contiguous country, nor in the case of a citizen entitled to the benefits of section 262.

(f) (1) The credits allowed by subdivisions (d) and (e) of this section shall be determined by the status of the taxpayer on the last day of his taxable year.

(2) The credit allowed by subdivision (c) of this section shall, in case the status of the taxpayer changes during his taxabe year, be the sum of (A) an amount which bears the same ratio to $1,000 as the number of months during which the taxpayer was single bears to 12 months, plus (B) an amount which bears the same ratio to $2,500 as the number of months during which the taxpayer was a married person living with husband or wife or was the head of a family bears to 12 months. For the purposes of this paragraph a fractional

part of a month shall be disregarded unless it amounts to more than half a month, in which case it shall be considered as a month.

(3) In the case of an individual who dies during the taxable year, the credits allowed by subdivisions (c), (d), and (e) shall be determined by his status at the time of his death, and in such case full credits shall be allowed to the surviving spouse, if any, according to his or her status at the close of the taxable year.

ART. 301. **Credits against net income.**—(*a*) For the purpose of computing the normal tax the taxpayer's net income as determined pursuant to section 212 of the statute and articles 21–26 is first reduced by the sum of the allowable credits. These include dividends (as defined in section 201 and article 1541) received from a domestic corporation (other than a corporation entitled to the benefits of section 262, or other than a corporation organized under the China Trade Act, 1922), or from a foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per cent of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 217 (see article 319); interest not entirely exempt from tax (and hence included in gross income) received upon obligations of the United States; a personal exemption; and a credit for dependents. Consequently, the normal tax does not apply to the dividends just described nor to interest on any obligations of the United States. See section 213 (b) of the statute and articles 77–84 and 1131. For the purpose of imposing the surtax the taxpayer's net income is entitled to none of these credits. As to credits allowed corporations, see section 236 and article 591.

(*b*) Under the Revenue Act of 1924 a single person is entitled to a personal exemption of $1,000 and the head of a family or a married person living with husband or wife to $2,500, regardless of the amount of the net income. A husband and wife living together have but one personal exemption, which is $2,500. If they make separate returns, such exemption may be taken by either or divided between them.

ART. 302. **Personal exemption of head of family.**—A head of a family is an individual who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation. In the absence of continuous actual residence together, whether or not a person with dependent relatives is a head of a family within the

meaning of the statute must depend on the character of the separation. If a father is absent on business, or a child or other dependent is away at school or on a visit, the common home being still maintained, the additional exemption applies. If, moreover, through force of circumstances a parent is obliged to maintain his dependent children with relatives or in a boarding house while he lives elsewhere, the additional exemption may still apply. If, however, without necessity the dependent continuously makes his home elsewhere, his benefactor is not the head of a family, irrespective of the question of support. A resident alien with children abroad is not thereby entitled to credit as the head of a family. As to the amount of the exemption see article 301.

ART. 303. **Personal exemption of married person.**—In the case of a married man or married woman the joint exemption replaces the individual exemption only if the man lives with his wife or the woman lives with her husband. In the absence of continuous actual residence together, whether or not a man or woman has a wife or husband living with him or her within the meaning of the statute must depend on the character of the separation. If merely occasionally and temporarily a wife is away on a visit or a husband is away on business, the joint home being maintained, the additional exemption applies. The unavoidable absence of a wife or husband at a sanatorium or asylum on account of illness does not preclude claiming the exemption. If, however, the husband voluntarily and continuously makes his home at one place and the wife hers at another, they are not living together for the purpose of the statute, irrespective of their personal relations. A resident alien with a wife residing abroad is not entitled to the joint exemption.

ART. 304. **Credit for dependents.**—A taxpayer, other than a nonresident alien who is not a resident of Canada or Mexico, receives a credit of $400 for each person (other than husband or wife), whether related to him or not and whether living with him or not, dependent upon and receiving his chief support from the taxpayer, provided the dependent is either (*a*) under eighteen or (*b*) incapable of self-support because defective. The credit is based upon actual financial dependency and not mere legal dependency. It may accrue to a taxpayer who is not the head of a family. But a father whose children receive half or more of their support from a trust fund or other separate source is not entitled to the credit.

ART. 305. **Date determining exemption.**—(*a*) The status of the taxpayer on the last day of his taxable year determines his right to the exemption and credits allowed by articles 304 and 306. If he is then the chief support of a dependent who is under eighteen years of age, or is incapable of self-support because mentally or physically defective, the credit for dependents allowed in article 304 may be taken.

(*b*) The credit allowed by subdivision (c) of section 216 to a single person, a head of family, or a married person living with husband or wife, will, in case the status of the taxpayer changes during the taxable year, be prorated according to the period during which the taxpayer occupied each status. The credit for any taxable year in such a case will thus be the sum of (1) an amount which bears the same ratio to $1,000 as the number of months the taxpayer was single bears to 12 months, plus (2) an amount which bears the same ratio to $2,500 as the number of months during which the taxpayer was a married person living with husband or wife or was the head of a family bears to 12 months. A fractional part of a month will be disregarded for this computation, unless it amounts to more than one-half month, in which case it will be considered to be a month.

Example.—A, who had been single during the preceding months of 1924, married B on July 20 and lived with her during the balance of the year. If A makes a return on a calendar-year basis, his personal exemption for 1924 will be $1,625, that is, $\frac{7}{12}$ of $1,000 plus $\frac{5}{12}$ of $2,500.

(*c*) 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 341–347. If a husband or wife so dies the joint personal exemption may be used by the executor or administrator in making a return for the decedent, and 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.

ART. 306. **Credits to citizen entitled to benefits of section 262 and nonresident alien individual.**—A citizen entitled to the benefits of section 262 and a nonresident alien individual, similarly to a citizen or resident, are entitled, for the purpose of the normal tax, to the dividend credit described in article 301. They are, also, entitled in every case to a personal exemption of $1,000. This exemption however is limited to $1,000, irrespective of the marital status of the individual. The credit for dependents shall not be allowed in the case of a nonresident alien individual unless he is a resident of Canada or Mexico, nor in the case of a citizen entitled to the benefits of section 262. Under the Revenue Act of 1924 the provisions of tax laws of the foreign country of which a nonresident is a citizen or subject are immaterial in determining the right to the personal exemption, since the right of a nonresident alien individual to a personal exemption of $1,000 is absolute.

NET INCOME OF NONRESIDENT ALIEN INDIVIDUALS

SEC. 217. (a) In the case of a nonresident alien individual or of a citizen entitled to the benefits of section 262, the following items of gross income shall be treated as income from sources within the United States:

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

(2) The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262, and other than a corporation less than 20 per centum of whose gross income is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence), or (B) from a foreign corporation unless less than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of this section;

(3) Compensation for labor or personal services performed in the United States;

(4) Rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property; and

(5) Gains, profits, and income from the sale of real property located in the United States.

(b) From the items of gross income specified in subdivision (a) there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States.

(c) The following items of gross income shall be treated as income from sources without the United States:

(1) Interest other than that derived from sources within the United States as provided in paragraph (1) of subdivision (a);

(2) Dividends other than those derived from sources within the United States as provided in paragraph (2) of subdivision (a);

(3) Compensation for labor or personal services performed without the United States;

(4) Rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property; and

(5) Gains, profits, and income from the sale of real property located without the United States.

(d) From the items of gross income specified in subdivision (c) there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be treated in full as net income from sources without the United States.

(e) Items of gross income, expenses, losses and deductions, other than those specified in subdivisions (a) and (c), shall be allocated or apportioned to sources within or without the United States under rules and regulations prescribed by the Commissioner with the approval of the Secretary. Where items of gross income are separately allocated to sources within the United States, there shall be deducted (for the purpose of computing the net income therefrom) the expenses, losses and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States. In the case of gross income derived from sources partly within and partly without the United States, the net income may first be computed by deducting the expenses, losses or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses or other deductions which can not definitely be allocated to some items or class of gross income; and the portion of such net income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Commissioner with the approval of the Secretary. Gains, profits and income from (1) transportation or other services rendered partly within and partly without the United States, or (2) from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced (in whole or in part) by the taxpayer without and sold within the United States, shall be treated as derived partly from sources within and partly from sources without the United States. Gains, profits and income derived from the purchase of personal property within and its sale without the United States or from the purchase of personal property without and its sale within the United States, shall be treated as derived entirely from sources within the country in which sold.

(f) As used in this section the words "sale" or "sold" include "exchange" or "exchanged"; and the word "produced" includes "created," "fabricated," "manufactured," "extracted," "processed," "cured," or "aged."

(g) (1) Except as provided in paragraph (2) a nonresident alien individual or a citizen entitled to the benefits of section 262 shall receive the benefit of the deductions and credits allowed in this title only by filing or causing to be filed with the collector a true and accurate return of his total income received from all sources in the United States, in the manner prescribed in this title; including therein all the information which the Commissoner may deem necessary for the calculation of such deductions and credits.

(2) The benefit of the credits allowed in subdivisions (d) and (e) of section 216, and of the reduced rate of tax provided for in subdivision (b) of section 210, may, in the discretion of the Commissioner and under regulations prescribed by him with the approval of the Secretary, be received by a nonresident alien individual entitled thereto, by filing a claim therefor with the withholding agent.

ART. 311. **Definition.**—A "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. An alien actually present in the United States who is not a mere transient or sojourner 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 the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. A foreign corporation is one which is not domestic. See article 1509. As to when a citizen or domestic corporation is entitled to the benefits of section 262, see articles 1135–1137. For the treatment of foreign life insurance companies, see section 245(c) and article 687.

ART. 312. **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 313, although the nature of his calling requires him to be absent for a long period from the place where his residence is established. 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, 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. As to when the wages of alien seamen are subject to tax, see article 93.

ART. 313. **Proof of residence of alien.**—The following rules of evidence shall govern in determining whether or not an alien within the United States has acquired residence therein within the meaning of the Revenue Act. An alien, by reason of his alienage, is presumed to be a nonresident alien. Such presumption may be overthrown (1) in the case of an alien who presents himself for determination of tax liability prior to departure for his native country, by (*a*) proof that the alien, at least six months prior to the date he so presents himself, has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (*b*) proof that the alien, at least six months prior to the date he so presents himself, has filed Form 1078 or its equivalent, or (*c*) proof of acts and statements of the alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States had been of such an extended nature as to constitute him a resident; (2) in other cases by (*a*) proof that the alien has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (*b*) proof that the alien has filed Form 1078 or its equivalent, or (*c*) proof of acts and statements of an alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident. In any case in which an alien seeks to overcome the presumption of nonresidence under (1) (*c*) or (2) (*c*) above, if the officer who examines the alien is in doubt as to the facts, such officer may, to assist him in determining the facts, require an affidavit or affidavits setting forth the facts relied upon, executed by some credible person or persons, other than the alien and members of his family, who have known the alien at least six months prior to the date of execution of the affidavit or affidavits.

ART. 314. **Loss of residence by alien.**—An alien who has acquired residence in the United States retains his status as a resident until he abandons the same and actually departs from the United States. An intention to change his residence does not change his status as a

resident alien to that of a nonresident alien. Thus an alien who has acquired a residence in the United States is taxable as a resident for the remainder of his stay in the United States. The status of an 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. See article 305.

ART. 315. **Duty of employer to determine status of alien employee.**—If wages are paid to aliens without withholding the tax, except as permitted in article 316, the employer should be prepared to prove the status of the alien as provided in the foregoing articles. An employer may rely upon the evidence of residence afforded by the fact that an alien has filed Form 1078, or an equivalent certificate of the alien establishing residence. An employer need not secure Form 1078 from the alien if he is satisfied that the alien is a resident alien. An employer who seeks to account for failure to withhold in the past, if he had not at the time secured Form 1078 or its equivalent, is permitted to prove the former status of the alien by any competent evidence. The written statement of the alien employee may ordinarily be relied upon by the employer as proof that the alien is a resident of the United States.

ART. 316. **Allowance of personal exemption to nonresident alien employee.**—A nonresident alien employee may claim the benefit of the personal exemption (section 216(e)) by filing with his employer Form 1115 duly filled in and executed under oath. If the alien employee is a resident of Canada or Mexico, he may also obtain the benefit of the credit for dependents (section 216(d)) and the benefit of the reduced rates of tax (section 210(b)) by filing Form 1115 with his employer. 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 is 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, with the collector on or before March 15. 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, 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. See further section 221 and articles 361–376.

ART. 317. **Income from sources within the United States.**—Nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 262 are taxable only upon income from sources within the United States. See sections 213(c), 233(b), and 262.

The statute divides the income of such taxpayers into three classes: (1) Income which is derived in full from sources within the United States; (2) income which is derived in full from sources without the United States; and (3) income which is derived partly from sources within and partly from sources without the United States. The taxable income includes that derived in full from sources within the United States and that portion of the income which is derived partly from sources within and partly from sources without the United States which is allocated or apportioned to sources within the United States.

ART. 318. **Interest.**—There shall be included in the gross income from sources within the United States, of nonresident alien individuals, foreign corporations and citizens of the United States or domestic corporations which are entitled to the benefits of section 262, all interest received or accrued, as the case may be, on bonds, notes, or other interest-bearing obligations of residents of the United States, whether corporate or otherwise, except:

(*a*) Interest paid on deposits with persons, including individuals, partnerships, or corporations carrying on the banking business, to persons (nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 262) not engaged in business within the United States, and not having an office or place of business therein; and

(*b*) Interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of the Commissioner that less than 20 per cent of the gross income of such resident payor or domestic corporation has been derived from sources within the United States (as determined under the provisions of articles 317 to 331, inclusive) for the three-year period ending with the close of the taxable year of the payor which precedes the payment of such interest, or for such part of that period as may be applicable.

Any taxpayer who excludes from gross income from sources within the United States income of the type specified in (*a*) or (*b*) above shall file with his return a statement setting forth the amount of such income and such information as may be necessary to show that the income is of the type specified in those paragraphs.

ART. 319. **Dividends.**—Gross income from sources within the United States includes all dividends, as defined by section 201:

(*a*) From a domestic corporation other than one entitled to the benefits of section 262, and other than a corporation less than 20 per cent of whose gross income is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of section 217, for the three-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence); or

(*b*) From a foreign corporation unless less than 50 per cent of its gross income for the three-year period ending with the close of its taxable year preceding the declaration of such dividends, or for such part of such period as it has been in existence, was derived from sources within the United States.

Dividends will be treated as income from sources within the United States unless the taxpayer submits sufficient data to establish to the satisfaction of the Commissioner that they should be excluded from gross income under subdivisions (*a*) or (*b*) of this article. See also section 213 (b) (13) of the statute.

ART. 320. **Compensation for labor or personal services.**—Gross income from sources within the United States includes compensation for labor or personal services performed within the United States regardless of the residence of the payor, of the place in which the contract for services was made, or of the place of payment. When a specific amount is paid for labor or personal services performed in the United States, such amount shall be included in the gross income. When no accurate allocation or segregation of compensation for labor or personal services performed in the United States can be made, or when such labor or service is performed partly within and partly without the United States, the amount to be included in the gross income shall be determined by an apportionment on the time basis, i. e., there shall be included in the gross income an amount which bears the same relation to the total compensation as the number of days of performance of the labor or services within the United States bears to the total number of days of performance of labor or services for which the payment is made.

ART. 321. **Rentals and royalties.**—Gross income from sources within the United States includes rentals or royalties from property located within the United States or from any interest in such property, including rentals or royalties for the use of or the privilege of using, in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. The income arising from the rental of property,

whether tangible or intangible, located within the United States, or from the use of property, whether tangible or intangible, within the United States, is from sources within the United States.

ART. 322. **Sale of real property.**—Gross income from sources within the United States includes gain, computed under the provisions of sections 202–204, derived from the sale or other disposition of real property located in the United States. For the treatment of capital net gain and capital net losses, see section 208 and articles 1651–1654.

ART. 323. **Income from sources without the United States.**—Gross income from sources without the United States includes:

(1) Interest other than that specified in section 217(a)(1), and article 318, as being derived from sources within the United States.

(2) Dividends other than those derived from sources within the United States as provided in section 217(a)(2) and article 319.

(3) Compensation for labor or services performed without the United States. For the treatment of compensation for labor or personal services performed partly within the United States and partly without the United States, see article 320.

(4) Rentals or royalties derived from property without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. See article 321.

(5) Gain derived from the sale of real property located without the United States. See sections 202–204.

ART. 324. **Sale of personal property.**—Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold. The word " sold " includes " exchanged " and ordinarily means the place where marketed. This article does not apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States or produced (in whole or in part) by the taxpayer without and sold within the United States. See article 328.

ART. 325. **Deductions in general.**—The deductions provided for in section 214 shall be allowed to nonresident alien individuals and to citizens of the United States entitled to the benefits of section 262, and the deductions provided for in section 234 shall be allowed to foreign corporations and to domestic corporations entitled to the benefits of section 262 only if and to the extent that they are connected with income from sources within the United States. In the case of nonresident alien individuals, however, (1) losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business, are deductible

only if and to the extent that the profit, if such transaction had resulted in a profit, would have been taxable as income from sources within the United States; (2) losses sustained during the taxable year of property not connected with the trade or business if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise are deductible only if the property was located within the United States; and (3) contributions or gifts made within the taxable year are deductible only if made to domestic corporations or to community chests, funds, or foundations created in the United States of the type specified in section 214(a) (10) and article 251, or to the vocational rehabilitation fund, subject to the limitations contained in that article.

Losses embraced under clause (2) above are deductible in full from items of gross income specified as being derived in full from sources within the United States, but if greater than the sum of such items, the excess of unabsorbed loss may be deducted from the income apportioned to sources within the United States under the provisions of article 328. Losses embraced under clause (1) are deductible in full (as provided in article 326 or article 327) when the profit from the transaction, if it had resulted in a profit, would have been taxable in full as income from sources within the United States, but should be deducted under the provisions of article 328 when the profit from the transaction, if it had resulted in profit, would have been taxable only in part. The amount of dividends included in the gross income may be deducted or credited, but in the case of a nonresident alien individual, for the purpose of the normal tax only.

ART. 326. **Apportionment of deductions.**—From the items specified in articles 318–324 as being derived specifically from sources within and without the United States there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any other expenses, losses, or deductions which can not definitely be allocated to some item or class of gross income. The remainder shall be included in full as income from sources within the United States. The ratable part is based upon the ratio of gross income from sources within the United States to the total gross income.

Example.—A nonresident alien individual derived gross income from all sources for 1924 of $180,000. There was included therein:

$9,000 interest on bonds of a domestic corporation.
4,000 dividends on stock of a domestic corporation.
12,000 royalty for the use of patents within the United States.
11,000 gain from the sale of real property located within the United States.

$36,000 total.

That is, one-fifth of the total gross income was from sources within the United States. The remainder of the gross income was from

sources without the United States, determined under article 323 above.

The expenses of the taxpayer for the year amounted to $78,000. Of these expenses the amount of $8,000, including such items as commission paid for the sale of the real property located within the United States and interest on indebtedness incurred to purchase the stock of a domestic corporation, is properly allocated to income from sources within the United States and the amount of $40,000 is properly allocated to income from sources without the United States.

The remainder of the expenses, $30,000, can not be definitely allocated to any class of income. A ratable part thereof, based upon the relation of gross income from sources within the United States to the total gross income, shall be deducted in computing net income from sources within the United States. Thus, there is deducted from the $36,000 of gross income from sources within the United States, expenses amounting to $14,000 (representing $8,000 properly apportioned to the income from sources within the United States and $6,000, a ratable part (one-fifth) of the expenses which could not be allocated to any item or class of gross income). The remainder, $22,000, is the net income from sources within the United States.

ART. 327. **Other income from sources within the United States.**—Items of gross income other than those specified in section 217 (a) and (c) and articles 318–324 shall be allocated or apportioned to sources within or without the United States, as provided in subdivision (e) of section 217.

The income derived from the ownership or operation of any farm, mine, oil or gas well, other natural deposit, or timber, located within the United States, and from the sale by the producer of the products thereof within or without the United States, shall ordinarily be included in gross income from sources within the United States. If, however, it is shown to the satisfaction of the Commissioner that due to the peculiar conditions of production and sale in a specific case or for other reasons all of such gross income should not be allocated to sources within the United States, an apportionment thereof to sources within the United States and to sources without the United States shall be made as provided in article 328.

Where items of gross income are separately allocated to sources within the United States, there shall be deducted therefrom, in computing net income, the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income.

ART. 328. **Income derived from sources partly within and partly without the United States.**—Items of gross income not allocated by articles

317–324 or 327 to sources within or without the United States shall (unless unmistakably from a source within or a source without the United States) be treated as derived from sources partly within and partly without the United States, according to the following rules and cases:

Manufacturers and producers.—Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced in whole or in part by the taxpayer without and sold within the United States shall be treated as derived partly from sources within and partly from sources without the United States, under one of the cases named below. As used herein, the word "produced" includes created, fabricated, manufactured, extracted, processed, cured, or aged.

Case 1: Where the manufacturer or producer regularly sells part of his output to wholly independent distributors or other selling concerns in such a way as to establish fairly an independent factory or production price—or shows to the satisfaction of the Commissioner that such an independent factory or production price has been otherwise established—unaffected by considerations of tax liability, and the selling or distributing branch or department of the business is located in a different country than that in which the factory is located or the production carried on, the net income attributable to sources within the United States shall be computed by an accounting which treats the products as sold by the factory or productive department of the business to the distributing or selling department at the independent factory price so established. In all such cases the basis of the accounting shall be fully explained in a statement attached to the return.

Case 2: Where an independent factory or production price has not been established as provided under case 1, the net income shall first be computed by deducting from the gross income derived from sources partly within and partly without the United States the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. Of the amount of net income so determined, one-half shall be apportioned in accordance with the value of the taxpayer's property within and without the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer's property within the United States and the denominator of which consists of the value of the taxpayer's property both within and without the United States. The remaining one-half of such net income shall be appor-

tioned in accordance with the gross sales of the taxpayer within and without the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the taxpayer's gross sales for the taxable year or period within the United States, and the denominator of which consists of the taxpayer's gross sales for the taxable year or period both within and without the United States. " Gross sales within the United States " means the aggregate amount of all sales made during the taxable year which were principally secured, negotiated or effected by employees, agents, offices, or branches of the taxpayer's business resident or located in the United States.

The term " property " as used in this article includes only the property held or used to produce income which is derived from sources partly within and partly without the United States (excluding all property held or used to produce income which is allocated or apportioned under other articles or paragraphs of these regulations). Such property should be taken at its actual value, which in the case of property valued or appraised for purposes of inventory, depreciation, depletion, or other purposes of the Revenue Act of 1924 shall be the highest amount at which so valued or appraised, and which in other cases shall be deemed to be its book value in the absence of affirmative evidence showing such value to be greater or less than the actual value. The average value during the taxable year or period shall be employed. The average value of property as above prescribed at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis. Bills and accounts receivable shall (unless satisfactory reason for a different treatment is shown) be assigned or allocated to the United States when the debtor resides in the United States, unless the taxpayer has no office, branch, or agent in the United States.

Case 3: Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer who, in good faith and unaffected by considerations of tax liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the processes or formulas prescribed under cases 1 and 2, the income derived from sources within the United States.

ART. 329. **Transportation services.**—A foreign corporation carrying on the business of transportation service between points in the United States and points outside the United States derives income

partly from sources within and partly from sources without the United States.

(1) The gross income from sources within the United States derived from such services shall be determined by taking such a portion of the total gross revenues therefrom as (*a*) the sum of the costs or expenses of such transportation business carried on by the taxpayer within the United States and a reasonable return upon the property used in its transportation business while within the United States bears to (*b*) the sum of the total costs or expenses of such transportation business carried on by the taxpayer and a reasonable return upon the total property used in such transportation business. Revenues from operations incidental to transportation services (such as the sale of money orders) shall be apportioned on the same basis as direct revenues from transportation services.

In allocating the total costs or expenses incurred in such transportation business, costs or expenses incurred in connection with such part of the services as were wholly rendered in the United States should be assigned to the cost of transportation business within the United States. For example, expenses of loading and unloading in the United States, rentals, office expenses, salaries, and wages wholly incurred for services rendered to the taxpayer in the United States belong to this class. Costs and expenses incurred in connection with services rendered partly within and partly without the United States may be prorated on a reasonable basis between such services. For example, ship wages, charter money, insurance, and supplies chargeable to voyage expenses should ordinarily be prorated for each voyage on the basis of the proportion which the number of days the ship was within the territorial limits of the United States bears to the total number of days on the voyage, and fuel consumed on each voyage may be prorated on the basis of the proportion which the number of miles sailed within the territorial limits of the United States bears to the total number of miles sailed on the voyage. Income, war-profits, and excess-profits taxes should not be regarded as costs or expenses for the purpose of determining the proportion of gross income from sources within the United States; and for such purpose, interest and other expenses for the use of borrowed capital should not be taken into the cost of services rendered, for the reason that the return upon the property used measures the extent to which such borrowed capital is the source of the income. For other expenses entering into the cost of services, only such expenses as are allowable deductions under the Revenue Act of 1924 should be taken.

The value of the property used should be determined upon the basis of cost less depreciation. Eight per cent may ordinarily be

taken as a reasonable rate of return to apply to such property. The property taken should be the average property employed in the transportation service between points in the United States and points outside the United States during the taxable year. For ships the average should be determined upon a daily basis for each ship and the amount to be apportioned for each ship as assets employed within the United States should be computed upon the proportion which the number of days the ship was within the territorial limits of the United States bears to the total number of days the ship was in service during the taxable period. For other assets employed in the transportation business, the average of the assets at the beginning and end of the taxable period ordinarily may be taken, but if the average so obtained does not, by reason of material changes during the taxable year, fairly represent the average for such year either for the assets employed in the transportation business in the United States or in total, the average must be determined upon a monthly or daily basis.

(2) Interest and income, war-profits and excess-profits taxes should be excluded from the apportionment process, as explained in (1) above; but for the purpose of computing net income there may be deducted from the gross income from sources within the United States, after the amount of such gross income has been determined, a ratable part (*a*) of all interest (deductible under section 214(a) (2) or section 234(a) (2)), and (*b*) of all income, war-profits and excess-profits taxes (deductible under sections 214(a) (3) and 234(a) (3)), paid or accrued in respect of the business of transportation service between points in the United States and points outside the United States. Such ratable part should ordinarily be based upon the ratio of gross income from sources within the United States to the total gross income, from such transportation service.

(3) If a foreign corporation subject to this article is also engaged in a business other than that of providing transportation service between points in the United States and points outside the United States, the costs and expenses (including taxes) properly apportioned or allocated to such other business should be excluded both from the deductions and from the apportionment process prescribed in (1) above; but, for the purpose of determining net income, a ratable part of any general expenses, losses, or deductions, which can not definitely be allocated to some item or class of gross income, may be deducted from the gross income from sources within the United States after the amount of such gross income has been determined. Such ratable part should ordinarily be based upon the ratio of gross income from sources within the United States to the total gross income.

(4) Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer subject to this article, who, in good faith and unaffected by considerations of tax liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the process prescribed in (1) and (2) above, the income derived from sources within the United States.

ART. 330. **Computation of income.**—Where a taxpayer has gross income from sources within or without the United States as defined by section 217(a) or (c) together with gross income derived partly from sources within and partly from sources without the United States, the amounts thereof, together with the expenses and investment applicable thereto shall be segregated, and the net income from sources within the United States shall be separately computed therefrom.

ART. 331. **Allowance of deductions and credits.**—Unless a nonresident alien individual, a foreign corporation, or a citizen of the United States or domestic corporation entitled to the benefits of section 262, shall file, or cause to be filed with the collector, a true and accurate return of income from sources within the United States, regardless of amount, the tax shall be collected on the basis of the gross income (not the 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 of such nonresident alien within the United States, without allowance for deductions or credits. The benefit of the credits allowed against net income for the purpose of the normal tax may be claimed by a nonresident alien only in his individual return, except that the personal exemption (and credit for dependents in the case of a resident of Canada or Mexico) may be obtained by filing a claim therefor with the withholding agent in accordance with the provisions of articles 316 and 364 (*a*) and (*b*). See section 216 of the statute and article 306.

The benefit of the reduced rate of tax in the case of compensation for services performed within the United States by aliens resident in Canada or Mexico may be obtained at the source only if the alien files a claim therefor on Form 1115 as prescribed in article 316. See also article 361.

PARTNERSHIPS

SEC. 218. (a) Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the taxable year upon the basis of which the partner's net income is computed.

(b) The partner shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the partnership.

(c) The net income of the partnership shall be computed in the same manner and on the same basis as provided in section 212 except that the deduction provided in paragraph (10) of subdivision (a) of section 214 shall not be allowed.

ART. 335. **Partnerships.**—Partnerships as such are not subject to taxation under the statute, but are required to make returns of income. See section 224 of the statute and articles 411 and 412. Individuals carrying on business in partnership are, however, taxable upon their distributive shares of the net income of such partnership, whether distributed or not, and are required to include such distributive shares in their returns. The net income of the 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, as these are allowable deductions, subject to the limitations provided by section 214 (a) (10) of the statute, to the respective partners in their individual returns. See section 212 and articles 21–26. In the case of a partnership closely related to other trades or businesses, see section 240(d) and article 637.

ART. 336. **Distributive shares of partners.**—The distributive share of the net income of the 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 partners in their returns for their next succeeding taxable years. Where the result of partnership operation is a net loss, the loss will be divisible by the partners in the same pro-

portion as net income would have been divisible (or, if the partnership agreement provides for the division of a loss in a manner different from the division of a gain, in the manner so provided), and may be taken by the individual partners in their returns of income.

ART. 337. **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 proportionate shares of such dividends specified in section 216 (a) and article 301, and of such interest not entirely exempt from tax upon obligations of the United States 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 or to any possession of the United States subject to the limitations of section 222 of the statute. See sections 216 and 222 and articles 301 and 381–387.

ART. 338. **Taxation of partners in partnership with fiscal year ending in 1924.**—If the fiscal year of a partnership began in the calendar year 1923 and ended in the calendar year 1924, the method of computing the taxes of the partners is as follows: (*a*) The amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1923 is found by determining the net income of the partnership for its entire fiscal year in accordance with the law applicable to the calendar year 1923 (Title II of the Revenue Act of 1921) and the distributive share thereof of each partner, and then taking such proportion of that distributive share as the part of the taxable period falling within the calendar year 1923 bears to the entire taxable period; (*b*) the amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1924 is found by determining the net income of the partnership for its entire fiscal year in accordance with the law applicable to the calendar year 1924 and the distributive share thereof of each partner, and then taking such proportion of that distributive share as the part of the taxable period falling within the calendar year 1924 bears to the entire taxable period. The tax upon the amount of each partner's distributive share attributable to the calendar year 1923 shall be determined at the rates applicable to that year under the Revenue Act of 1921, and the tax upon such share attributable to the calendar year 1924 shall be determined at the rates prescribed in the Revenue Act of 1924. The distributive share of the partner which is subject to the rates in effect for 1924 shall be added to the partner's other income which is subject to such rates, and the re-

sulting amount shall be placed in the lower brackets of the rate schedule applicable to 1924. The distributive share of the partner subject to the rates in effect in 1923 shall be placed in the next higher brackets of the rate schedule applicable to 1923. See section 207 (b) of the statute.

ESTATES AND TRUSTS

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

(1) There shall be allowed as a deduction (in lieu of the deduction authorized by paragraph (10) of subdivision (a) of section 214) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (10) of subdivision (a) of section 214, or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) in the same or any succeeding taxable year;

(3) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

(c) For the purpose of the normal tax the estate or trust shall be allowed the same credit as is allowed to a single person under subdivision (c) of section 216, and, if no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, then in addition the same credits as are allowed by subdivisions (a) and (b) of section 216.

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

(e) If the taxable year of a beneficiary is different from that of the estate or trust, the amount which he is required, under paragraph (2) of subdivision (b) of this section, to include in computing his net income, shall be based upon the income of the estate or trust for its taxable year ending within his taxable year.

(f) A trust created by an employer as a part of a stock bonus or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under this section, but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent that it exceeds the amounts paid in by him. Such distributees shall for the purpose of the normal tax be allowed as credits such part of the amounts so distributed or made available as represents the items specified in subdivisions (a) and (b) of section 216.

(g) Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.

(h) Where any part of the income of a trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him, or where any part of the income of a trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in paragraph (10) of subdivision (a) of section 214), such part of the income of the trust shall be included in computing the net income of the grantor.

Art. 341. **Estates and trusts.**—In general, the income of a trust for the taxable year which is to be distributed to the beneficiaries must be returned by and will be taxed to the respective beneficiaries, but the income of a trust which is to be accumulated or held for future distribution, whether consisting of ordinary income or gain from the sale of assets included in the corpus of the trust, must be returned by and will be taxed to the trustee. The exception to this general rule is

with respect to the income of a trust revocable by the grantor, and the income of a trust which may be distributed to the grantor or used to pay the premiums upon policies of insurance on his life, which income, whether or not distributed, must be returned by and will be taxed to the grantor of the trust. (See article 347.)

See section 225 and articles 421 and 423 with reference to fiduciary returns, and article 294 with reference to deductions.

ART. 342. **Method of computation of net income and tax.**—The statute provides that the tax computed upon the net income of the estate or trust shall be paid by the fiduciary, except in the case of the trusts described in article 347. However, in computing the net income of the estate or trust, the following deductions will be allowed either in addition to, or in lieu of (as the case may be) those specified in section 214 in the case of individuals:

(1) If the terms of the will or of the deed creating the trust direct that any part of the gross income of the estate or trust (*a*) be paid or permanently set aside for charitable or other purposes, as specified in section 214 (a) (10), or (*b*) be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit, such gross income so paid or set aside during the taxable year shall be allowed as a deduction in lieu of the deduction authorized by section 214 (a) (10).

(2) The amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, shall be allowed as an additional deduction in computing the net income of the estate or trust. The amount so allowed as a deduction must be included by a beneficiary in computing his net income, whether distributed to him or not. If the taxable year of the beneficiary differs from that of the estate or trust, the amount which he is required to include in computing his net income shall be based upon the income of the estate or trust for its taxable year ending within his taxable year. The amounts which are allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) of this article in any taxable year.

(3) Income received by the estate of a deceased person during the period of administration or settlement of the estate, and income of a trust which may in the discretion of the fiduciary be either distributed to the beneficiary or accumulated, is allowable as an additional deduction in computing the net income of the estate or trust for its taxable year to the amount thereof properly paid or credited

during such year to any legatee, heir, or beneficiary. Any amount so allowed as a deduction shall be included by a legatee, heir, or beneficiary in computing his net income.

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, or may be capital gain, taxable to the estate. See article 1594. An allowance paid a widow out of the corpus of the estate is not deductible from gross income. Where real estate is sold by the devisee or heir thereof, whether before or after settlement of the estate, he is taxable individually on any profit derived.

ART. 344. **Incidence of tax on estate or 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 the estate has been distributed, the heirs, devisees, legatees, and distributees may be required to discharge the amount of the tax due and unpaid, to the extent of any share received. 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, the net income on which the tax is paid is free from tax when distributed to the beneficiaries.

ART. 345. **Credits to trust or beneficiary.**—(*a*) An estate or a trust is allowed the same credits against net income as are single persons, including a personal exemption of $1,000 but no credit for dependents.

(*b*) If no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, the

estate or trust shall be allowed the credits provided in subdivisions (a) and (b) of section 216, in respect of certain dividends, and of interest upon certain obligations of the United States.

(*c*) If any part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, he is allowed for the purpose of the normal tax, in addition to his individual credits, his appropriate share of such dividends as are described in article 301 and of such interest not entirely exempt from tax upon obligations of the United States as are received by the estate or trust. Any remaining portion of such amounts will be allowed for the purpose of the normal tax to the estate or trust. Each beneficiary is entitled to but one personal exemption, no matter from how many trusts he may receive income. See section 216 of the statute and articles 301–306.

ART. 346. **Stock bonus or profit-sharing trust.**—Subdivision (f) of section 219 provides that a trust created by an employer as a part of a stock bonus or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under this section; but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent that it exceeds the amounts paid in by him. Such distributees shall for the purpose of the normal tax be allowed as credits that part of the amount so distributed or made available as represents the dividend and interest items specified in subdivisions (a) and (b) of section 216.

ART. 347. **Income of trusts taxable to grantor.**—In the case of certain trusts which are in whole or in part subject to revocation by the grantor, or which are for the benefit of the grantor, the income of the trust is to be included in computing the net income of the grantor. The income of such trusts must be so included, whether or not the trust was created before the enactment of this Act. The cases in which the income of the trust is to be included, in whole or in part, in computing the net income of the grantor are as follows:

(1) Where the grantor of the trust has, at any time during the taxable year, either alone or in conjunction with a person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, the income of such part of the trust for that taxable year shall be included in computing the net income of the grantor. The grantor shall include in his income the entire gross income of such part of the trust, and shall be entitled to such deductions with reference to such income as he would have been en-

titled to if the trust had not been created. Where the grantor relinquishes during the taxable year his power to revest in himself title to the corpus of the trust, the income of the trust shall be taxable to the grantor only for the period during which he had such power.

(2) Where any part of the income of the trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him; and

(3) Where any part of the income of the trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor, other than policies irrevocably payable for the purposes and in the manner specified in section 214 (a) (10), such part of the income of the trust shall be included in computing the net income of the grantor.

The term " beneficiary " as used in this article includes any person entitled to an interest in the income or the principal of a trust, but does not include one having merely a nominal interest in the income or principal.

EVASION OF SURTAXES BY INCORPORATION

SEC. 220. (a) If any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, there shall be levied, collected, and paid for each taxable year upon the net income of such corporation a tax equal to 50 per centum of the amount thereof, which shall be in addition to the tax imposed by section 230 of this title and shall (except as provided in subdivision (d) of this section) be computed, collected, and paid upon the same basis and in the same manner and subject to the same provisions of law, including penalties, as that tax.

(b) The fact that any corporation is a mere holding or investment company, or that the gains or profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to escape the surtax.

(c) When requested by the Commissioner, or any collector, every corporation shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed, and of the amounts that would be payable to each.

(d) As used in this section the term " net income " means the net income as defined in section 232, increased by the sum of the amount of the deduction allowed under paragraph (6) of subdivision (a) of section 234, and the amount of the interest on obligations of the United States issued after September 1, 1917, which would be subject to tax in whole or in part in the hands of an individual owner.

ART. 351. **Taxation of corporation utilized for evasion of surtax.**— Section 220 of the statute is designed to discourage the formation or use of a corporation for the purpose of preventing the imposition of

surtaxes upon its shareholders, through the device of permitting its gains and profits to accumulate instead of being distributed. If a domestic or foreign corporation is so formed or availed of after January 1, 1924, it is subject to a tax at the rate of 50 per cent upon its net income in addition to the tax imposed by section 230 of the statute.

ART. 352. **Purpose to escape surtax.**—Prima facie evidence of a purpose to escape the surtax exists where a corporation is a mere investment company, where a corporation has practically no business except holding stocks, securities or other property and collecting the income therefrom or investing therein, or where a corporation other than a mere holding or investment company permits its gains and profits to accumulate beyond the reasonable needs of the business. The statutory presumption that a mere holding or investment company is subject to the additional tax imposed by section 220 may be overcome if the corporation can show, either by reason of the fact that it distributed a large portion of its earnings for the year in question, or that its stock was held not by the members of a family or of a small group but by a large number of persons and in comparatively small blocks, or by other evidence, that it was not availed of for the purpose of preventing the imposition of the surtax upon its stockholders.

The business of a corporation is not merely that which it has previously carried on, but includes in general 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 anything further to be regarded as employment of the income in its business.

ART. 353. **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. It is not intended, however, to penalize reasonable accumulations of sur-

plus for the needs of the business. 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. Distributions made by a corporation shortly after the close of its taxable year shall be taken into consideration in determining the reasonableness of the amount of earnings and profits of the corporation retained by it for the year in question. 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. It is an unreasonable accumulation of gains and profits by corporations, after the effective date of this Act, with the purpose of enabling their shareholders to escape surtaxes on such gains and profits, which subjects such corporations to the additional tax imposed by section 220. The financial condition of the corporation at the close of the taxable year in question, the manner in which its funds are invested at that date, determines the reasonableness of the accumulations.

For the purpose of section 220 the term "net income" means the net income of the corporation as defined in section 232 increased by the sum of (1) the amounts received as dividends and allowed as a deduction by section 234 (a) (6), plus (2) the amount of interest on obligations of the United States issued after September 1, 1917, which would be subject to tax in whole or in part in the hands of an individual owner. The Commissioner or any collector may require any corporation to furnish a statement of its gains and profits, the names and addresses of and number of shares held by each of its shareholders, and the amounts that would be payable to each, if the income of the corporation were distributed.

PAYMENT OF INDIVIDUAL'S TAX AT SOURCE

SEC. 221. (a) All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States having the control, receipt, custody, disposal, or payment of interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having an office or place of business therein), rent,

salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, of any nonresident alien individual, or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, (other than income received as dividends of the class allowed as a credit by subdivision (a) of section 216) shall (except in the cases provided for in subdivision (b) and except as otherwise provided in regulations prescribed by the Commissioner under section 217) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 6 per centum thereof: *Provided,* That the Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent.

(b) In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon, or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods and whether payable to a nonresident alien individual or to an individual citizen or resident of the United States or to a partnership: *Provided,* That the Commissioner may authorize such tax to be deducted and withheld in the case of interest upon any such bonds, mortgages, deeds of trust, or other obligations, the owners of which are not known to the withholding agent. Such deduction and withholding shall not be required in the case of a citizen or resident entitled to receive such interest, if he files with the withholding agent on or before February 1 a signed notice in writing claiming the benefit of the credits provided in subdivisions (c) and (d) of section 216; nor in the case of a nonresident alien individual if so provided for in regulations prescribed by the Commissioner under subdivision (g) of section 217.

(c) Every person required to deduct and withhold any tax under this section shall make return thereof on or before March 15 of each year and shall on or before June 15 pay the tax to the official of the United States Government authorized to receive it. Every such person is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this section.

(d) Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income, but any amount of tax so withheld shall be credited against the amount of income tax as computed in such return.

(e) If any tax required under this section to be deducted and withheld is paid by the recipient of the income, it shall not be re-collected from the withholding agent; nor in cases in which the tax is so paid shall any penalty be imposed upon or collected from the recipient of the income or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

ART. 361. **Withholding tax at source.**—In general, withholding is required (*a*) of a tax of 6 per cent in the case of fixed or determinable annual or periodical income payable to a nonresident alien

individual or to a partnership not engaged in trade or business within the United States and not having any office or place of business therein, and composed in whole or in part of nonresident alien individuals, except (1) dividends of a class allowed as a credit by subdivision (a) of section 216, (2) interest on deposits with persons carrying on the banking business, paid to persons not engaged in business in the United States and not having any office or place of business therein, and (3) interest upon corporate bonds containing a tax-free covenant clause; (*b*) of a tax of 12½ per cent in the case of fixed or determinable annual or periodical income (with the exceptions just stated) payable to a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein (sec. 237); and (*c*) of a tax of 2 per cent in the case of interest payable to an individual or a partnership, whether resident or nonresident, or to a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, upon bonds or other obligations of domestic or resident foreign corporations containing a so-called tax-free covenant clause. If the owner of bonds or other like obligations is unknown to the withholding agent a tax of 2 per cent must be withheld from interest on so-called tax-free covenant bonds, and a tax of 6 per cent must be withheld from interest on all other corporate bonds or securities. Bonds issued under a trust deed containing a tax-free covenant are treated as if they contained such a covenant. Where neither the bonds nor the trust deeds given by the obligor to secure them contain a tax-free covenant, supplemental agreements executed by the obligor corporation and the trustee containing a tax-free covenant which modify the original trust deeds to that extent are of the same effect from the date of their proper execution as if they had been part of the original deeds of trust, and the bonds from such date are subject to the provisions of subdivision (b) of section 221, provided appropriate authority exists for the modification of the trust deeds in this manner. The authority must be contained in the original trust deeds, however, or actually secured from the bondholders.

A foreign corporation having a fiscal agent or a paying agent in this country is required to withhold a tax of 2 per cent upon the interest on its tax-free covenant bonds. A debtor corporation having an issue of bonds or other similar obligations may appoint a duly authorized withholding agent to act in its behalf, provided notice of such appointment is filed with the collector for the district in which the debtor corporation is located, giving the name and address of the withholding agent. Compensation paid to alien residents of Canada or Mexico for personal services actually performed in the

United States is subject to the rates of normal tax provided by subdivision (b) of section 210 of the statute. The benefit of such reduced rates may be procured by a nonresident alien for withholding purposes only by filing claim therefor on Form 1115 as provided in articles 316, 331, and 373. See also section 217(g) of the statute. See further sections 200, 217, 237, and 256 of the statute, and articles 1523, 311–317, 331, 601, and 1071–1080.

ART. 362. **Fixed or determinable annual or periodical income.**—Only fixed or determinable 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, as for instance, royalties. (*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 some one'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. The income derived from the sale in the United States of property, whether real or personal, is not fixed or determinable annual or periodical income.

ART. 363. **Exemption from withholding.**—Withholding from interest on bonds or other obligations containing a tax-free covenant shall not be required in the case of a citizen or resident alien individual if he files with the withholding agent when presenting interest coupons for payment, or not later than February 1 following the taxable year, an ownership certificate on Form 1001 claiming a personal exemption or credit for dependents. See section 216 of the statute and articles 301–305. To avoid inconvenience a resident alien individual should file a certificate of residence on Form 1078 with withholding agents, who shall forward such certificates to the Commissioner with a letter of transmittal. See article 315. The income of domestic and resident foreign corporations is free from withholding. No withholding from corporate dividends is required except from the amount distributed as dividends by a corporation organized under the China Trade Act, 1922, to (*a*) a nonresident alien individual other than a citizen of China resident therein at the time of such distribution; (*b*) a partnership not engaged in trade or business within the United States and not having any office or place of busi-

ness therein, composed in whole or in part of nonresident aliens; or (*c*) a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein. In the case of (*a*) and (*b*) the rate of withholding applicable is 6 per cent and in the case of (*c*) 12½ per cent. See further sections 213(b) (13) and 263.

ART. 364. **Exemption certificates of nonresident aliens.**—(*a*) When the gross income (including bond interest) of a nonresident alien, which is derived from sources within the United States, does not exceed the personal exemption of $1,000, and, in the case of a resident of Canada or Mexico, does not exceed the personal exemption of $1,000 and the credit for dependents, an exemption certificate, Form 1001 B, should be executed and filed with the withholding agent, if any part of the gross income is derived from interest upon bonds or similar obligations of a domestic corporation which contain a tax-free covenant clause. The amount of tax due from the withholding agent, as shown by Form 1013, may be reduced by 2 per cent of the aggregate amount of interest payments made to such nonresident alien upon tax-free covenant bonds during the calendar year. If the withholding agent has paid the tax shown to be due on Form 1013 prior to the receipt of Form 1001 B, a claim for refund of the excess tax paid should be filed by the withholding agent. See section 281(d) of the statute and articles 1301–1308. If assessment has been made upon the basis of Form 1013 prior to the receipt of Forms 1001 B, the withholding agent should file an amended return, Form 1013, accompanied by the exemption certificates, together with a request for adjustment of its account. The collector will forward the return and request to the Commissioner for action.

(*b*) When the gross income of a nonresident alien derived from sources within the United States does not exceed the personal exemption of $1,000, and in the case of a resident of Canada or Mexico does not exceed the personal exemption of $1,000 and the credit for dependents, such person may file with the withholding agent an exemption certificate on Form 1001 C with respect to interest upon bonds or similar obligations of a domestic corporation not containing a tax-free covenant clause. The debtor organization or withholding agent, upon receipt of such certificate properly filled in and executed, shall release and pay over to the nonresident alien upon demand any tax withheld during the preceding calendar year. The amount of tax due from the withholding agent, as shown by Form 1013, should be reduced by the amount of excess tax withheld. The adjustment of the amount of tax assessed against the withholding agent will be made as provided in subdivision (*a*) of this article. In case the tax so withheld has been paid to the Government, refund

of the tax withheld can be made only to the bond owner or his duly authorized representative, who should file a claim therefor on Form 843 accompanied with Forms 1001 C. In case the Forms 1001 C are received after the tax has been paid to the Government by the withholding agent, they should be returned to the individual or his duly authorized representative with the advice that claim therefor must be filed with the Government.

The exemption certificates, Forms 1001 B and 1001 C, properly executed, may be filed with the debtor organization or its duly authorized withholding agent at any time after the close of the calendar year, but not later than June 1 of the succeeding year. Ownership certificates, however, must be filed in connection with all interest payments upon bonds and similar obligations of domestic corporations in accordance with the regulations, notwithstanding the fact that Form 1001 B or Form 1001 C is filed.

ART. 365. **Ownership certificates for interest coupons.**—The owners, except domestic and resident corporations, of bonds or other obligations containing a tax-free covenant clause, issued by a domestic or resident foreign corporation, when presenting interest coupons for payment shall file a certificate of ownership for each issue of bonds, showing the name and address of the debtor corporation, the name and address of the owner of the bonds, the nature of the obligations, the amount of interest and its due date, and the amount of any tax withheld. In case of corporate bonds or similar obligations not containing a tax-free covenant clause, no ownership certificates are required unless the owner of such bonds is a nonresident alien individual or fiduciary, a partnership not engaged in trade or business within the United States and not having any office or place of business therein, composed in whole or in part of nonresident aliens, or a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein. Ownership certificates are required in the case of such bonds if the owner is unknown to the withholding agent. Ownership certificates need not be filed in the case of interest payments on bonds or similar obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or the obligations of the United States or its possessions. See section 213(b) of the statute and articles 74–85. Ownership certificates are not required to be filed in connection with interest payments on bonds or similar obligations issued by an individual or a partnership whether or not such obligations contain a tax-free covenant clause. Ownership certificates need not be filed by a nonresident alien individual or fiduciary, a partnership not

engaged in trade or business within the United States and not having any office or place of business therein, composed in whole or in part of nonresident aliens, or a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, in connection with interest payments on bonds or similar obligations of a resident foreign corporation or a domestic corporation qualifying under section 217(a) (1) (B).

Where in connection with the sale of its property payment of the bonds or other obligations of a corporation is assumed by the assignee, such assignee, whether an individual, partnership, corporation, or a State or political subdivision thereof, must deduct and withhold such taxes as would have been required to be withheld by the assignor had no such sale and transfer been made. Where the payment of interest and principal of the bonds issued by an individual or partnership is assumed by a corporation, the character of the bond obligation remains unchanged and as created, notwithstanding the corporation has assumed the payment of the interest and may ultimately pay off the mortgage. As to ownership certificates in the case of bonds of foreign countries or bonds of nonresident foreign corporations, see article 1077.

ART. 366. **Form of certificate where withholding required.**—For the purposes of article 365, Form 1000 shall be used (*a*) by citizens or residents of the United States when no personal exemption or credit is claimed against interest on bonds containing a tax-free covenant, and by resident partnerships owning such bonds; (*b*) by nonresident alien individuals, by partnerships composed in whole or in part of nonresident aliens, not engaged in trade or business within the United States and not having an office or place of business therein, and by foreign corporations not engaged in trade or business within the United States and not having any office or place of business therein, whether or not such bonds contain a tax-free covenant; and (*c*) where the owner is unknown to the withholding agent whether or not the bonds contain a tax-free covenant.

ART. 367. **Form of certificate where no withholding required.**—For the purposes of article 365, Form 1001 shall be used by citizens or residents of the United States when personal exemption is claimed against interest on bonds containing a tax-free covenant clause. In case a citizen or resident alien individual receives interest on bonds containing a tax-free covenant clause in excess of the amount of personal exemption which the individual may claim, any such excess must be reported on Form 1000. A citizen or a resident alien individual or a resident partnership is not required to file an ownership certificate in connection with interest on bonds or similar obligations not containing a tax-free covenant clause.

ART. 368. **Use of substitute certificates.**—Resident collecting agents, including responsible banks and bankers receiving interest coupons for collection with ownership certificates attached, may present the coupons with the original certificates to the debtor corporation or its duly authorized withholding agent for collection, or may detach and forward the original certificates directly to the Commissioner, provided each such collecting agent shall substitute for such original certificates its own certificates, Form 1058 or Form 1059, and shall keep a complete record of each transaction, showing (*a*) serial number of item received; (*b*) date received; (*c*) name and address of person from whom received; (*d*) name of debtor corporation; (*e*) class of bonds from which coupons were cut (whether containing a tax-free covenant or not); and (*f*) face amount of coupons. The original certificate for which the certificate of the collecting agent is substituted shall be indorsed, preferably with a rubber stamp, by the collecting agent, as follows:

Owner's certificate No. ______

____
(Name of collecting agent.)

_______________________________, 19__.
(Give date of certificate.)

The counterpart of the within certificate bearing like number was attached to the coupons within mentioned for delivery to the debtor or withholding agent, by whom the coupons are payable.

For the purpose of identification the substitute certificates shall be numbered consecutively, reverting to the numeral 1 at the beginning of each calendar year, and corresponding numbers given the original certificates of ownership. The use of substitute certificates by collecting agents, banks, and bankers is only permitted, however, in the case of ownership certificates presented with coupons for collection by citizens or residents of the United States (individual or fiduciary) or resident partnerships.

ART. 369. **Interest coupons without ownership certificates.**—When interest coupons are received unaccompanied by certificates of ownership, unless the first bank be satisfied that the owner is a citizen of the United States or a resident individual, fiduciary, partnership, or corporation, the first bank shall require of the payee a statement 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 statement shall be forwarded to the Commissioner with the monthly return on Form 1012. The first bank receiving such coupons shall also prepare a certificate on Form 1000, crossing out " owner " and inserting "payee " and entering the amount of interest on line 4, and shall

stamp or write across the face of the certificate "Statement furnished," adding the name of the bank.

Art. 370. **Interest on registered bonds.**—Ownership certificates are required in connection with interest on registered bonds, as in the case of coupon bonds, if such bonds contain a tax-free covenant clause or if such bonds are owned by a nonresident alien (individual or fiduciary), a partnership not engaged in trade or business within the United States and not having any office or place of business therein, composed in whole or in part of nonresident aliens, or a foreign corporation having no office or place of business within the United States and not engaged in trade or business therein. If ownership certificates are not furnished by the owner of the bonds, such certificates must be prepared by the debtor corporation or its withholding agent. (*a*) If the bonds contain a tax-free covenant clause, ownership certificates must be prepared on Form 1000 for the following classes of bondholders: Citizens or residents of the United States (individual or fiduciary), nonresident aliens (individual or fiduciary), partnerships, whether foreign or domestic, and foreign corporations having no office or place of business within the United States and not engaged in trade or business therein. (*b*) If the bonds do not contain a tax-free covenant clause Form 1000 shall be prepared in the case of nonresident aliens (individual or fiduciary), partnerships not engaged in trade or business within the United States and not having any office or place of business therein, composed in whole or in part of nonresident aliens, and foreign corporations not engaged in trade or business within the United States and not having any office or place of business therein. Whether or not registered bonds contain a tax-free covenant clause, no ownership certificate is required in connection with registered bonds owned by domestic or resident corporations.

Art. 371. **Return of tax withheld.**—(*a*) Every withholding agent shall make an annual return of the tax withheld from interest on corporate bonds or other obligations on or before March 15 on Form 1013. This return need not be executed in duplicate and should be filed with the collector for the district in which the withholding agent is located. The withholding agent shall also make a monthly return on Form 1012 on or before the 20th day of the month following that for which the return is made. The original ownership certificates, or the substitute certificates where authorized, must be forwarded to the Commissioner with the monthly return, which need not be executed in duplicate. (*b*) Every person required to deduct and withhold any tax from income other than such bond interest shall make an annual return thereof to the collector on or before March 15 on Form 1042, showing the amount of tax required to be withheld for

each nonresident alien (individual or fiduciary), partnership not engaged in trade or business in the United States, and not having an office or place of business therein, composed in whole or in part of nonresident aliens, or foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, to whom income other than bond interest was paid during the previous taxable year. Form 1042 (no duplicate necessary) should be filed with the collector for the district in which the withholding agent is located. In every case of both classes the tax withheld must be paid on or before June 15 of each year to the collector. For penalties attaching upon failure to make such returns or such payment, see sections 276 and 1017 of the statute, section 3176 of the Revised Statutes as amended, and articles 1261 and 1361.

ART. 372. **Release of excess tax withheld from interest on bank deposits.**—The withholding provisions of section 221(a) of the Revenue Act of 1924 apply to payments made after 4.01 p. m., eastern standard time, June 2, 1924.

During 1924 prior to the passage of the Revenue Act of 1924 withholding was required at the rates imposed by the Revenue Act of 1921. Therefore, with respect to income subject to the provisions of section 221(a), withholding agents were required to withhold at the rate of 8 per cent. Any sum withheld for tax since December 31, 1923, in excess of the amount required to be withheld under section 221(a) of the Revenue Act of 1924 (except compensation for services performed within the United States by aliens who are residents of a contiguous country, as to which see article 373), shall be released by the withholding agent and paid over to the person from whom it was withheld or his proper representative. In order to reconcile the discrepancy between the aggregate amount of tax as shown by the monthly returns, Form 1012, and the annual return, Form 1013, required to be filed after the close of the calendar year 1924, an itemized statement showing names, addresses, and amounts refunded should be attached to the annual return, Form 1013. It will be unnecessary to make any reference on Form 1042 to the refund of excess tax withheld from the income reported on such return.

ART. 373. **Release of excess tax withheld from compensation paid alien residents of a contiguous country.**—Any sum withheld for tax since December 31, 1923, from the compensation paid aliens who are residents of Canada or Mexico for services rendered within the United States which exceeds the amount of the tax imposed by section 210(b) of the statute shall be released to such alien by the employer. Such tax, however, may only be released by the em-

ployer if the nonresident alien files a properly executed Form 1115 establishing the fact that he is a resident of Canada or Mexico. If Form 1115 has already been filed by the alien during the year 1924, it will be unnecessary to file another form in order that the total amount of the excess tax may be released and paid over to him.

ART. 374. **Use of information return where no actual withholding.**—Where a debtor corporation or its duly authorized withholding agent has made payments of interest on its bonds, but in certain instances has been required to withhold no tax, the ownership certificates on Form 1001 filed in connection with such payments shall be transmitted to the Commissioner, accompanied by a return on Form 1096 A showing the number of ownership certificates thus transmitted and the total amount of interest paid. This return shall be made by the 20th day of each month following that for which the return is made and need not be sworn to. An annual return shall be forwarded to the Commissioner not later than March 15 of each year on Form 1096 B, on which shall be given a summary of the monthly returns. To the extent that there has been actual withholding of the tax, returns should be made in accordance with article 371.

ART. 375. **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 two or more persons, a separate ownership certificate must be executed in behalf of each of the owners.

ART. 376. **Return of income from which tax withheld.**—The entire amount of the income from which the tax was withheld shall be included in gross income without deduction for such payment of the tax. But any tax actually so withheld shall be credited against the total tax as computed in the taxpayer's return. See article 31. If the tax is paid by the recipient of the income or by the withholding agent it shall not be re-collected from the other, regardless of the original liability therefor, and in such event no penalty will be asserted against either person for failure to return or pay the tax where no fraud or purpose to evade payment is involved.

CREDIT FOR TAXES IN CASE OF INDIVIDUALS

SEC. 222. (a) The tax computed under Parts I and II of this title shall be credited with:

(1) In the case of a citizen of the United States the amount of any income, war-profits and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

(2) In the case of a resident of the United States, the amount of any such taxes paid or accrued during the taxable year to any possession of the United States; and

(3) In the case of an alien resident of the United States, the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and

(4) In the case of any such individual who is a member of a partnership or a beneficiary of an estate or trust, his proportionate share of such taxes of the partnership or the estate or trust paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

(5) The above credits shall not be allowed in the case of a citizen entitled to the benefits of section 262; and in no other case shall the amount of credit taken under this subdivision exceed the same proportion of the tax (computed on the basis of the taxpayer's net income without the deduction of any income, war-profits, or excess-profits tax any part of which may be allowed to him as a credit by this section), against which such credit is taken, which the taxpayer's net income (computed without the deduction of any such income, war-profits, or excess-profits tax) from sources without the United States bears to his entire net income (computed without such deduction) for the same taxable year.

(b) If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Commissioner, who shall redetermine the amount of the tax due under Parts I and II of this title for the year or years affected, and the amount of tax due upon such redetermination, if any, shall be paid by the taxpayer upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 281. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the taxpayer to give a bond with sureties satisfactory to and to be approved by the Commissioner in such sum as the Commissioner may require, conditioned upon the payment by the taxpayer of any amount of tax found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(c) The credits provided for in subdivision (a) of this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subdivision (b) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken upon the same basis.

(d) These credits shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources without the United States, and all other information necessary for the verification and computation of such credits.

ART. 381. **Analysis of credit for taxes.**—(1) In the case of a citizen of the United States, whether resident or nonresident, the basis of the credit for taxes is as follows: (*a*) The amount of any income, war-profits, and excess-profits taxes paid or accrued during the

taxable year to any foreign country or to any possession of the United States; and (*b*) his proportionate share of any such taxes of a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

(2) In the case of an alien resident of the United States the basis of the credit for taxes is as follows: (*a*) The amount of any such taxes paid or accrued during the taxable year to any possession of the United States; (*b*) the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and (*c*) his proportionate share of any such taxes of a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country, or to any possession of the United States, as the case may be. A citizen deriving income from sources within a possession of the United States, who is entitled to the benefits of section 262, is not allowed any of the credits provided by section 222. As to credits for taxes in the case of corporations see section 238 of the statute and articles 611 and 612.

ART. 382. **Meaning of terms.**—"Amount of any income, war-profits and excess-profits taxes paid or accrued 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. As to the meaning of "sources" see section 217. See also section 2 of the statute.

ART. 383. **Conditions of allowance of credit.**—(*a*) When credit is sought for income, war-profits or excess-profits taxes paid other than to the United States, the income-tax return of the individual must be accompanied by Form 1116, carefully filled in with all the information there called for and with the calculations of credits there indicated, and duly signed and sworn to or affirmed. When credit is sought for taxes already paid the form must have attached to it the receipt for each such tax payment. When credit is sought for taxes

accrued the form must have attached to it the return on which each such accrued tax was based. This receipt or return so attached must be either the original, a duplicate original, a duly certified or authenticated copy, or a sworn copy. In case only a sworn copy of a receipt or return is attached, there must be kept readily available for comparison on request the original, a duplicate original or a duly certified or authenticated copy. (*b*) In the case of a credit sought for a tax accrued but not paid, the Commissioner may require as a condition precedent to the allowance of credit a bond from the taxpayer in addition to Form 1116. If such a bond is required, Form 1117 shall be used for it. It shall be in such sum as the Commissioner may prescribe, and shall be conditioned for the payment by the taxpayer of any amount of tax found due upon any redetermination of the tax made necessary by such credit proving incorrect, with such further conditions as the Commissioner may require. This bond shall be executed by the taxpayer, his agent or representative, as principal, and by sureties satisfactory to and approved by the Commissioner. See also section 1029 of the statute.

ART. 384. **Redetermination of tax when credit proves incorrect.**—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 281 of the statute and articles 1301–1308.

ART. 385. **Countries which do or do not satisfy the similar credit requirement.**—(*a*) The following is an incomplete list of the countries which satisfy the similar credit requirement of section 222(a)(3) of the Revenue Act of 1924, either by allowing to citizens of the United States residing in such countries a credit for the amount of income taxes paid to the United States, or in imposing such taxes, by exempting from taxation the incomes received from sources within the United States by citizens of the United States residing in such countries: Australia, Austria, Bulgaria, Canada, Czechoslovakia, Italy, Netherlands, Newfoundland, Salvador. (*b*) The following is an incomplete list of the countries which do not satisfy the similar

credit requirement of section 222(a)(3) of the Revenue Act of 1924, either because such countries do not allow any credit to citizens of the United States residing in such countries for the amount of income taxes paid to the United States, or because such countries do not impose any income taxes: Argentina, Bahama, Belgium, Bermuda, Bolivia, Bosnia, Brazil, Chile, China, Costa Rica, Dutch Guiana, Ecuador, Egypt, Finland, France, Germany, Great Britain and Ireland, Guatemala, Herzegovina, India, Jamaica, Japan, Montenegro, Morocco, New Zealand, Nicaragua, Panama, Paraguay, Persia, Peru, Portugal, Rumania, Santo Domingo, Serbia, Siam, Straits Settlements, Sweden, Switzerland, Venezuela. The former names of certain of these territories are here used for convenience in spite of the actual or possible change in the name or sovereignty. A resident of the United States who is a citizen or subject of any country in the first list is entitled, for the purpose of the total tax due the United States for 1924 and subsequent years, to a credit for the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country. If he is a citizen or subject of any country in the second list, he is not entitled to such credit. If he is a citizen or subject of a country which is in neither list, then to secure the desired credit he must prove to the satisfaction of the Commissioner that his country satisfies the similar credit requirement of the statute.

ART. 386. **Limitation of credit for taxes.**—The amount allowable as a credit against the income tax under Parts I and II of Title II of the statute is limited by section 222(a)(5) to a sum not in excess of the same proportion of the tax (computed upon the basis of the taxpayer's net income without deducting any income or profits taxes, any part of which may be allowed as a credit under section 222) against which the credit is taken, which the taxpayer's net income (computed without deduction for such income and profits taxes) from sources without the United States bears to his entire net income (computed without such deduction) for the same taxable year. The operation of this limitation in the case of a citizen of the United States having $10,000 earned income within the meaning of section 209 and entitled to an exemption of $1,000, is illustrated as follows:

Income from sources within the United States	$50,000
Income from sources without the United States	25,000
Total net income (without deduction of income and profits taxes paid or accrued to foreign countries or possessions of the United States)	75,000
United States normal tax and surtax on $75,000	13,290
Foreign income and profits taxes upon $25,000	5,000
Amount which may be credited against the United States tax ($\frac{25000}{75000}$ of $13,290)	4,430

In addition to the credit of $4,430, the taxpayer in this case is entitled to a further credit of $75 against the total tax, such sum of $75 being the amount of the credit by reason of earned income computed under section 209(b).

ART. 387. **When credit for taxes may be taken.**—The credit for taxes provided by subdivision (a) of section 222 may ordinarily be taken either in the return for the year in which the taxes accrued or in which the taxes were paid, dependent upon whether the accounts of the taxpayer are kept and his returns filed upon the accrual basis or upon the cash receipts and disbursements basis. Subdivision (c) of section 222 allows the taxpayer at his option and irrespective of the method of accounting employed in keeping his books to take such credit for taxes as may be allowable in the return for the year in which the taxes accrued. An election thus made must be followed in returns for all subsequent years. A taxpayer whose accounts are kept upon the cash receipts and disbursements basis and who elects under section 222(c) to take the allowable credit for taxes in the year in which the taxes accrued, may include in the credit for the first such year the amount of taxes accrued for that year plus the amount of taxes, if any, paid for the preceding year, and not previously taken as a credit.

INDIVIDUAL RETURNS

SEC. 223. (a) The following individuals shall each make under oath a return stating specifically the items of his gross income and the deductions and credits allowed under this title—

(1) Every individual having a net income for the taxable year of $1,000 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of $2,500 or over, if married and living with husband or wife; and

(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income.

(b) If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

(c) If the taxpayer is unable to make his own return, the return shall be made by a duly authorized agent or by the guardian or other person charged with the care of the person or property of such taxpayer.

ART. 401. **Individual returns.**—For each taxable year every single person, whose gross income as defined in section 213 of the statute is $5,000 or over, or whose net income as defined in section 212 of the statute and articles 21–26 is $1,000 or over, must make a return of income. The return shall be for his taxable year, whether calendar or fiscal. Whether or not an individual is the head of a

family or has dependents is immaterial in determining his liability to render a return. A husband and wife living together need make no returns unless their aggregate gross income for the taxable year is at least $5,000, or their aggregate net income is at least $2,500. If their aggregate net income for the taxable year is $2,500 or more, or their aggregate gross income is $5,000 or more, either each must make a return, or the income of each must be included in a single joint return. Where the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. 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. For returns by partnerships see section 224 and articles 411 and 412; by fiduciaries see section 225 and articles 421–425; and by corporations see sections 239 and 240 and articles 621–625 and 631–638. See also section 227 and articles 441–446.

ART. 402. **Form of return.**—The return shall be on Form 1040, except that it may be on short Form 1040 A where the net income does not exceed $5,000, and is derived chiefly from salaries and wages. The forms may be had from the collectors of the several districts. The return may be made by an agent when by reason of illness, absence, or nonresidence the person liable for the return is unable to make it, the agent assuming the responsibility for making the return and incurring liability for the penalties provided for erroneous, false, or fraudulent returns.

ART. 403. **Return of income of minor.**—An individual under the statutory age of majority is required to render a return of income if he has a net income of his own of $1,000 or over, or a gross income of $5,000 or over, for the taxable year. If he is married, see article 401. If a minor has been emancipated by his parent, his earnings are his own income, and such earnings, regardless of amount, are not required to be included in the return of the parent. 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 his earnings in case he has been emancipated, is at least $1,000, or his gross income is at least $5,000, 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. See article 422. In the absence of proof to the contrary, a parent will be assumed to have the legal right to the earnings of the minor and must include them in his return.

Art. 404. Return of income of nonresident alien.—A nonresident alien individual shall make or have made a full and accurate return on Form 1040 B 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 317–331. 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. See article 364.

Art. 405. Return of corporate dividends.—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 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.

Art. 406. Verification of returns.—All income tax returns must be verified under oath or affirmation. The oath or affirmation may be administered by any officer duly authorized to administer oaths for general purposes by the law of the United States or of any State, Territory, or possession of the United States, wherein such oath is administered, or by a consular officer of the United States. Persons in the naval or military service of the United States may verify their returns before any official authorized to administer oaths for the purposes of those services. Income tax returns executed abroad may be attested free of charge before United States consular officers.

Where a foreign notary or other official having no seal shall act as attesting officer, the authority of such attesting officer should be certified to by some judicial official or other proper officer having knowledge of the appointment and official character of the attesting officer.

ART. 407. **Use of prescribed forms.**—Copies of the prescribed return forms will so far as possible be furnished taxpayers by collectors. A taxpayer will not be excused from making a return, however, by the fact that no return form has been furnished to him. Taxpayers not supplied with the proper forms should make application therefor to the collector in ample time to have their returns prepared, verified, and filed with the collector on or before the last due date. Each taxpayer should carefully prepare his return so as fully and clearly to set forth the data therein called for. Imperfect or incorrect reurns will not be accepted as meeting the requirements of the statute. In lack of a prescribed form a statement made by a taxpayer disclosing his gross income and the deductions therefrom may be accepted as a tentative return, and if filed within the prescribed time a return so made will relieve the taxpayer from liability to penalties, provided that without unnecessary delay such a tentative return is replaced by a return made on the proper form. See further articles 443–445.

PARTNERSHIP RETURNS

SEC. 224. Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

ART. 411. **Partnership returns.**—Every partnership must make a return of income, regardless of the amount of its net income. The return shall be on Form 1065 and shall be sworn to by one of the partners. Such return shall be made for the taxable year of the partnership; that is, for its annual accounting period (fiscal year or calendar year, as the case may be), irrespective of the taxable years of the partners. See section 218 of the statute and articles 335–338. If the partnership makes any change in its accounting period, it shall make its return in accordance with the provisions of section 226 and article 431. See also article 424.

ART. 412. **Contents of partnership return.**—The return of a partnership shall state specifically (*a*) the items of its gross income enumerated in section 213 of the statute; (*b*) the deductions enumerated in section 214, other than the deduction provided in paragraph (10) of subdivision (a) of that section; (*c*) the amounts specified in subdivisions (a) and (b) of section 216 received by the partner-

ship; (*d*) the amount of any income, war-profits and excess-profits taxes of the partnership 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 names and addresses of the individuals who would be entitled to share in the net income of the partnership if distributed; (*f*) the amount of the distributive share of such net income of each such individual; (*g*) the part of such share of the net income which consists of earned income; and (*h*) such other facts as are required by Form 1065. See also sections 209, 222, and 227 and articles 381–387, 441–446, and 1661.

FIDUCIARY RETURNS

SEC. 225. (a) Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for any of the following individuals, estates, or trusts for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this title—

(1) Every individual having a net income for the taxable year of $1,000 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of $2,500 or over, if married and living with husband or wife;

(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income;

(4) Every estate or trust the net income of which for the taxable year is $1,000 or over;

(5) Every estate or trust the gross income of which for the taxable year is $5,000 or over, regardless of the amount of the net income; and

(6) Every estate or trust of which any beneficiary is a nonresident alien.

(b) Under such regulations as the Commissioner with the approval of the Secretary may prescribe a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be sufficient compliance with the above requirement. Such fiduciary shall make oath (1) that he has sufficient knowledge of the affairs of the individual, estate or trust for which the return is made, to enable him to make the return, and (2) that the return is, to the best of his knowledge and belief, true and correct. Any fiduciary required to make a return under this Act shall be subject to all the provisions of this Act which apply to individuals.

ART. 421. **Fiduciary returns.**—Every fiduciary, or at least one of joint fiduciaries, must make a return of income (*a*) for the individual whose income is in his charge, if the gross income of such individual is $5,000 or over, or if the net income of such individual is $2,500 or over if married and living with husband or wife, or is $1,000 or over in other cases, or (*b*) for the estate or trust for which he acts if the net income of such estate or trust is $1,000 or over, or if the gross income of the estate or trust is $5,000 or over, re-

gardless of the amount of the net income, or if any beneficiary of such estate or trust is a nonresident alien. The return in case (*a*) shall be on Form 1040. In case (*b*) a return is required on Form 1040 with respect to any taxable net income of the estate or trust computed in accordance with section 219(b) of the statute and a return on Form 1041 with respect to any income deducted under paragraph (2) or (3) of subdivision (b) of section 219. If a portion of the income of the estate or trust is retained by the fiduciary and the remainder is distributable or distributed to beneficiaries, both Forms 1040 and 1041 will be required. See article 342. See article 425 for returns in cases where any beneficiary is a nonresident alien. If the net income of a decedent from the beginning of the taxable year to the date of his death was $1,000 or more if unmarried, or $2,500 or more if married, or if his gross income for the same period was $5,000 or over the executor or administrator shall make a return for such decedent. See article 305.

ART. 422. **Return by guardian or committee.**—A fiduciary acting as the guardian of a minor having a net income of $1,000 or more, or $2,500 or more, according to the marital status of such person, or having a gross income of $5,000 or over, must make a return for such minor on Form 1040 or 1040 A and pay the tax, unless such minor himself makes a return or causes it to be made. A fiduciary acting as a guardian or the committee of an insane person having an income of $1,000 or more or $2,500 or more, according to the marital status of such person, or having a gross income of $5,000 or over, must make a return for such incompetent on Form 1040 or 1040 A and pay the tax.

ART. 423. **Returns where two trusts.**—In the case of two or more trusts the income of which is taxable to the beneficiaries, which were created by the same person and are in charge of the same trustee, the trustee shall make a single return on Form 1041 for all such trusts, notwithstanding that they may arise from different instruments. When, however, a trustee holds trusts created by different persons for the benefit of the same beneficiary, he shall make a return on Form 1041 for each trust separately.

ART. 424. **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 or 1040 A. 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. 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. See also section 256 of the statute and articles 1071–1080.

ART. 425. **Return for nonresident alien beneficiary.**—Where a citizen or resident fiduciary has the distribution of the income of a trust any beneficiary of which is a nonresident alien, the fiduciary shall make a return on Form 1040 B for such nonresident alien and pay any tax shown thereon to be due. Unless such return is a true and accurate return of the nonresident alien beneficiary's income from all sources within the United States the benefits of the credits and deductions to which the beneficiary is entitled can not be obtained in the return filed by the fiduciary. See section 217(g). If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns the fiduciary shall be relieved from the necessity of filing Form 1040 B in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. If the sole beneficiary of an estate or trust is a nonresident alien and Form 1040 B is filed by the fiduciary, the filing of Form 1041 will not be required. If there are two or more nonresident alien beneficiaries the fiduciary shall render a return on Form 1041 and also a return on Form 1040 B for each nonresident alien beneficiary. In no case will a fiduciary be required to withhold tax at the rate of 6 per cent and render a return on Form 1042 with respect to income of a nonresident alien beneficiary, as a complete return thereof will be included in Form 1040 B. See further article 404.

RETURNS FOR A PERIOD OF LESS THAN TWELVE MONTHS

SEC. 226. (a) If a taxpayer, with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year.

(b) Where a separate return is so made and in all other cases where a separate return is required or permitted, by regulations prescribed by the Commissioner with the approval of the Secretary, to be made for a fractional part of a year, then the income shall be computed on the basis of the period for which separate return is made.

(c) If a separate return is made under subdivision (a) the net income, computed in accordance with the provisions of subdivision (b), shall be placed on an annual basis by multiplying the amount thereof by twelve and dividing by the number of months included in the period for which the separate return is made. The tax shall be such part of the tax computed on such annual basis as the number of months in such period is of twelve months.

(d) The Commissioner with the approval of the Secretary shall by regulations prescribe the method of applying the provisions of subdivisions (b) and (c) to cases where the taxpayer makes a separate return under subdivision (a) and it appears that for the period for which the return is so made he has derived a capital net gain, or sustained a capital net loss, or received earned income.

(e) In the case of a return made for a fractional part of a year, except a return made under subdivision (a), the credits provided in subdivisions (c), (d), and (e) of section 216 shall be reduced respectively to amounts which bear the same ratio to the full credits provided in such subdivisions as the number of months in the period for which return is made bears to twelve months.

Art. 431. **Returns for periods of less than twelve months.**—No return can be made for a period of more than twelve months. A separate return for a fractional part of a year is therefore required wherever there is a change, with the approval of the Commissioner, in the basis of computing net income from one taxable year to another taxable year. The periods to be covered by such separate returns in the several cases are stated in the statute. The requirements with respect to the filing of a separate return and the payment of tax for a part of a year are the same as for the filing of a return and the payment of tax for a full taxable year closing at the same time. See sections 227 and 270 of the statute and articles 441–446 and 1201. The tax on net income computed on the basis of the period for which a separate return is made shall be paid thereon at the rate for the calendar year in which such period is included. In case of a change in the accounting period the net income computed on the return for the fractional part of a year shall be placed on an annual basis and the tax computed as provided in subdivision (c) of section 226. See illustration below. See further section 212 and articles 25 and 26, and as to corporations, sections 232 and 239 and articles 531 and 625.

Since it is not required that income be placed on an annual basis except where the taxpayer voluntarily changes his accounting period, the income of a decedent or of his estate for the fractional parts of the year in which he died need not be placed on an annual basis.

The income tax of a citizen of the United States entitled to a personal exemption of $2,500, making a return for a six months' period of $10,000 net income, of which $5,000 is earned net income, is $502.50, computed as follows:

Net income	$10,000.00
Multiplied by 12	120,000.00
Divided by 6	20,000.00
Subtracting exemption of $2,500	17,500.00
Normal tax on $17,500	810.00
Surtax on $20,000	220.00
Total	1,030.00
Divided by 2	515.00
Less credit for earned income	12.50
Amount of tax	502.50

TIME AND PLACE FOR FILING INDIVIDUAL, PARTNERSHIP, AND FIDUCIARY RETURNS

SEC. 227. (a) Returns (except in the case of nonresident aliens) shall be made on or before the fifteenth day of the third month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall be made on or before the 15th day of March. In the case of a nonresident alien individual returns shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall be made on or before the 15th day of June. The Commissioner may grant a reasonable extension of time for filing returns, if application therefor is made before the date prescribed by law for filing the return, whenever in his judgment good cause exists, and shall keep a record of every such extension and the reason therefor. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

(b) Returns shall be made to the collector for the district in which is located the legal residence or principal place of business of the person making the return, or, if he has no legal residence or principal place of business in the United States, then to the collector at Baltimore, Maryland.

ART. 441. **Time for filing return.**—Returns of income (except in the case of nonresident aliens) on a calendar year basis must be made on or before the fifteenth day of March following the taxable year, and returns on the basis of a fiscal year must be made on or before the fifteenth day of the third month following the close of the fiscal year. Returns in the case of nonresident aliens must be made on or before the fifteenth day of the sixth month following the close of the fiscal year or on or before the fifteenth day of June, if on the basis of the calendar year.

ART. 442. **Time for filing return upon death, or termination of trust.**—After his appointment and qualification, an executor or administrator may immediately file a return for the decedent without wait-

ing for the close of the taxable year. Upon the completion of the administration of an estate and final accounting, an executor or administrator may immediately file a return of income of the estate for the fractional part of the taxable year in which the administration was closed. Similarly upon the termination of a trust, the trustee may immediately make a return without waiting for the close of the taxable year. Any income return required to be filed for a decedent, or for the fractional part of a year in which an estate is closed or a trust terminated, is due on the fifteenth day of the third month following the close of the taxable year during which the decedent dies, the estate is closed, or the trust is terminated, which date shall also be the due date for payment of the tax or the first installment thereof if payment is made under the provisions of section 270(b). 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. See sections 273 and 274 and articles 1231–1235.

The domiciliary representative is required to include in the return rendered by him as such domiciliary representative the entire income of the estate. Consequently the only return required to be filed by the ancillary representative is on Form 1041, which shall be filed with the collector for his district and shall show the name and address of the domiciliary representative, the amount of gross income received by the ancillary representative, and the deductions to be claimed against such income including any amount of income properly paid or credited by the ancillary representative to any legatee, heir, or other beneficiary. If the ancillary representative for the estate of a nonresident alien is a citizen or resident of the United States, and the domiciliary representative is a nonresident alien, such ancillary representative is required to render the return otherwise required of the domiciliary representative.

ART. 443. **Extension of time by Commissioner.**—It is important that the taxpayer render on or before the due date a return as complete and final as it is possible for him to prepare. However, the Commissioner, whenever in his judgment good cause exists, may grant a reasonable extension of time for filing the return, if application therefor is made by the taxpayer before the date prescribed by law for filing the return. Under the Revenue Act of 1924 the collector does not have authority to grant extensions in the case of income tax returns. See section 1003. Application to the Commissioner for an extension must contain a full recital of the causes for the

delay. Except in the case of taxpayers who are abroad, no such extension will be granted for more than six months.

If the return is not filed within the time as extended, penalties for delinquency will attach. If a taxpayer finds that he is unable to file his return within the extended period, he should before the expiration of the extension make application to the Commissioner, setting forth fully therein the reasons why additional time is required. An extension of time under section 227 for filing a return does not extend the time for payment of the tax or any installment thereof unless so specified in the extension. For extensions of time for payment of tax see sections 270(c) and 274(g) of the statute and articles 1201 and 1234. As a condition of granting an extension of time for filing a return the Commissioner may require the submission of a tentative return and estimate of the tax and the payment of at least one-fourth of the estimated amount of tax. A tentative return should be made on the usual return form, plainly marked "tentative" at the top, contain a statement as to the estimated amount of tax believed to be due, and be properly executed. No other data need be given. Tentative returns will not be accepted unless permission is obtained previous to filing. A copy of the authority for filing the tentative return must be attached thereto when filed. Where a taxpayer has filed a tentative return and has failed to file a complete return within the period of the extension granted to him, the complete return when filed is subject to penalties prescribed for delinquency.

ART. 444. **Last due date.**—The last due date is the last day upon which a return is required to be filed in accordance with the provisions of the statute or the last day of the period covered by an extension of time granted by the Commissioner. When the last due date falls on Sunday or a legal holiday, the last due date for filing returns will be the day following such Sunday or legal holiday. If placed in the mails, the return should be posted in ample time to reach the collector's office, under ordinary handling of the mails, on or before the date on which the return is required to be filed. If a return is made and placed in the mails in due course, properly addressed and postage paid, in ample time to reach the office of the collector on or before the last due date, no penalty will attach should the return not actually be received by such officer until subsequent to that date. Where a question may be raised as to whether or not the return was posted in ample time to reach the collector's office on or before the due date, the envelope in which the return was transmitted will be preserved by the collector and forwarded to the Commissioner with the return.

ART. 445. Procedure in case of delinquency in filing return.—Section 3176 of the Revised Statutes as amended by section 1003 of the Revenue Act of 1924 provides:

> SEC. 3176. If any person, corporation, company, or association fails to make and file a return or list at the time prescribed by law or by regulation made under authority of law, or makes, willfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise. In any such case the Commissioner of Internal Revenue may, from his own knowledge and from such information as he can obtain through testimony or otherwise, make a return or amend any return made by a collector or deputy collector. Any return or list so made and subscribed by the Commissioner, or by a collector or deputy collector and approved by the Commissioner, shall be prima facie good and sufficient for all legal purposes.
>
> If the failure to file a return (other than a return under Title II of the Revenue Act of 1924) or a list is due to sickness or absence, the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper.
>
> The Commissioner of Internal Revenue shall determine and assess all taxes, other than stamp taxes, as to which returns or lists are so made under the provisions of this section. In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner of Internal Revenue or the collector in pursuance of law, the Commissioner shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner shall add to the tax 50 per centum of its amount.
>
> The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax.

Accordingly, if any person charged by law or regulations with making a return fails to make such return or makes a false or fraudulent return, the collector or his deputy is required to make a return from his own knowledge and from such information as he can obtain from testimony or otherwise. In such a case the Commissioner may, from similar sources of information, make a return or amend the return made by the collector.

In case of failure to file a return on time a penalty of 25 per cent of the amount of the tax is added to the tax unless the return is later filed and failure to file the return within the prescribed time is satisfactorily shown to the Commissioner to be due to reasonable cause and not to willful neglect. Two classes of delinquents are liable to this 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. A taxpayer who files a tardy return and wishes to avoid the penalty must make an affirmative showing of all facts alleged as a reasonable cause for failure to file the return on time in the form of an affidavit, which should be attached to the return. If such an affidavit 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 and not to willful neglect the 25 per cent penalty will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return in the prescribed time, then the delay is due to "reasonable cause." Where the 25 per cent penalty for delinquency in filing the return has been added to the tax the amount so added shall be collected in the same manner as the tax.

The 50 per cent addition to tax, provided by section 3176 of the Revised Statutes as amended, in cases where the taxpayer willfully makes a false or fraudulent return does not apply in the case of income tax returns. See section 275(b).

ART. 446. **Place for filing return.**—Returns of income must be delivered or mailed to the collector for the district of the legal residence or principal place of business of the person making the return. Persons having no domicile or place of business in the United States should file their returns of income with the collector at Baltimore.

PART II

INCOME TAX ON CORPORATIONS

TAX ON CORPORATIONS

SEC. 230. In lieu of the tax imposed by section 230 of the Revenue Act of 1921 there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax of 12½ per centum of the amount of the net income in excess of the credits provided in sections 236 and 263.

ART. 501. **Income tax on corporations.**—The statute imposes an income tax at a fixed rate on all corporations not expressly exempt. See section 231 of the statute. The tax is upon net income, as defined in the statute, after deducting from gross income, as defined in the statute, the allowable deductions. See sections 232–235. Certain credits are allowed against net income and against the amount of the tax. See sections 236, 238, and 263. The tax is payable upon the basis of returns rendered by the corporations liable thereto, except that in some cases it is to be paid at the source of the income. See also sections 237, 239, 240, and 241. For the income tax on individuals, for administrative provisions, and for definitions and general provisions, see Parts I, III, and IV of the regulations. For the income tax on life insurance companies, see sections 242–245; on insurance companies other than life or mutual, sections 246–247. Mutual insurance companies other than life are taxed under section 230. As to foreign corporations, see sections 233(b), 234(b), and 241; as to domestic corporations deriving 80 per cent of their gross income from sources within possessions of the United States, see section 262; as to China Trade Act corporations, see section 263.

ART. 502. **Rates of tax.**—The income tax on corporations for 1924 and subsequent years is at the rate of 12½ per cent of the net income subject to tax. In order to determine the amount subject to tax the net income, as defined in section 232 of the statute and article 531 of the regulations, may be reduced by the amount of any credits allowable under sections 236 and 263.

ART. 503. **Corporations liable to tax.**—Every corporation, domestic or foreign, not exempt under section 231 of the statute, is liable to the tax. It makes no difference that a domestic corporation (unless entitled to the benefits of section 262) 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. See section 233(b) of the statute and article 550. For

what the term "corporation" includes and for the difference between domestic and foreign corporations, see section 2 and articles 1501–1509.

CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS

SEC. 231. The following organizations shall be exempt from taxation under this title—

(1) Labor, agricultural, or horticultural organizations;

(2) Mutual savings banks not having a capital stock represented by shares;

(3) Fraternal beneficiary societies, orders, or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and (b) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

(4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

(5) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(7) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes;

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;

(10) Benevolent life insurance associations of a purely local character, farmers' or other mutual hail, cyclone, casualty, or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 per centum or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses;

(11) Farmers', fruit growers', or like associations, organized and operated as sales agents for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them; or organized and operated as purchasing agents for the purpose of purchasing supplies

and equipment for the use of members and turning over such supplies and equipment to such members at actual cost, plus necessary expenses;

(12) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title; and

(13) Federal land banks, national farm-loan associations, and Federal intermediate credit banks, as provided in the Federal Farm Loan Act, as amended.

ART. 511. **Proof of exemption.**—In order to establish its exemption, and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached (1) a copy of the charter or articles of incorporation, (2) the by-laws of the organization, and (3) the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization.

In the case of the particular classes of organizations listed below, the following additional information should be embodied in the affidavit referred to above:

(1) Fraternal beneficiary societies, orders or associations: (*a*) The number of subordinate lodges in active operation, (*b*) whether periodical meetings are actually held;

(2) Educational organizations: Whether any of the shareholders are paid by the organization, and if so, the reason for each such payment and the amount thereof;

(3) Hospitals: Whether nonpay patients are accepted;

(4) Business leagues: (*a*) A statement of the services performed for members, (*b*) a statement of the services performed for nonmembers;

(5) Clubs: The income received from the use of the facilities by the general public;

(6) Benevolent life insurance associations: (*a*) The number of counties in which the association accepts risks, (*b*) copies of the policies or certificates of membership;

(7) Mutual insurance companies: Copies of the policies or certificates of membership;

(8) Farmers and like cooperative associations: (*a*) Whether refunds are paid equally to both shareholders and nonshareholders based on the quantity of produce furnished or supplies purchased,

(*b*) whether the association accumulates and maintains a reserve required by State statute, and if so, the amount, and a reference to such statute, (*c*) whether the association has a sinking fund or surplus, and if so, the purpose for which it is so set aside, (*d*) whether the association pays a dividend on its capital stock, and if so, the rate, (*e*) whether any of the outstanding capital stock is owned by nonproducers, and if so, the total number of shares outstanding, the number of shares owned by nonproducers and the manner in which such shares were acquired by nonproducers;

(9) Holding companies: (*a*) The name of the organization for which it holds title; (*b*) the information necessary to establish the exemption, under section 231, of the organization for which title is held.

The collector, upon receipt of the affidavit and other papers, will forward them to the Commissioner for decision as to whether the organization is exempt.

When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created. Collectors will keep a list of all exempt corporations, to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

ART. 512. **Labor, agricultural, and horticultural organizations.**—The organizations contemplated by paragraph (1) of section 231 as entitled to exemption from income taxation are those which (1) have no net income inuring to the benefit of any member; (2) are educational or instructive in character; and (3) have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations. Organizations such as county fairs and like associations of a quasi-public character, which are designed to encourage the development of better agricultural and horticultural products through a system of awards, and whose income from gate receipts, entry fees, and donations is used exclusively to meet the necessary expenses of upkeep and operation, are thus exempt. On the other hand, associations which have for their purpose, for example, the holding of periodical race meets, the profits from which may inure to the benefit of their shareholders, are not exempt. Similarly, corporations engaged in growing agricultural or horticultural products for profit are not exempt from tax under this paragraph.

ART. 513. **Mutual savings banks.**—In order that a corporation may be entitled to exemption as a mutual savings bank, it must appear

that it is an organization (1) which has no capital stock represented by shares, and (2) whose earnings, less only the expenses of operation, are distributable wholly among the depositors. If it appears that the organization has shareholders who participate in the profits, the organization will not be exempt from income taxation under the statute.

ART. 514. **Fraternal beneficiary 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.

ART. 515. **Building and loan associations and cooperative banks.**—In general, a building and loan association entitled to exemption is one organized pursuant to the laws of any State, Territory, or the District of Columbia, which accumulates funds to be loaned primarily to its shareholders for the purpose of building or acquiring homes. In order to be exempt the association (1) must be mutual, that is, all of its shareholders or members must share in the profits on substantially the same footing; and (2) must be operated so that substantially all of its business is confined to the making of loans to bona fide shareholders. A building and loan association otherwise exempt does not lose its exempt status because—

(1) It has paid-up shares which are (*a*) preferred as to earnings and (*b*) have a definite rate of interest which may be higher than the rate of dividends paid on other stock.

(2) It borrows money (accepting deposits is held to be a form of borrowing) which it uses for loans to shareholders, the dues, fines, and penalties paid by shareholders being inadequate for this purpose.

(3) It makes loans to nonmembers from accumulated funds which are not needed for loans to shareholders. In any such case, however, the burden will be upon the association to show that substantially all of its loans are made to members.

(4) The amount of its prepaid or full-paid stock is disproportionate to running or installment stock, provided the issuance of such prepaid or full-paid stock is ancillary to the furtherance of the main business of the association; that is, that it is intended to provide a fund from which loans may be made primarily to persons subscribing to running or installment stock to enable them to acquire or build homes.

Cooperative banks without capital stock organized and operated for mutual purposes and without profit are exempt. Credit unions such as those organized under the laws of Massachusetts, being in substance and in fact the same as cooperative banks, are likewise exempt from tax.

ART. 516. **Cemetery companies.**—A cemetery company may be entitled to exemption, (1) if it is owned by and operated exclusively for the benefit of its lot owners, or (2) if it is not operated for profit. Any cemetery corporation chartered solely for burial purposes and not permitted by its charter to engage in any business not necessarily incident to that purpose, is exempt from income tax, provided that no part of its net earnings inures to the benefit of any private shareholder or individual. A cemetery company which fulfills the other requirements of the statute may be exempt, even though it issues preferred stock entitling the holders to dividends at a fixed rate, provided that its articles of incorporation require (1) that the preferred stock shall be retired at par as soon as sufficient funds are realized from sales, and (2) that all funds not required for the payment of dividends upon or for the retirement of preferred stock shall be used by the company for the care and improvement of the cemetery property.

ART. 517. **Religious, charitable, scientific, literary, and educational organizations and community chests.**—In order to be exempt under paragraph (6) of section 231, the organization must meet two tests: (1) It must be organized and operated exclusively for one or more of the specified purposes; and (2) its net income must not inure in whole or in part to the benefit of private shareholders or individuals.

Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor. The fact that a corporation established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily deprive it of exemption.

An association whose sole purpose is the instruction of the public, or an association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community may be exempt as an educational corporation, even though such an association has incidental amusement features. Associations formed to disseminate controversial or partisan propaganda are not educational within the meaning of the statute.

Since a corporation to be exempt under paragraph (6) of section 231 must be organized and operated exclusively for one or more of the specified purposes, an organization which has certain religious purposes for example, and which also manufactures and sells articles

to the public for profit 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 organization.

The words "private shareholder or individual" in the Act refer to individuals having a personal and private interest in the activities of the corporation. If 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.

ART. 518. **Business 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. If it engages in a regular business of a kind ordinarily carried on for profit, the fact that the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not ground for exemption. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not exempt, since its members have no common business interest, even though all of its income is devoted to the purpose stated. A clearing house association, not organized for profit, no part of the net income of which inures to any private shareholder or individual, is exempt provided its activities are limited to the exchange of checks and similar work for the common benefit of its members. An association of persons who are engaged in the business of carrying freight and passengers by boats propelled by steam, which is designed to promote the legitimate objects of such business, and all of the income of which is derived from membership dues and is expended for office expenses and the salary of a secretary-treasurer is exempt from tax. An incorporated cotton exchange whose shares carry the right to dividends is organized for profit and is not exempt.

ART. 519. **Civic leagues and local associations of employees.**—Civic leagues entitled to exemption under paragraph (8) of section 231 comprise those not organized for profit but operated exclusively for purposes beneficial to the community as a whole. In general, organizations engaged in promoting the welfare of mankind, other than organizations comprehended within paragraph (6) of section 231, are included within this paragraph.

Under this paragraph certain local associations of employees are also expressly exempted from income taxation. The statute

prescribes as conditions to exemption (1) that the membership of such an association be limited to the employees of a designated person or persons in a particular municipality, and (2) that the net earnings of the association be devoted exclusively to charitable, educational, or recreational purposes. See article 517 with reference to the meaning of "charitable" and "educational" in the Act.

ART. 520. **Social clubs.**—The exemption granted by paragraph (9) of section 231 applies to practically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club, by reason of the comprehensive powers granted in its charter, engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes, and any profit realized from such activities is subject to tax.

ART. 521. **Local benevolent life and mutual insurance companies and like organizations.**—It is a prerequisite to exemption under paragraph (10) of section 231 that at least 85 per cent of the income of the organization in question shall consist of amounts collected from members for the sole purpose of meeting losses and expenses. If an organization issues policies for stipulated cash premiums, or if it requires advance deposits to cover the cost of the insurance and maintains investments from which more than 15 per cent of its income is derived, it is not entitled to exemption. On the other hand, an organization may be entitled to exemption, although it makes advance assessments for the sole purpose of meeting future losses and expenses, provided that the balance of such assessments remaining on hand at the end of the year is retained to meet losses and expenses in the ensuing year.

The phrase "of a purely local character" applies to benevolent life insurance associations, and not to the other organizations specified in the paragraph. It applies, however, to any organization seeking exemption on the ground that it is an organization similar to a benevolent life insurance association. An organization of a purely local character is one whose business activities are confined to a particular community, place, or district, irrespective, however, of political subdivisions.

See section 1013(b) of the Act with reference to the exemption of mutual insurance companies under preceding revenue acts.

ART. 522. **Cooperative associations.**—(*a*) Cooperative associations, acting as sales agents for farmers, fruit growers, live-stock growers, dairymen, etc., or engaged in the marketing of farm products, and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of the produce furnished by them, are exempt from income tax and shall not

be required to file returns. Thus cooperative dairy companies which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of the quantity of milk or of butter fat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the statute and is not exempt. The accumulation and maintenance of a reasonable reserve for depreciation or possible losses or a reserve required by State statute or a reasonable sinking fund or surplus to provide for the erection of buildings and facilities required in business, or for the purchase and installation of machinery and equipment, or to retire indebtedness incurred for such purposes, will not destroy the exemption. A corporation organized to act as a sales agent for farmers, or to market cooperatively the products of the farm, and having a capital stock on which it pays a dividend not exceeding 8 per cent per annum or not exceeding the legal rate of interest, and in which the voting control is retained by the shareholders who are actual producers, will not for such reasons be denied exemption.

(*b*) Cooperative associations organized and operated as purchasing agents for farmers, fruit growers, live-stock growers, dairymen, etc., for the purpose of buying supplies and equipment for their use and turning over such supplies and equipment to them at actual cost, plus necessary operating expenses, are also exempt. The provisions of paragraph (*a*) relating to a reserve, sinking fund, or surplus, and to capital stock shall apply to associations coming under this paragraph.

In order to be exempt under either (*a*) or (*b*) an association must establish that it has no net income for its own account other than that reflected in a reserve, sinking fund, or surplus specifically authorized in paragraph (*a*). An association acting both as a sales and a purchasing agent is exempt if as to each of its functions it meets the requirements of the statute.

NET INCOME OF CORPORATIONS DEFINED

SEC. 232. In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivision (b) of section 212 or in section 226. In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the computation shall also be made in the manner provided in section 217.

ART. 531. **Net income.**—Net income is that portion of the gross income which remains after all proper deductions have been taken

into account. The net income of corporations is determined in general in the same manner as the net income of individuals, but the deductions allowed corporations are not precisely the same as those allowed individuals. See sections 206, 233, 234, and 235 of the statute. The net income of corporations is to be computed on the same basis as to accounting periods as the net income of individuals. See sections 212 and 226 and articles 21–26 and 431; see also sections 217 and 262 and articles 311–331 and 1135–1137.

GROSS INCOME OF CORPORATIONS DEFINED

SEC. 233. (a) In the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

(b) In the case of a foreign corporation gross income means only gross income from sources within the United States, determined (except in the case of insurance companies subject to the tax imposed by sections 243 or 246) in the manner provided in section 217.

ART. 541. **Gross income.**—The gross income of a corporation for the purpose of the tax, in general, includes and excludes the same things as the gross income of an individual. It embraces not only the operating revenues, but also gains, profits, and income from all other sources such as rentals, royalties, interest, dividends from stock in other corporations, and profits from the sale of capital assets. As to the basis for determining gain or loss on disposition of property see sections 202–204 and articles 1561–1603. The proceeds of life insurance policies paid upon the death of the insured to any beneficiary (corporate or otherwise) are not to be included in the beneficiary's gross income. See section 213(b)(1). In the case of mutual insurance companies and of foreign corporations there are special provisions. See articles 549 and 550. As to domestic corporations deriving 80 per cent of their gross income from sources within possessions of the United States see section 262. As to life insurance companies see section 244 and article 671; as to other insurance companies (except life or mutual) see section 246 and article 692. Mutual insurance companies (other than life) are included within the provisions of section 233 and this article.

ART. 542. **Creation of sinking fund.**—If a corporation, in order solely to secure the payment of its bonds or other indebtedness, places property in trust, or sets aside certain amounts in a sinking fund under the control of a trustee who may be authorized to invest and reinvest such sums from time to time, the property or fund thus set aside by the corporation and held by the trustee is an asset of the corporation, and any gain arising therefrom is income of the corporation and shall be included as such in its annual return. The

trustee, however, is not taxable as such on account of the property or fund so held. See section 219 and articles 341–347.

ART. 543. **Sale of capital stock.**—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders 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 or sale of its own stock. See article 563.

ART. 544. **Contributions by shareholders.**—Where a corporation requires additional funds for conducting its business and obtains such needed money through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special capital account, such amounts will not be considered income, although there is no increase in the outstanding shares of stock of the corporation. The payments in such circumstances are in the nature of voluntary assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. See articles 49 and 292.

ART. 545. **Sale and retirement of corporate bonds.**—(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. See section 234 of the statute and article 563. (*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 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.

ART. 546. **Sale of capital assets.**—Where property is acquired and later sold for a higher price the gain on the sale is income. Where, then, a corporation sells its capital assets in whole or in part it shall include in its gross income for the year in which the sale was made the amount of the excess of the sales price over the cost or other basis determined as provided in sections 202–204. In every case, however, in ascertaining the gain, the cost of the assets, including any expenditures properly charged to capital account, or the fair market value as of March 1, 1913, of the assets acquired prior thereto, should first be reduced by the amount of depreciation, obsolescence, amortization, and depletion allowed as a deduction in computing net income. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the purchase price. See also sections 202–204 and articles 1561–1603.

ART. 547. **Income from leased property.**—Where a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact

that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability to the tax. While the payments made by the lessee directly to the bondholders or shareholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the shareholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

ART. 548. **Gross 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. See, further, articles 622 and 1545.

ART. 549. **Gross income of mutual insurance companies.**—The gross income of mutual insurance companies (other than life) consists of their total revenue from the operation of the business and of their income from all other sources within the taxable year, except as otherwise provided by the statute. Gross income includes net premiums (that is, gross premiums less returned premiums on policies canceled and premiums on policies not taken), investment income, profits from the sale of assets, and all gains, profits, and income reported to the State insurance departments, except income specifically exempt from tax. Premiums received by mutual marine insurance companies which are paid out for reinsurance should be eliminated from gross income and the payments for reinsurance from disbursements. Deposit premiums on perpetual risks received and returned by mutual fire insurance companies should be treated in the same manner, as no reserve will be recognized covering liability for such deposits. The earnings on such deposits, including such portion, if any, of the deposits as are not returned to the policyholders upon cancellation of the policies, must be included in the gross income. A net decrease in reserve funds required by law within the taxable year must be included in the gross income to the extent that such funds are released to the general uses of the com-

pany and increase its free assets. Any net decrease in reserves shall be added to the gross income, unless the company shall show that such decrease resulted from the application of reserves to the purposes for which they were established. See articles 541 and 568–571.

ART. 550. **Gross income of foreign corporations.**—The gross income of a foreign corporation, including a mutual insurance company, means its gross income from sources within the United States, as defined and described in section 217 and articles 317–331 relating to nonresident alien individuals. As to other foreign insurance companies, see article 687. See also article 541.

DEDUCTIONS ALLOWED CORPORATIONS

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

(3) Taxes paid or accrued within the taxable year except (A) income, war-profits, and excess-profits taxes imposed by the authority of the United States, (B) so much of the income, war-profits and excess-profits taxes imposed by the authority of any foreign country or possession of the United States as is allowed as a credit under section 238, and (C) taxes assessed against local benefits of a kind tending to increase the value of the property assessed. In the case of obligors specified in subdivision (b) of section 221 no deduction for the payment of the tax imposed by this title, or any other tax paid pursuant to the tax-free covenant clause, shall be allowed, nor shall such tax be included in the gross income of the obligee. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder of a corporation upon his interest as shareholder, which are paid by the corporation without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes. For the purpose of this paragraph, estate, inheritance, legacy, and succession taxes accrue on the due date thereof except as otherwise provided by law of the jurisdiction imposing such taxes;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise. No deduction shall be allowed under this paragraph for any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities where it appears that within thirty days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) or has entered into a contract or option to acquire substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition, unless such claim is made by a dealer in stock or securities and with respect

to a transaction made in the ordinary course of its business. If such acquisition or the contract or option to acquire is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed. The basis for determining the amount of the deduction for losses sustained shall be the same as is provided in section 204 for determining the gain or loss from the sale or other disposition of property;

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

(6) The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262, and other than a corporation organized under the China Trade Act, 1922, or (B) from any foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the foreign corporation has been in existence) was derived from sources within the United States as determined under section 217;

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

(9) In the case of insurance companies (other than life insurance companies), in addition to the above (unless otherwise allowed): (A) 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); and (B) the sums other than dividends paid within the taxable year on policy and annuity contracts. This paragraph shall apply only to mutual insurance companies other than life insurance companies;

(10) In the case of mutual marine insurance companies, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (9), inclusive, unless otherwise allowed, amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(11) In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (9), inclusive, unless otherwise allowed, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

(b) In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the deductions allowed in subdivision (a) shall be

allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 217 under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

ART. 561. **Allowable deductions.**—In general the deductions from gross income allowed corporations are the same as allowed individuals, except that corporations may deduct dividends as provided in paragraph (6) of section 234(a) and may not deduct contributions or gifts. See section 214 of the statute. Particularly, as to business expenses, see articles 101–112; as to interest paid see article 121; as to taxes paid see articles 131–135; as to losses see articles 141–146; as to bad debts see articles 151–155; as to depreciation see articles 161–171; as to depletion see articles 201–239; as to involuntary conversion of property into cash or its equivalent see sections 203(a) (5) and 204(a) (10) and articles 1579, 1580, and 1600; as to life insurance companies see articles 681–687; and as to other insurance companies see articles 568, and 691–693.

ART. 562. **Donations.**—Corporations are not entitled to deduct from gross income contributions or gifts which individuals may deduct under paragraph (10) of section 214(a). Donations made by a corporation for purposes connected with the operation of its business, however, when limited to charitable institutions, hospitals, or educational institutions conducted for the benefit of its employees or their dependents, are a proper deduction as ordinary and necessary expenses. Donations which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business are allowable deductions from gross income. For example, a street railway corporation may donate a sum of money to an organization intending to hold a convention in the city in which it operates, with the reasonable expectation that the holding of such convention will augment its income through a greater number of people using the cars. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.

ART. 563. **Sale of capital stock, bonds, and capital assets.**—A corporation sustains no deductible loss from the sale of its capital stock. See article 543. If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. See article 545. Any loss sustained by a corporation upon the sale of its capital assets, computed as provided in sections 202–204, subject to the limitation provided in sec-

tion 234(a) (4) as to the purchase and sale of stock or securities is deductible.

ART. 564. **Interest.**—Interest paid by a corporation on scrip dividends is an allowable deduction. So-called interest on preferred stock, which is in reality a dividend thereon, can not be deducted in computing net income. 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.

ART. 565. **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 for some one else, pursuant to its agreement, a State tax or any tax other than a Federal tax may deduct such payment as interest paid on indebtedness.

ART. 566. **Tax on bank or other stock.**—Under the Revenue Act of 1924 banks or other corporations paying taxes assessed against their shareholders on account of their ownership of the shares of stock issued by such corporations without reimbursement from such shareholders may deduct the amount of taxes so paid. The statute specifically provides, however, that in such cases the shareholders may not deduct the amount of the taxes.

ART. 567. **Depositors' guaranty fund.**—Banking corporations, which pursuant to the laws of the States in which they are doing business are required to set apart, keep, and maintain in their banks the amount levied and assessed against them by the State authorities as a "Depositors' guaranty fund," may deduct from their gross income the amount so set apart each year to this fund, provided that such fund, when set aside and carried to the credit of the State banking board or duly authorized State officer, ceases to be an asset of the bank and may be withdrawn in whole or in part upon demand by such board or State officer to meet the needs of these officers in reimbursing depositors in insolvent banks, and provided further that no portion of the amount thus set aside and credited is returnable under the laws of the State to the assets of the banking corporation. If, however, such amount is simply set up on the books of the bank as a reserve to meet a contingent liability and remains an asset of the bank, it will not be deductible except as it is actually paid out as required by law and upon demand of the proper State officers.

Art. 568. Deductions allowed mutual insurance companies other than life insurance companies.—Mutual insurance companies (other than life 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. As to life insurance companies, see sections 242–245 and articles 661–687. Other insurance companies, except mutual and life companies, are entitled only to the deductions allowed by section 247. See article 693. Mutual insurance companies (other than life) are not entitled to the deductions allowed by section 247, but are entitled to the deductions allowed by section 234. See articles 569–572. "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.

Art. 569. Required addition to reserve funds of mutual insurance companies.—Mutual insurance companies, other than life 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. Reserve funds "required by law" include not only reserves required by express statutory provisions but also reserves required by the rules and regulations of State insurance departments when promulgated in the exercise of an appropriate power conferred by statute, but do not include assets required to be held for the ordinary running expenses of the business, such as taxes, salaries, reinsurance, and unpaid brokerage. 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. 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 "guarantee surplus" fund or similar fund.

Art. 570. Special deductions allowed mutual marine insurance companies.—Mutual marine insurance companies should include in gross

income the gross premiums collected and received by them less amounts paid for reinsurance. See section 233 of the statute and article 549. They may deduct from gross income amounts repaid to policyholders on account of premiums previously paid by them, together with the interest actually paid upon such amounts between the date of ascertainment and the date of payment thereof. The remainder of the premiums accordingly form part of the net income of the company, except to the extent that they are subject to the deductions allowed such insurance companies and other corporations.

ART. 571. **Special deductions allowed mutual insurance companies.**—Mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses, and reinsurance reserves. In determining the amount of premium deposits retained by a mutual fire or mutual casualty insurance company for the payment of losses, expenses, and reinsurance reserves, it will be presumed that losses and expenses have been paid out of earnings and profits other than premiums to the extent of such earnings and profits. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses, or reinsurance reserves, for which a separate allowance is taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to the payment of expenses, losses, or reinsurance reserves, then such payment can not be separately deducted. The amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.

ART. 572. **Deductions allowed foreign corporations.**—Foreign corporations and corporations entitled to the benefits of section 262, 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. The proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 217 and articles 326–331. As to foreign insurance companies, see sections 243 (2), 245(c), 246(a) (2), and 247(b).

ITEMS NOT DEDUCTIBLE BY CORPORATIONS

SEC. 235. In computing net income no deduction shall in any case be allowed in respect of any of the items specified in section 215.

ART. 581. **Items not deductible.**—No deduction from gross income may be made for any amounts paid out for new buildings or for permanent improvements or betterments made to increase the value of any property, or for any amounts expended in restoring property or in making good the exhaustion thereof for which an allowance for depreciation or depletion or other allowance is or has been made, or for any amounts paid for premiums on any life insurance policy covering the life of an officer or employee or of any person financially interested in the business of the corporation when the corporation is directly or indirectly a beneficiary under such policy. See section 215 of the statute and articles 291–294.

ART. 582. **Capital expenditures.**—Expenses of the organization of a corporation, such as incorporation fees, attorneys' and accountants' charges, are ordinarily capital expenditures, but where such expenditures are limited to purely incidental expenses, a taxpayer may charge such items against income in the year in which they are incurred. A holding company which guarantees dividends at a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and increasing the value of its stock holdings in the subsidiary may not deduct amounts paid in carrying out this guaranty in computing its net income, but such payments may be added to the cost of its stock in the subsidiary.

CREDITS ALLOWED CORPORATIONS

SEC. 236. For the purpose only of the tax imposed by section 230 there shall be allowed the following credits:

(a) The amount received as interest upon obligations of the United States which is included in gross income under section 233; and

(b) In the case of a domestic corporation the net income of which is $25,000 or less, a specific credit of $2,000; but if the net income is more than $25,000 the tax imposed by section 230 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000.

ART. 591. **Credits allowed.**—If the net income of a domestic corporation is $25,000 or less, it is allowed as a credit against such net income before the computation of the income tax the sum of $2,000,

plus the amount of interest upon obligations of the United States which is included in gross income under section 233. See also section 213(b) (4) and articles 77–82. Consequently, in the case of corporations no income tax is imposed on any interest received upon obligations of the United States. A foreign corporation is not entitled to the credit of $2,000. To lessen the inequality between the tax upon net income of $25,000 and upon net income slightly in excess of that amount, section 236(b) provides that the tax shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000. This provision affects only those cases in which the net income is between $25,000 and $25,250. See section 239(b) and article 625 for the manner of applying the $2,000 credit when a return is filed for a period of less than 12 months.

PAYMENT OF CORPORATION INCOME TAX AT SOURCE

SEC. 237. In the case of foreign corporations subject to taxation under this title not engaged in trade or business within the United States and not having any office or place of business therein, there shall be deducted and withheld at the source in the same manner and upon the same items of income as is provided in section 221 a tax equal to 12½ per centum thereof, and such tax shall be returned and paid in the same manner and subject to the same conditions as provided in that section: *Provided*, That in the case of interest described in subdivision (b) of that section the deduction and withholding shall be at the rate of 2 per centum.

ART. 601. **Withholding in the case of nonresident foreign corporations.**—With respect to payments to foreign corporations not engaged in trade or business within the United States and not having any office or place of business therein, withholding is required of a tax of 2 per cent in the case of interest payable upon corporate bonds or other obligations containing a tax-free covenant clause, and of a tax of 12½ per cent in the case of other fixed or determinable annual or periodical income except (1) corporate dividends other than dividends distributed by a corporation organized under the China Trade Act, 1922, and (2) interest on deposits with persons carrying on the banking business. See section 221 of the statute and articles 361–376. To enable debtors in the United States to distinguish between foreign corporations which have and those which have not any office or place of business in the United States, and also to enable such corporations as have an office or place of business in the United States to claim exemption from withholding the tax on bond interest or other income, a certificate, Form 1086, stating that any such corporation has an office or place of business in the United States should be filed by it with the debtor.

CREDIT FOR TAXES IN CASE OF CORPORATIONS

SEC. 238. (a) In the case of a domestic corporation the tax imposed by this title shall be credited with the amount of any income, war-profits, and excess-profits taxes paid or accrued during the same taxable year to any foreign country, or to any possession of the United States: *Provided*, That the amount of such credit shall in no case exceed the same proportion of the tax (computed on the basis of the taxpayer's net income without the deduction of any income, war-profits, or excess-profits taxes imposed by any foreign country or possession of the United States), against which such credit is taken, which the taxpayer's net income (computed without the deduction of any such income, war-profits, or excess-profits tax) from sources without the United States bears to its entire net income (computed without such deduction) for the same taxable year. In the case of domestic insurance companies subject to the tax imposed by section 243 or 246, the term "net income" as used in this subdivision means net income as defined in sections 245 and 246, respectively.

(b) If accrued taxes when paid differ from the amounts claimed as credits by the corporation, or if any tax paid is refunded in whole or in part, the corporation shall at once notify the Commissioner, who shall redetermine the amount of the taxes for the year or years affected, and the amount of taxes due upon such redetermination, if any, shall be paid by the corporation upon notice and demand by the collector, or the amount of taxes overpaid, if any, shall be credited, or refunded to the corporation in accordance with the provisions of section 281. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the corporation to give a bond with sureties satisfactory to and to be approved by him in such sum as he may require, conditioned upon the payment by the taxpayer of any amount of taxes found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(c) The credits provided for in subdivision (a) of this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping its books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subdivision (b) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken upon the same basis.

(d) These credits shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources without the United States, and all other information necessary for the verification and computation of such credit.

(e) For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234) in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: *Provided*, That the credit allowed to any domestic corporation under this subdivision shall in no case exceed the same proportion of the taxes

against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. The term "accumulated profits" when used in this subdivision in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings. In the case of a foreign corporation, the income, war-profits, and excess-profits taxes of which are determined on the basis of an accounting period of less than one year. the word "year" as used in this subdivision shall be construed to mean such accounting period.

(f) For the purposes of this section a corporation entitled to the benefits of section 262 or 263 shall be treated as a foreign corporation.

ART. 611. **Credit for foreign taxes.**—This credit includes income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States, but shall not exceed the same proportion of the tax (computed on the basis of the corporation's net income without the deduction of any income, war-profits, or excess-profits taxes imposed by any foreign country or possession of the United States) against which the credit is taken, which the corporation's net income (computed without the deduction of any such income, war-profits, or excess-profits tax) from sources without the United States bears to its entire net income (computed without such deduction) for the same taxable year. To secure such a credit a domestic corporation must pursue the same course as that prescribed for an individual by article 383, except that Form 1118 is to be used for claiming credit and Form 1119 for the bond, if a bond be required. For the redetermination of the tax, when a credit for such taxes has been rendered incorrect by later developments, see article 384, all of the provisions of which apply with equal force to a corporation taxpayer. For credit where taxes are paid by a foreign corporation controlled by a domestic corporation, see article 612. A claim for credit in such a case is also to be made on Form 1118. For the meaning of the terms used in section 238 of the statute see section 2 and article 382. See article 387 with reference to the option granted by section 238(c).

As to the meaning of net income in the case of domestic life insurance companies, see articles 671–686, and in the case of other domestic insurance companies (except mutual), see articles 691–693.

ART. 612. ***Domestic corporation owning a majority of the stock of foreign corporation.***—A domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives

dividends (not deductible under section 234) in any taxable year, shall be entitled to credit against the amount of its income tax, the same proportion of the sum of any income, war-profits, or excess-profits taxes paid or accrued by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such corporation from which such dividends were paid, which the amount of any such dividends received bears to the amount of such accumulated profits. But in no case shall such credit exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. 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.

For the purposes of section 238 a corporation entitled to the benefits of section 262 or 263 is treated as a foreign corporation.

CORPORATION RETURNS

SEC. 239. (a) Every corporation subject to taxation under this title shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

(b) Returns made under this section shall be subject to the provisions of section 226. In the case of a return made for a fractional part of a year, except a return made under subdivision (a) of section 226, the credit provided in subdivision (b) of section 236 shall be reduced to an amount which bears the same ratio to the full credit therein provided as the number of months in the period for which the return is made bears to twelve months.

(c) There shall be included in the return or appended thereto a statement of such facts as will enable the Commissioner to determine the portion of the earnings or profits of the corporation (including gains, profits and income not taxed) accumulated during the taxable year for which the return is made, which have been distributed or ordered to be distributed, respectively, to its shareholders during such year.

ART. 621. **Corporation returns.**—Every corporation not expressly exempt from tax must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations,

the return shall be on Form 1120. For returns of insurance companies see article 623; of foreign corporations see article 624; and of affiliated corporations see section 240 of the statute and article 632. A corporation having an existence during any portion of a taxable year is required to make a return. A corporation which has received a charter, but has never perfected its organization, which has transacted no business and had no income from any source, may upon presentation of the facts to the collector be relieved from the necessity of making a return so long as it remains in an unorganized condition. In the absence of a proper showing to the collector such a corporation will be required to make a return. A corporation which was dissolved in 1924 prior to the enactment of the present statute is not relieved from the necessity of rendering returns thereunder for such portion of 1924 as elapsed before its dissolution. Section 239 (c) requires every corporation to include in its return a statement of such facts as will enable the Commissioner to determine the portion of the earnings, including gains, profits, and income not taxed, accumulated during the taxable year which have been distributed or ordered to be distributed, respectively, to its shareholders during such year. See also articles 406 and 407.

ART. 622. **Returns by receivers.**—Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations on Form 1120, covering each year or part of a year during which they are in control. Notwithstanding that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income. See articles 424 and 548.

ART. 623. **Returns of insurance companies.**—Insurance companies transacting business in the United States or deriving any income from sources therein are required to file returns of income. The return shall be on Form 1120, except that life insurance companies shall make return on Form 1120 L. As an aid in auditing the returns, wherever possible a copy of the report to the State insurance department should be submitted with the return. Otherwise a copy of Schedule D, parts 1, 3, and 4, of the report should be attached to the return, showing the Federal, State, and municipal obligations from

which the interest omitted from gross income was derived, and a copy of the complete report should be furnished as soon as ready for filing.

ART. 624. **Returns of foreign corporations.**—Every foreign corporation and corporation satisfying the conditions set forth under section 262, having income from sources within the United States, must make a return of income on Form 1120. If such a corporation has no office or place of business here, but has a resident agent, he shall make the return. Although the foreign corporation is not engaged in business in this country and has no office, branch, or agency in the United States, it is required to make a return if it has received income from sources within the United States. See articles 404, 550, and 572.

ART. 625. **Returns for fractional part of year.**—If a corporation, with the approval of the Commissioner, changes its accounting period from calendar year to fiscal year, from fiscal year to calendar year, or from one fiscal year to another fiscal year, a separate return shall be made for a fractional part of a year and the net income on such return shall be placed on an annual basis as provided in section 226(c). See article 431. In all other cases the credit of $2,000 against net income allowed a domestic corporation having a net income not exceeding $25,000 shall be reduced to such proportion of the full credit as the number of months in the period for which the return is made bears to twelve months.

CONSOLIDATED RETURNS OF CORPORATIONS

SEC. 240. (a) Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

(b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit computed as provided in subdivision (b) of section 236.

(c) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 per centum of the voting stock of the other or others, or (2) if at least 95 per centum of the voting stock of two or more corporations is owned by the same interests. A corporation organized under the China Trade Act, 1922, shall not be deemed to be affiliated with any other corporation within the meaning of this section.

(d) In any case of two or more related trades or businesses (whether unincorporated or incorporated and whether organized in the United States or not) owned or controlled directly or indirectly by the same interests, the Commissioner may and at the request of the taxpayer shall, if necessary in order to make an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses, consolidate the accounts of such related trades or businesses.

(e) For the purposes of this section a corporation entitled to the benefits of section 262 shall be treated as a foreign corporation.

ART. 631. **Affiliated corporations.**—Consolidated returns are based upon the principle of levying the tax according to the true net income of a single 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 net income of the branch forms a part of the net income of the entire organization.

ART. 632. **Consolidated returns.**—Affiliated corporations as defined in section 240(c) and article 633, irrespective of the basis upon which returns were filed prior to 1924 under section 240(a) of the Revenue Act of 1921, may elect to make separate returns or file a consolidated return in which will be reported the consolidated net income of the affiliated group. If return is made upon either of these bases, all subsequent returns must be made upon the same basis except as permission to change may be granted by the Commissioner. In applying for permission to change from one basis to the other there should be submitted a statement in the form of an affidavit executed by a person or persons qualified to sign the returns (see section 239) setting forth completely the reasons for making the request.

The consolidated return shall be filed on Form 1120 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 for the first time shall include in such return a statement 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, the stock of which is owned or controlled by the same interests, a list of the individuals, partnerships, or corporations constituting such interests, with the percentage of the total outstanding stock of each affiliated corporation held by each of such individuals, partnerships, or corporations during all or any part 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. If there are substantial changes of ownership during the taxable year, the information required under (*b*) and (*c*) above should show the conditions existing immediately subsequent to such changes.

Foreign corporations and corporations entitled to the benefits of section 262, and corporations organized under the China Trade Act, 1922, may not file consolidated returns; but see article 637.

ART. 633. **When corporations are affiliated.**—Two or more domestic corporations will be deemed to be affiliated (*a*) if one corporation owns at least 95 per cent of the voting stock of the other or others, or (*b*) if at least 95 per cent of the voting stock of two or more corporations is owned by the same interests. A corporation organized under the China Trade Act, 1922, will not be deemed to be affiliated with any other corporation within the meaning of this article. The words "the same interests" shall be deemed to mean the same individual, partnership, or corporation, or the same individuals, partnerships, or corporations, but when the stock of two or more corporations is owned by two or more individuals, by two or more partnerships, or by two or more corporations, the corporations will not be held to be affiliated unless the percentage of stock of such corporations held by each individual, each partnership, or each corporation is substantially the same in each of the corporations.

ART. 634. **Change in ownership during taxable year.**—(*a*) Where corporations are affiliated at the beginning of a taxable year but due to a change in stock ownership or control during the year the affiliated status is terminated, or (*b*) where corporations are not affiliated at the beginning of the taxable year but through change of stock ownership during the year become affiliated, a full disclosure of the circumstances of such changes of stock ownership shall be submitted to the Commissioner. Ordinarily in such cases the parent or principal company, under the conditions described in (*a*) above, should exclude from its return the income of such subsidiary or subordinate company from the date of the change of stock ownership, and under the conditions described in (*b*) above, should include in its return the income of such subsidiary or subordinate company from the date of the change of stock ownership. In

either case the subsidiary or subordinate corporation whose status is changed during the taxable year should make a separate return for that part of the taxable year during which it was outside of the affiliated group.

Where, in accordance with the procedure set forth above, a return is made by a corporation for a period less than a year, the tax shall be computed in accordance with sections 226 and 239 and the articles thereunder. In any case in which the change of consolidated status is for a period so short as to be negligible, a consolidated return or separate returns for the entire period, as the case may be, may be filed; in such cases, however, there should accompany the return a complete statement setting forth the changes in the affiliated status occurring during the taxable year.

ART. 635. **Domestic corporation affiliated with foreign corporation.**—A domestic corporation which owns a majority of the stock of a foreign corporation or of a corporation entitled to the benefits of section 262 will not be permitted to include the net income of such corporation in a consolidated return; but see article 637 regarding related trades or businesses owned or controlled by the same interests, as comprehended by section 240(d). See subdivision (e) of section 238 and article 612 regarding credit for taxes on account of ownership of stocks of foreign corporations and of corporations entitled to the benefits of section 262.

ART. 636. **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 (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. Only one specific credit of $2,000, as provided in section 236(b) and article 591, shall be allowed the consolidated group, and this only in case the net income of the group does not exceed $25,000; but if such net income is more than $25,000, the tax imposed by section 230 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000. 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. 637. Consolidated accounts of related trades owned by same interests.—Subdivision (d) of section 240 provides that in any case of two or more related trades or businesses (whether incorporated or not, and whether organized in the United States or not), owned or controlled directly or indirectly by the same interests, the Commissioner may, and at the request of the taxpayer shall, consolidate the accounts of such related trades or businesses, if necessary in order to make an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses. This provision relates not to the *payment* of taxes, but to the determination of the true income of related trades or businesses and thus indirectly to the *amount* of taxes which may be due under Title II of the statute.

Art. 638. Different fiscal years of affiliated corporations.—In the case of all consolidated returns the consolidated net income must be computed on the basis of the taxable year of the parent or principal reporting corporation. 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 corporation. See section 226 of the statute and article 431.

TIME AND PLACE FOR FILING CORPORATE RETURNS

Sec. 241. (a) Returns of corporations shall be made at the same time as is provided in subdivision (a) of section 227, except that in the case of foreign corporations not having any office or place of business in the United States returns shall be made at the same time as provided in section 227 in the case of a nonresident alien individual.

(b) Returns shall be made to the collector of the district in which is located the principal place of business or principal office or agency of the corporation, or, if it has no principal place of business or principal office or agency in the United States, then to the collector at Baltimore, Maryland.

Art. 651. Time and place for filing returns.—Returns of income must be made on or before the fifteenth day of the third month following the close of the fiscal or calendar year, as provided in section 227 of the statute and articles 441–446. In the case of foreign corporations not having any office or place of business in the United States, however, returns shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then, on or before June 15. A corporation going into liquidation during any taxable year may upon the completion of such liquidation prepare a return covering its income for the fractional part of the year during which

it was engaged in business and may immediately file such return with the collector. A corporation having an office or agency in the United States must make its return to the collector of the district in which is located its principal office or agency. Other corporations must make their returns to the collector at Baltimore.

TAXES ON INSURANCE COMPANIES

SEC. 242. When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

SEC. 243. In lieu of the taxes imposed by sections 230 and 700, there shall be levied, collected, and paid for each taxable year upon the net income of every life insurance company a tax as follows:

(1) In the case of a domestic life insurance company, the same percentage of its net income as is imposed upon other corporations by section 230;

(2) In the case of a foreign life insurance company, the same percentage of its net income from sources within the United States as is imposed upon the net income of other corporations by section 230.

ART. 661. **Life insurance companies.**—Life insurance companies, as defined in section 242, are subject to the tax imposed by section 243, in lieu of the taxes imposed by sections 230 and 700 of the statute. The rate for 1924 and for subsequent years is 12½ per cent, as in the case of other corporations, but the net income upon which the tax is imposed differs from the net income of other corporations. Insurance companies are entitled to the benefit of section 206 (net losses) but not of section 208 (capital gains and losses). All provisions of the statute and of these regulations not inconsistent with the specific provisions of sections 242 to 245, inclusive, are applicable to the assessment and collection of this tax, and life insurance companies are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. In determining whether an insurance company is a "life insurance company" as defined in section 242, no reserve shall be regarded as held for the fulfillment of life insurance and annuity contracts unless the company is entitled to a deduction from gross income on account thereof under the provisions of section 245(a) (2) and article 681. As to foreign companies see section 245(c) and article 687.

SEC. 244. (a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

(b) The term "reserve funds required by law" includes, in the case of assessment insurance, sums actually deposited by any company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorpora-

tion of the company or association exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

Art. 671. **Gross income of life insurance companies.**—Net income in the case of life insurance companies is gross income from interest, dividends, and rents less the deductions allowed by section 245. Gross income comprises items 25–34, inclusive, of the income page of the annual statement for life companies (edition of 1920) adopted by the National Convention of Insurance Commissioners and items 23–30, inclusive, of the income page of the annual statement for miscellaneous stock companies if any other branches of the insurance business are conducted by the company; except that the rental value of the space occupied by the company in its own building or buildings if included in gross income shall be determined according to the provisions of section 245(b) and article 686. As to "reserve funds required by law," see article 681.

Sec. 245. (a) In the case of a life insurance company the term "net income" means the gross income less—

(1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title;

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

(3) The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262, and other than a corporation organized under the China Trade Act, 1922, or (B) from any foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the foreign corporation has been in existence) was derived from sources within the United States as determined under section 217;

(4) An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than five years from the date of the policy contract;

(5) Investment expenses paid during the taxable year: *Provided*, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes

assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder of a company upon his interest as shareholder, which are paid by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes;

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence;

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title; and

(9) In the case of a domestic life insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $2,000; but if the net income is more than $25,000 the tax imposed by section 243 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000.

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

(c) In the case of a foreign life insurance company the amount of its net income for any taxable year from sources within the United States shall be the same proportion of its net income for the taxable year from sources within and without the United States, which the reserve funds required by law and held by it at the end of the taxable year upon business transacted within the United States is of the reserve funds held by it at the end of the taxable year upon all business transacted.

Art. 681. **Reserve funds.**—Under paragraphs (1) and (2) of section 245(a), life insurance companies are entitled to deduct from gross income: (1) Interest which is exempted in the case of other taxpayers by section 213(b)(4) and articles 74–82; and (2) the excess, if any, of the reserve deduction specified in section 245(a)(2) over the amount of such interest. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance. In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan,

continuing for life and not subject to cancellation, it is required that reserves thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. Reserves "maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage" (Maryland Casualty Co. *v.* United States, 251 U. S., 342), will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7, 8, 9, 10, and 11 of the liability page of the annual statement for life companies, and items 16, 17, 18, 19, and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance, will be considered.

ART. 682. **Reserve for deferred dividends.**—The deduction for deferred dividends under section 245(a) (4) will be based upon item 37 of the liability page of the annual statement for life companies but shall not include any dividend payable during the year immediately following the taxable year.

ART. 683. **Investment expenses.**—If any general expenses are in part assigned to or included in the investment expenses, the total investment expenses (other than taxes and expenses with respect to real estate) allowable as a deduction shall not exceed one-quarter of 1 per cent of the mean of the book value of the invested assets held at the beginning and end of the taxable year. If there be no allocation of general expenses to investment expenses the deduction may consist of investment expenses actually paid during the taxable year, in which case an itemized schedule of such expenses must be appended to the return. The invested assets are items 1–6, inclusive, item 9, and items 10 and 11 (if interest-bearing assets) of the asset page of the annual statement for life companies, and items 1–4, inclusive, item 7, and items 27–30, inclusive (if interest-bearing assets), of the asset page of the annual statement for miscellaneous stock companies.

If the method used by any company in ascertaining the investment expenses where there is any allocation of general expenses shall be changed so that a greater deduction is claimed, the company shall file with its return; information sufficient to enable the Commissioner to determine the validity of the claim. The maximum allowance of one-quarter of 1 per cent will not be granted unless it is shown to the satisfaction of the Commissioner that such allowance is justified.

ART. 684. **Taxes and expenses with respect to real estate.**—This deduction comprises items 31 and 32 of the disbursement page of the annual statement for life companies and items 34 and 35 of the disbursement page of the annual statement for miscellaneous stock companies, except as noted below, and any sum included in any other item representing taxes imposed upon the individual shareholders' interest in the real estate of the corporation which is paid by the corporation without reimbursement from the individual shareholder. In the latter case the amount allowable as a deduction (subject to the provisions of art. 686) shall be that proportion of the total tax imposed upon the individual shareholders' interest in the corporation which the book value of the real estate owned by the corporation at the end of the taxable year is of the book value of all the corporation's ledger assets, and so much thereof as represents the tax upon real estate occupied in whole or in part by the company must be included in the calculation referred to in article 686. The amount so included shall be that proportion of the total amount allowable as a deduction which the book value of the real estate owned and occupied in whole or in part is of the book value of all the real estate owned. Full details must accompany the return. Any other taxes and expenses (and depreciation) upon any real estate owned and occupied in whole or in part by the company must also be included in the calculation referred to in article 686. Taxes shall not include assessments against local benefits of a kind tending to increase the value of the property assessed and expenses shall not include any amount paid out for buildings or for permanent improvements and betterments made to increase the value of any property.

ART. 685. **Other deductions.**—(1) The deduction allowed by section 245(a) (3) for dividends received from other corporations is identical with the deduction allowed other corporations by section 234(a) (6). See article 561.

(2) The deduction allowed by section 245(a) (7) for depreciation is identical with that allowed other corporations by section 234(a) (7). See articles 561 and 161–171.

(3) The deduction allowed by section 245(a) (8) for interest on indebtedness is the same as that allowed corporations by section 234(a) (2) (see arts. 561 and 121), but this deduction includes

item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.

(4) The deduction of $2,000 allowed domestic life insurance companies with net income of $25,000 or less by section 245(a) (9) is identical with the specific credit allowed other corporations by section 236(b) and there is the same equalizing provision in the case of incomes slightly in excess of $25,000. See article 591.

Art. 686. **Home office properties.**—No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and other expenses) at the rate of 4 per cent per annum of the book value at the end of the taxable year of the real estate so owned and occupied. For example, if the book value of a parcel of real estate owned and occupied in whole or in part by the company is $1,000,000, the rents received from other tenants $30,000, taxes and expenses $40,000, and depreciation $20,000, the company would have to include in its gross income a sum not less than $70,000 ($40,000 taxes and expenses, plus $20,000 depreciation, minus $30,000 rents from tenants, plus 4 per cent of $1,000,000) as the rental value of the space occupied by it in order to avail itself of the deductions of $40,000 and $20,000. In any case the rents received from other tenants must be included in gross income.

Art. 687. **Foreign companies.**—Foreign life insurance companies holding reserve funds upon business transacted within the United States are taxed under section 243 upon their net income from sources within the United States. All business transacted by a United States branch or agency of a foreign insurance company, for which a reserve fund is required by the laws of any State or Territory of the United States or of the District of Columbia, will be regarded as business transacted within the United States. A foreign life-insurance company not doing an insurance business within the United States and holding no reserve funds upon business transacted within the United States, but which derives income from sources within the United States as defined in section 217 (see arts. 317–331) is subject to the tax imposed by section 230 upon income derived from sources within the United States. See articles 501

and 550. As to taxation of life insurance companies between United States and Porto Rico and Philippine Islands, see article 1133.

SEC. 246. (a) In lieu of the taxes imposed by sections 230 and 700, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company the same percentage of its net income as is imposed upon other corporations by section 230;

(2) In the case of such a foreign insurance company the same percentage of its net income from sources within the United States as is imposed upon the net income of other corporations by section 230.

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

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

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

(3) The term "investment income" means the gross amount of income earned during the taxable year from interest, dividends and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

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

(5) The term "premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

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

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

(7) The term "expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as

defined in this paragraph all expenses incurred which are not allowed as deductions by section 247.

SEC. 247. (a) In computing the net income of an insurance company subject to the tax imposed by section 246 there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in paragraph (1) of subdivision (a) of section 234;

(2) All interest as provided in paragraph (2) of subdivision (a) of section 234;

(3) Taxes as provided in paragraph (3) of subdivision (a) of section 234;

(4) Losses incurred;

(5) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(6) The amount received as dividends from corporations as provided in paragraph (6) of subdivision (a) of section 234;

(7) The amount of interest earned during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title, and the amount of interest allowed as a credit under section 236;

(8) A reasonable allowance for the exhaustion, wear and tear of property, as provided in paragraph (7) of subdivision (a) of section 234;

(9) In the case of such a domestic insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $2,000; but if the net income is more than $25,000 the tax imposed by section 246 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000.

(b) In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in subdivision (b) of section 234.

(c) Nothing in this section or in section 246 shall be construed to permit the same item to be twice deducted.

ART. 691. **Tax on insurance companies.**—For the calendar year 1924 and subsequent years all insurance companies (other than life and mutual companies) are subject to the tax imposed by section 246. Mutual insurance companies (other than life) remain subject to the tax imposed by section 230. In articles 691–693 the term "insurance companies" means only those companies subject to the tax imposed by section 246. The rate of the tax imposed by section 246 is the same as the rate imposed by section 230 (12½ per cent), but the net income upon which the tax is imposed, as defined in sections 246 and 247, differs from the net income of other corporations. Insurance companies are entitled to the benefit of section 206 (net losses) but not of section 208 (capital gains and losses). All provisions of the statute and of these regulations not inconsistent with the specific provisions of sections 246 and 247 are applicable to the assessment and collection of this tax, and insurance companies are subject to the same penalties as provided in the case of returns and payment of income tax by other corporations. Since section 246 provides that the underwriting and investment exhibit of the annual statement approved by the National Convention of

Insurance Commissioners shall be the basis for computing gross income and since the annual statement is rendered on the calendar year basis, the first returns under section 246 will be for the taxable year ending December 31, 1924, and will be made on or before March 15, 1925.

ART. 692. **Gross income of insurance companies.**—Net income is gross income as defined in section 246 less the deductions allowed in section 247. Gross income is the combined gross amount earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners. Gross income does not include gain derived from sale or disposition of capital assets, nor are losses sustained from such sale or disposition allowable deductions. It does not include increase in liabilities during the year on account of reinsurance treaties; remittances from home office of a foreign insurance company to United States branch; borrowed money; gross profit on maturity of capital assets; gross increase due to adjustments in book value of capital assets and premium on capital stock sold. The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the statute will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the statute. By reason of the definition of investment income, profit or loss on investment items is ignored, as well as those miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as dividends declared, home office remittances and receipts, and special deposits. Gain or loss from agency balances and bills receivable not admitted as assets on the underwriting and investment exhibit will be ignored, excepting only such agency balances and bills receivable as have been charged off the books of the company as bad debts, or having been previously charged off are recovered during the taxable year.

ART. 693. **Deductions allowed insurance companies.**—Insurance companies are entitled to the deductions specified in section 247. The deduction of $2,000 allowed domestic companies with net income not exceeding $25,000 is identical with the specific credit allowed other corporations by section 236 (b) and there is the same equalizing provision in the case of incomes slightly in excess of $25,000. See article 591. A domestic insurance company is also entitled to the credit for income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States which is allowed other domestic corporations by section 238. See article 611. Among the items which may

not be deducted are income taxes, paid or accrued, imposed by the United States and so much of the income and profits taxes imposed by any foreign country or possession of the United States as is allowed as a credit under section 238; taxes assessed against local benefits; donations; decrease during the year due to adjustments in book value of capital assets; decrease in liabilities during the year on account of reinsurance treaties; dividends paid to stockholders; remittances to home office of a foreign insurance company by United States branch; and borrowed money repaid.

PART III

ADMINISTRATIVE PROVISIONS

RETURNS OF PAYMENTS OF DIVIDENDS

SEC. 254. Every corporation subject to the tax imposed by this title shall, when required by the Commissioner, render a correct return, duly verified under oath, of its payments of dividends, stating the name and address of each shareholder, the number of shares owned by him, and the amount of dividends paid to him.

ART. 1060. **Return of information as to payments of dividends.**—When directed by the Commissioner, either specially or by general regulation, every domestic or resident foreign corporation shall render a return on Form 1097 of its payments of dividends and distributions to shareholders for such period as may be specified, stating the name and address of each shareholder, 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.

Dividends on the stock of domestic corporations or resident foreign corporations are prima facie the income of the record owner of the stock. The record owner will be liable for any tax based thereon, unless a disclosure to the Commissioner of the actual ownership is made on Form 1087. Returns of information (Form 1097) and ownership certificates (Form 1087) should be forwarded to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C.

RETURNS OF BROKERS

SEC. 255. Every person doing business as a broker shall, when required by the Commissioner, render a correct return duly verified under oath, under such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe, showing the names of customers for whom such person has transacted any business, with such details as to the profits, losses, or other information which the Commissioner may require, as to each of such customers, as will enable the Commissioner to determine whether all income tax due on profits or gains of such customers has been paid.

ART. 1065. **Return of information by brokers.**—When directed by the Commissioner, either specially or by general regulation, every person doing business as a broker shall render a return on Form 1100, showing the names and addresses of customers to whom payments were made or for whom business was transacted during the calendar year or other specified period next preceding, and giving the other information called for by the form.

INFORMATION AT SOURCE

SEC. 256. All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, and employers, making payment to another person, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in sections 254 and 255), of $1,000 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him with the approval of the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Such returns may be required, regardless of amounts, (1) in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations, and (2) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by persons undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the person paying the income.

The provisions of this section shall not apply to the payment of interest on obligations of the United States.

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 any calendar year must render a return thereof to the Commissioner for such year on or before March 15 of the following year, except as specified in articles 1073, 1074, 1075, 1076, and 1079. The return shall be made in each case on Form 1099, accompanied by a letter of transmittal on Form 1096 showing the number of returns filed. The street and number where the recipient of the payment lives 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. See article 362.

ART. 1072. **Return of information as to payments to employees.**—The names of all employees to whom payments of $1,000 or over 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 ade-

quate records, the return should be filed by the main office. In case an employer has a large number of employees and the computation of exact amounts paid during the calendar year will result in an undue hardship, careful estimates may be made on the basis of any representative month, and unless the yearly payment based on this estimate in the case of any employee amounts to $1,000 or more, no return of payments to such employee is required.

ART. 1073. **Cases where no return of information required.**—Payments of the following character, although over $1,000, need not be reported in returns of information on Form 1099: (*a*) Payments of interest on obligations of the United States; (*b*) payments by a broker to his customers; (*c*) payments of any type made to corporations; (*d*) bills paid for merchandise, telegrams, telephone, freight, storage, professional services, and similar charges; (*e*) payments of rent made to real estate agents (but the agent must report payments to the landlord if they amount to $1,000 or more annually); (*f*) payments made by branches of business houses located in foreign countries to alien employees serving in foreign countries; and (*g*) payments made by the United States Government to sailors and soldiers and to its civilian employees.

ART. 1074. **Return of information as to interest on corporate bonds.**—In the case of payments of interest, regardless of amount, upon bonds and similar obligations of domestic or resident foreign corporations, the original ownership certificates, when duly filed, shall constitute and be treated as returns of information. If a bondholder files no ownership certificate in the case of payments of interest on registered bonds, if such bonds contain a tax-free covenant clause, or if such bonds are owned by a nonresident alien (individual or fiduciary), a partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, or a foreign corporation not engaged in trade or business within the United States and having no office or place of business therein, the withholding agent shall make out such a certificate in each instance and file it with the monthly return. See sections 221 and 237 of the statute and articles 361–376 and 601.

ART. 1075. **Return of information as to payments to nonresident aliens.**—In the case of payments of fixed or determinable annual or periodical income to nonresident aliens (individual or fiduciary), to partnerships not engaged in trade or business within the United States and not having any office or place of business therein, and composed in whole or in part of nonresident aliens, or to foreign corporations not engaged in trade or business within the United States and not having any office or place of business therein, the returns

filed by withholding agents on Form 1042 shall constitute and be treated as returns of information. See sections 221 and 237 of the statute and articles 361–376 and 601.

ART. 1076. **Foreign items.**—The term " foreign item," as here used, means any dividend upon the stock of a nonresident foreign corporation or any item of interest upon the bonds of foreign countries or nonresident foreign corporations, whether or not such dividend or interest is paid in the United States or by check drawn on a domestic bank. (*a*) Wherever a foreign country or nonresident foreign corporation issuing bonds has appointed a paying agent in this country, charged with the duty of paying the interest upon such bonds, such paying agent shall be the source of information. If such foreign country or foreign corporation has no such agent, then the last bank or collecting agent in this country shall be the source of information. (*b*) In the case of dividends on the stock of a nonresident foreign corporation, however, the first bank or collecting agent accepting such item for collection shall be the source of information. No return of information is required with respect to foreign items unless the amount thereof is $1,000 or more in any taxable year except as otherwise provided in articles 1077 and 1078, and then only if the owner of the item is a citizen or resident of the United States (individual or fiduciary) or a resident partnership. No return of information is required with respect to foreign items owned by a nonresident alien (individual or fiduciary), a partnership not engaged in trade or business within the United States and having no office or place of business therein and composed in whole or in part of nonresident aliens, or a foreign corporation not engaged in trade or business within the United States and having no office or place of business therein, provided the first bank or collecting agent is satisfied as to such ownership. In the latter case the foreign item may be stamped " foreign owner."

ART. 1077. **Ownership certificates for foreign items.**—When bonds of foreign countries or of nonresident foreign corporations contain a tax-free covenant clause and are owned by citizens or residents of the United States, the foreign country or nonresident foreign corporation having a fiscal or paying agent in the United States, such agent is required to withhold a tax of 2 per cent from the interest on such bonds. Ownership certificate, Form 1000, modified to show the name and address of the fiscal agent or the paying agent, should be used unless the owner (if so entitled) desires to claim exemption, in which case Form 1001 should be filed. See article 361.

ART. 1078. **Foreign items presented for collection unaccompanied by ownership certificates.**—If the foreign item is an interest coupon detached from bonds containing a tax-free covenant clause, issued by

a foreign country or corporation having a paying agent in the United States, a statement and ownership certificate, Form 1000, shall be furnished as provided in article 369.

ART. 1079. **Return of information as to foreign items.**—In the case of collections of foreign items, the original ownership certificates (Form 1000 or 1001) when required and duly filed shall constitute and be treated as returns of information. The use of substitute certificates is not permitted in the collection of foreign items. (*a*) Where ownership certificate Form 1000 is used, a monthly return shall be made on Form 1012 and an annual return on Form 1013 as provided in article 371. Forms 1012 and 1013, when so used, should be modified to show the name and address of the paying agent. (*b*) In the case of interest items on bonds containing a tax-free covenant clause as to which the paying agent in this country is the source of information, if Form 1001 is filed it shall accompany the coupon to such agent or source of information, who shall forward the ownership certificate to the Commissioner accompanied by a monthly return on Form 1096 A. An annual return on Form 1096 B shall be forwarded to the Commissioner not later than March 15 of each year, on which shall be given a summary of the monthly returns. (*c*) In the case of dividends on the stock of a nonresident foreign corporation or interest on bonds of a nonresident foreign corporation paid to citizens or residents of the United States, or resident partnerships, except as provided in (*a*) and (*b*), a return of information on Form 1099 shall be required if the amount thereof is $1,000 or more in any taxable year. Such forms accompanied by Form 1096 should be forwarded to the Commissioner on or before March 15 of each year. See article 1071.

ART. 1080. **Information as to actual owner.**—When the person receiving a payment falling within the provisions of the statute for information at the source is not the actual owner of the income received, the name and address of the actual owner shall be furnished upon demand of the individual, corporation or partnership paying the income, and in default of a compliance with such demand the payee becomes liable to the penalties provided. See section 1017 of the statute.

RETURNS TO BE PUBLIC RECORDS

SEC. 257. (a) Returns upon which the tax has been determined by the Commissioner shall constitute public records; but they shall be open to inspection only upon order of the President and under rules and regulations prescribed by the Secretary and approved by the President: *Provided*, That the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, or a special committee of the Senate or House, shall have the right to call on the Secretary of the Treasury for, and it shall be his

duty to furnish, any data of any character contained in or shown by the returns or any of them, that may be required by the committee; and any such committee shall have the right, acting directly as a committee, or by and through such examiners or agents as it may designate or appoint, to inspect all or any of the returns at such times and in such manner as it may determine; and any relevant or useful information thus obtained may be submitted by the committee obtaining it to the Senate or the House, or to both the Senate and House, as the case may be: *Provided further*, That the proper officers of any State may, upon the request of the governor thereof, have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the Secretary may prescribe: *Provided further*, That all bona fide shareholders of record owning 1 per centum or more of the outstanding stock of any corporation shall, upon making request of the Commissioner, be allowed to examine the annual income returns of such corporation and of its subsidiaries. Any shareholder who pursuant to the provisions of this section is allowed to examine the return of any corporation, and who makes known in any manner whatever not provided by law the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any such return, shall be guilty of a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both.

(b) The Commissioner shall as soon as practicable in each year cause to be prepared and made available to public inspection in such manner as he may determine, in the office of the collector in each internal-revenue district and in such other places as he may determine, lists containing the name and the post-office address of each person making an income-tax return in such district, together with the amount of the income tax paid by such person.

ART. 1090. **Inspection of returns.**—The returns upon which the tax has been determined by the Commissioner, although public records, are open to inspection only to the extent authorized by the President, except as otherwise expressly provided. The President, by an executive order dated September 27, 1924, directed that returns of income should be subject to inspection in accordance with the following regulations prescribed by the Secretary of the Treasury:

1. These regulations deal only with inspection of returns in so far as the statutes expressly require the approval of the President of regulations on this subject. Other uses to which returns may be lawfully put, without action by the President, are not covered by these regulations.

2. The word "corporation" when used alone herein shall, unless otherwise indicated, include corporations, associations, joint-stock companies, and insurance companies. The word "return" when so used shall, unless otherwise indicated, include income and profits tax returns, and also special excise tax returns of corporations filed pursuant to section 1000, Title X, of each of the Revenue Acts of 1918 and 1921, and pursuant to section 700 of Title VII of the Revenue Act of 1924.

3. Written statements filed with the Commissioner of Internal Revenue designed to be supplemental to and to become a part of tax returns shall be subject to the same rules and regulations as to inspection as are the tax returns themselves.

4. Except as hereinafter specifically provided, the Commissioner of Internal Revenue may, in his discretion, upon written application set-

ting forth fully the reasons for the request, grant permission for the inspection of returns in accordance with these regulations. The officers and employees of the Treasury Department whose official duties require inspection of returns, and the Solicitor of Internal Revenue, may inspect any such returns, without making such written application.

5. The return of an individual shall be open to inspection (*a*) by the person who made the return, or by his duly constituted attorney in fact; (*b*) if the maker of the return has died, by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; and (*c*) in the discretion of the Commissioner of Internal Revenue, by any heir at law or next of kin of such deceased person, upon a showing that such heir at law or next of kin has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law or next of kin.

6. A joint return of a husband and wife shall be open to inspection (*a*) by either spouse for whom the return was made, upon satisfactory evidence of such relationship being furnished, or by his or her duly constituted attorney in fact; (*b*) if either spouse has died, by the administrator, executor, or trustee of his or her estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; and (*c*) in the discretion of the Commissioner of Internal Revenue, by any heir at law or next of kin of such deceased spouse, upon a showing that such heir at law or next of kin has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law or next of kin.

7. The return of a partnership shall be open to inspection (*a*) by any individual who was a member of such partnership during any part of the time covered by the return, upon satisfactory evidence of such fact being furnished, or by his duly constituted attorney in fact; (*b*) if a member of such partnership during any part of the time covered by the return has died, by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; and (*c*) in the discretion of the Commissioner of Internal Revenue, by any heir at law or next of kin of such deceased person, upon a showing that such heir at law or next of kin has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law or next of kin.

8. The return of an estate shall be open to inspection (*a*) by the administrator, executor, or trustee of such estate, or by his duly constituted attorney in fact; and (*b*) in the discretion of the Commissioner of Internal Revenue by any heir at law or next of kin of the deceased person whose estate is being administered, upon a showing of a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law or next of kin.

9. The return of a trust shall be open to inspection (*a*) by the trustee or trustees, or the duly constituted attorney in fact of such trustee or trustees; (*b*) by any individual who was a beneficiary under such trust during any part of the time covered by the return, upon satisfactory evidence of such fact being furnished, or by his duly constituted attorney in fact; (*c*) if any individual who was a beneficiary of such trust during any part of the time covered by the return had died,

by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; and (*d*) in the discretion of the Commissioner of Internal Revenue by any heir at law or next of kin of such deceased person upon a showing that such heir at law or next of kin has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law or next of kin.

10. The return of a corporation shall be open to inspection by the president, vice president, secretary, or treasurer of such corporation, or, if none, by any of its principal officers, upon satisfactory evidence of identity and official position.

11. When the head of an executive department (other than the Treasury Department) or any other United States Government establishment desires to inspect or to have some other officer or employee of his branch of the service inspect a return in connection with some matter officially before him, the inspection may, in the discretion of the Secretary of the Treasury, be permitted upon written application to him by the head of such executive department or other Government establishment. The application must be signed by such head and must show in detail why the inspection is desired, the name and address of the taxpayer who made the return, and the name and official designation of the one it is desired shall inspect the return. When the head of a bureau or office in the Treasury Department, not a part of the Internal Revenue Bureau, desires to inspect a return in connection with some matter officially before him, other than an income, profits tax, or corporation excise tax matter, the inspection may, in the discretion of the Secretary, be permitted upon written application to him by the head of such bureau or office, showing in detail why the inspection is desired.

12. In the case of returns or copies thereof furnished by the Department for use in legal proceedings, only such inspection as necessarily results from such use is permitted.

13. Except as provided in paragraph 12 returns may be inspected only in the Office of the Commissioner of Internal Revenue, Washington, D. C.

14. A person who under these regulations is permitted to inspect a return may make and take a copy thereof or a memorandum of data contained therein.

15. By section 3167, Revised Statutes, as amended by the Revenue Act of 1918, and reenacted without change in section 1311 of the Revenue Act of 1921 and in section 1018 of the Revenue Act of 1924, it is made a misdemeanor for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof or source of income, profits, losses, or expenditures, appearing in any income return, which misdemeanor is punishable by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court, and if the offender be an officer or employee of the United States, by dismissal from office or discharge from employment.

16. All former regulations issued with the approval of the President in respect of inspection of returns are hereby withdrawn.

17. These regulations shall remain in force until expressly withdrawn or overruled.

ART. 1091. **Furnishing of copies of income returns.**—1. The original income return of an individual, partnership, corporation, association, joint-stock company, insurance company, or fiduciary, or a copy thereof, may be furnished by the Commissioner of Internal Revenue to a United States attorney for use as evidence before a United States grand jury or in litigation in any court, where the United States is interested in the result, or for use in the preparation for such litigation, or to an attorney connected with the Department of Justice designated to handle such matters, upon written request of the Attorney General, the Assistant to the Attorney General, or an Assistant Attorney General. When an income return or copy thereof is thus furnished, it must be limited in use to the purpose for which it is furnished and is under no conditions to be made public except where publicity necessarily results from such use. In case the original return is necessary, it shall be placed in evidence by the Commissioner of Internal Revenue or by some other officer or employee of the Internal Revenue Bureau designated by the Commissioner for that purpose, and after it has been placed in evidence it shall be returned to the files in the office of the Commissioner in Washington. An original return will be furnished only in exceptional cases, and then only when it is made to appear that the ends of justice may otherwise be defeated. Neither the original nor a copy of an income return desired for use in litigation in court will be furnished, where the United States Government is not interested in the result, and where such use might result in making public the information contained therein. This provision is not a limitation on the use of copies of returns by the persons entitled to such copies under the provisions of the succeeding paragraph.

2. A copy of an income return may be furnished by the Commissioner of Internal Revenue to the person who made the return or to his duly constituted attorney, or if the person is deceased, to his executor or administrator; or if the person is in the hands of a receiver, trustee in bankruptcy, guardian, or similar legal custodian, to the receiver, trustee, or other similar custodian upon written application for same, accompanied by satisfactory evidence that the applicant comes within this provision. "The person who made the return," as herein used, refers in the case of an individual return to the individual whose return is desired, and in the case of a return of a corporation, association, joint-stock company, insurance company, or fiduciary, to the corporation, association, joint-stock company, insurance company, or fiduciary, a copy of whose return is desired. A corporation may also designate by proper action of its board of directors the officer or individual to whom a copy of a return made by the corporation may be furnished, and upon sufficient evidence of

such action and of the identity of the officer or individual, a copy may be furnished to such person. A copy of a partnership income return will be furnished to any individual (or his duly constituted attorney in fact or legal representative) who was a member of such partnership during any part of the time covered by the return, upon satisfactory evidence of such fact being furnished.

ART. 1092. **Inspection of returns by committees of Congress.**—The Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, or a special committee of the Senate or the House is entitled, either acting directly as a committee, or by and through such examiners and agents as it may designate or appoint, to examine the annual income returns of any taxpayer, and any return of a corporation filed for the purpose of the tax imposed by section 1000, Title X, of the Revenue Acts of 1918 and 1921, or by section 700, Title VII, of the Revenue Act of 1924, at such times and in such manner as may be determined by any such committee. The Secretary of the Treasury is required to furnish any data of any character contained in or shown by any such returns that may be required by such committee. The committee may also submit to the Senate or the House or to both the Senate and the House any relevant or useful information obtained from such returns.

ART. 1093. **Inspection of returns by State officers.**—1. The proper officers of a State are entitled as of right upon the request of its governor to have access to the income and profits tax returns of a corporation, association, joint-stock company, or insurance company, or to an abstract thereof, showing its name and income.

2. The request or application of the governor must be in writing, signed by him under the seal of his State, and must show:

(*a*) The name and address of the corporation, association, joint-stock company, or insurance company making the returns to which access is desired.

(*b*) Why access is desired.

(*c*) The names and official positions of the officers designated to have the access.

3. The request or application of the governor may be addressed either to the Secretary of the Treasury or to the Commissioner of Internal Revenue, but should be transmitted to the Commissioner, who will set a convenient time for the access to the returns (or to an abstract thereof as he may determine).

4. Access shall be given only in the office of the Commissioner of Internal Revenue in Washington.

5. The officers designated by the governor will not be permitted to name another person or persons to examine the returns (or abstracts) for them.

6. The officers designated will be given access only to the returns of those corporations, associations, joint-stock companies, or insurance companies organized or doing business in their State.

7. The officers designated may have access to lists furnished to supplement and become a part of the returns to which they are given access.

8. The proper officers of a State may have access to the capital stock tax returns filed under the provisions of section 700 of the Revenue Act of 1924 and section 1000 of the Revenue Acts of 1918 and 1921 under the same conditions prescribed in the preceding paragraph for access to the income and profits tax returns of corporations, associations, joint-stock companies, and insurance companies.

ART. 1094. **Inspection of returns by shareholder.**—A bona fide shareholder of record owning 1 per cent or more of the outstanding stock of a corporation shall be entitled as of right, upon making request of the Commissioner of Internal Revenue, to examine the annual income returns of such corporation and of its subsidiaries, and all returns of such corporations and subsidiaries filed for purposes of the tax imposed by section 1000 of the Revenue Acts of 1918 and 1921, or by section 700 of the Revenue Act of 1924. His request for permission to examine such returns must be made in writing, and must be in the form of an affidavit showing his address, the name of the corporation, the period of time covered by the return he desires to inspect, the amount of the corporation's outstanding capital stock, the number of shares owned by him, the date when he acquired them, and whether he has the beneficial as well as the record title to such shares. It must also show that he has not acquired his shares for the purpose of the examination of the income returns of the corporation. If he has acquired them for this purpose he is not a bona fide shareholder within the meaning of the statute. The application must be supported by satisfactory evidence showing that the applicant is a bona fide shareholder of record of the required amount of stock of the corporation. The supporting evidence may be partly in the form of a certificate signed by the president or vice president of the corporation and countersigned by the secretary under the corporate seal. Upon being satisfied from the evidence presented that the applicant has fully met these conditions the Commissioner will grant the permission to examine the returns and set a convenient time for the examination in the office of the Commissioner. This privilege is personal and will be granted only to the shareholder, who can not delegate it to another.

ART. 1095. **Penalties for disclosure of returns.**—A shareholder 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. Section 3167 of the Revised Statutes, as amended by section 1317 of the Revenue Act of 1918 and reenacted without change by section 1018 of the Revenue Act of 1924, also provides:

SEC. 3167. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment.

An internal revenue officer discovering in the course of his duty information leading him to suspect a possible violation of any law with the enforcement of which he is not directly concerned should immediately report the matter to the Commissioner, who is authorized to communicate with the proper department involved.

PUBLICATION OF STATISTICS

SEC. 258. The Commissioner, with the approval of the Secretary, shall prepare and publish annually statistics reasonably available with respect to the operation of the income, war-profits and excess-profits tax laws, including classifications of taxpayers and of income, the amounts allowed as deductions, exemptions, and credits, and any other facts deemed pertinent and valuable.

ART. 1101. **Statistics of income.**—The Commissioner will publish annually a volume of statistics of income, showing, among other things, the distribution of incomes between corporations and individuals and by States, by classes and by occupations.

COLLECTION OF FOREIGN ITEMS

SEC. 259. All persons undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner and shall be subject to such regulations enabling the Government to obtain the information required under this title as the Commissioner, with the approval of the Secretary, shall prescribe; and whoever knowingly undertakes to collect such payments without having obtained a license therefor, or without complying with such regulations, shall be guilty of a misdemeanor and shall

be fined not more than $5,000, or imprisoned for not more than one year, or both.

ART. 1111. **License to collect foreign items.**—Banks or agents collecting foreign items, as defined in article 1076, and required by article 1079 to make returns of information with respect thereto, must obtain a license from the Commissioner to engage in such business. Application Form 1017 for such license may be procured from collectors. The license is issued without cost on Form 1010. In cases where ownership certificates are required to accompany foreign items (as set forth in articles 1077–1079), the licensee should not accept such items for collection unless accompanied by the proper certificates. Any person holding a license under the Revenue Act of 1921 or any prior Act will not be required to renew such license.

CITIZENS OF POSSESSIONS OF THE UNITED STATES

SEC. 260. Any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States, shall be subject to taxation under this title only as to income derived from sources within the United States, and in such case the tax shall be computed and paid in the same manner and subject to the same conditions as in the case of other persons who are taxable only as to income derived from such sources.

Nothing in this section shall be construed to alter or amend the provisions of the Act entitled "An Act making appropriations for the naval service for the fiscal year ending June 30, 1922, and for other purposes," approved July 12, 1921, relating to the imposition of income taxes in the Virgin Islands of the United States.

ART. 1121. **Status of citizen of United States possession.**—A citizen of a possession of the United States (except the Virgin Islands), who is not otherwise a citizen or a resident of the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, is treated for the purpose of the tax as if he were a nonresident alien individual. See articles 92, 93, 271, 306, 311, 317, and 404. His income from sources within the United States is subject to withholding. See section 221 and articles 361–376. The Act referred to in section 260 of the statute provides that income tax laws then or thereafter in force in the United States shall apply to the Virgin Islands, but that the taxes shall be paid into the treasury of the Virgin Islands. Accordingly, a citizen or resident of the Virgin Islands is taxed there under the provisions of the Revenue Act of 1924.

PORTO RICO AND THE PHILIPPINE ISLANDS

SEC. 261. In Porto Rico and the Philippine Islands the income tax shall be levied, assessed, collected, and paid as provided by law prior to the enactment of this Act.

The Porto Rican or the Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands, respectively.

ART. 1131. **Income tax in Porto Rico and Philippine Islands.**—The Revenue Act of 1924 is not in force in Porto Rico and the Philippine Islands. 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 taxable 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. See section 222 of the statute and articles 381–387. (*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 such credit. See also section 260 and article 1121. 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 taxable in both places. In the case of the United States corporation the income taxes in the United States are credited with 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. See section 238 of the statute and article 611. 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. See further section 238. For the purpose of withholding, a Porto Rico corporation is a foreign corporation. See section 237 and article 601. The same principles apply in the case of the Philippine Islands.

INCOME FROM SOURCES WITHIN THE POSSESSIONS OF THE UNITED STATES

SEC. 262. (a) In the case of citizens of the United States or domestic corporations, satisfying the following conditions, gross income means only gross income from sources within the United States—

(1) If 80 per centum or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section), for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States; and

(2) If, in the case of such corporation, 50 per centum or more of its gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States; or

(3) If, in the case of such citizen, 50 per centum or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

(b) Notwithstanding the provisions of subdivision (a) there shall be included in gross income all amounts received by such citizens or corporations within the United States, whether derived from sources within or without the United States.

(c) As used in this section the term "possession of the United States" does not include the Virgin Islands of the United States.

ART. 1135. **Citizens of the United States deriving income from sources within a possession of the United States.**—The gross income of a citizen of the United States (1) 80 per cent or more of whose gross income (computed without the benefit of this article) for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States, and (2) 50 per cent or more of whose gross income (computed without the benefit of this article) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States, either on his own account or as an employee or agent of another, means only gross income from sources within the United States. For a determination of the income from sources within the United States, see section 217 and articles 317–331. A citizen entitled to the benefits of this article is required to file with his individual return the schedule on Form 1040 E.

ART. 1136. **Domestic corporation deriving income from sources within a possession of the United States.**—The gross income of a domestic corporation (1) 80 per cent or more of the gross income of which (computed without the benefit of this article) for the three-year period immediately preceding the close of the taxable year (or for such

part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States, and (2) 50 per cent or more of the gross income of which (computed without the benefit of this article) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States, means only gross income from sources within the United States. See section 217 and articles 317–331.

ART. 1137. **Income received within the United States.**—Notwithstanding the provisions of articles 1135 and 1136, there shall be included in gross income of citizens and domestic corporations therein specified all amounts, whether derived from sources within or without the United States, which are received by such citizens or corporations within the United States. From the amounts so included in gross income there shall be deducted only the expenses properly apportioned or allocated thereto. The term "United States" as used herein includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia. The term "possession of the United States" as used in articles 1135, 1136, and this article includes Porto Rico, the Philippine Islands, the Panama Canal Zone, Guam, Tutuila, Wake, and Palmyra; it does not include the Virgin Islands.

CHINA TRADE ACT CORPORATIONS

SEC. 263. (a) For the purpose only of the tax imposed by section 230 there shall be allowed, in the case of a corporation organized under the China Trade Act, 1922, a credit of an amount equal to the proportion of the net income derived from sources within China (determined in a similar manner to that provided in section 217) which the par value of the shares of stock of the corporation owned on the last day of the taxable year by individual citizens of the United States or China, resident in China, bears to the par value of the whole number of shares of stock of the corporation outstanding on such date: *Provided*, That in no case shall the amount by which the tax imposed by section 230 is diminished by reason of such credit exceed the amount of the special dividend certified under subdivision (b) of this section.

(b) Such credit shall not be allowed unless the Secretary of Commerce has certified to the Commissioner—

(1) The amount which, during the year ending on the date fixed by law for filing the return, the corporation has distributed as a special dividend to or for the benefit of such individuals as on the last day of the taxable year were citizens of the United States or China, resident in China, and owned shares of stock of the corporation;

(2) That such special dividend was in addition to all other amounts, payable or to be payable to such individuals or for their benefit, by reason of their interest in the corporation; and

(3) That such distribution has been made to or for the benefit of such individuals in proportion to the par value of the shares of stock of the corporation owned by each; except that if the corporation has more than one class of stock, the certificate shall contain a statement that the articles of incorporation

provide a method for the apportionment of such special dividend among such individuals, and that the amount certified has been distributed in accordance with the method so provided.

(c) For the purposes of this section shares of stock of a corporation shall be considered to be owned by the person in whom the equitable right to the income from such shares is in good faith vested.

(d) As used in this section the term "China" shall have the same meaning as when used in the China Trade Act, 1922.

ART. 1141. **Income of China Trade Act corporations.**—The items of gross income to be included in the return of a corporation organized under the China Trade Act and the deductions allowable are the same as in the case of other domestic corporations.

ART. 1142. **Credits allowed China Trade Act corporations.**—In addition to the credits allowed under section 236, a China Trade Act corporation is, under certain conditions, allowed an additional credit for the purpose of computing the tax imposed by section 230. This credit is an amount equal to the proportion of the net income derived from sources within China (determined in a similar manner to that provided in section 217) which the par value of the shares of stock of the corporation owned on the last day of the taxable year by individual citizens of the United States or China, resident in China, bears to the par value of the whole number of shares of stock of the corporation outstanding on that date. The decrease in tax by reason of such credit must not, however, exceed the amount of the special dividend referred to in subdivision (b) of section 263, and is not allowable unless the special dividend has been certified to the Commissioner by the Secretary of Commerce. A China Trade Act corporation is not entitled to the credit for taxes paid to foreign countries and possessions of the United States allowed to domestic corporations under the provisions of section 238 of the statute. See articles 611 and 612.

ART. 1143. **Meaning of terms used in connection with China Trade Act corporations.**—A China Trade Act corporation is one organized under the provisions of the China Trade Act, 1922.

The term "China" means (1) China, including Manchuria, Thibet, Mongolia, and any territory leased by China to any foreign government, (2) the Crown Colony of Hongkong, and (3) the Province of Macao.

The term "special dividend" means the amount which during the year ending on March 15 succeeding the close of the corporation's taxable year is distributed as a special dividend to or for the benefit of such individuals as on the last day of the taxable year were citizens of the United States or China, resident in China, and owned shares of stock of the corporation. Such special dividend does not include any other amounts payable or to be payable to

such individuals or for their benefit by reason of their interest in the corporation and must be made in proportion to the par value of the shares of stock of the corporation owned by each.

For the purposes of section 263 the shares of stock of a China Trade Act corporation are considered to be owned by the person in whom the equitable right to the income from such shares is in good faith vested.

A corporation organized under the China Trade Act shall not be deemed to be affiliated with any other corporation within the meaning of section 240 of the statute. See article 632.

" Net income derived from sources within China," for the purpose of computing the special dividend, consists of the sum of the net income from sources wholly within China and that portion of the net income from sources partly within and partly without China which may be allocated to sources within China. The method of computing this income is similar to that described in articles 317–330.

ART. 1144. **Withholding by a China Trade Act corporation.**—Dividends paid by a China Trade Act corporation to persons other than individuals who are citizens of China, residing in China, are subject to both normal tax and surtax. Accordingly, tax should be withheld from such dividends when paid to nonresident alien individuals (other than citizens of China, resident in China), and to foreign corporations not engaged in trade or business in the United States and having no office or place of business therein, unless the dividends are exempt under section 217(a)(2)(A). In the case of an individual shareholder the rate of withholding is 6 per cent and in the case of a corporation 12½ per cent. A Filipino shareholder of a China Trade Act corporation, when resident without the United States, is treated as a nonresident alien for the purpose of the income tax and withholding is required from taxable dividends paid to such shareholder.

DATE ON WHICH TAX SHALL BE PAID

SEC. 270. (a) Except as provided in subdivisions (b), (c), and (d) of this section the total amount of tax imposed by this title shall be paid—

(1) In the case of a taxpayer, other than a nonresident alien individual, and other than a foreign corporation not having an office or place of business in the United States, on or before the fifteenth day of March following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on or before the fifteenth day of the third month following the close of the fiscal year; and

(2) In the case of a nonresident alien individual, and of a foreign corporation not having an office or place of business in the United States, on or before the fifteenth day of June following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on or before the fifteenth day of the sixth month following the close of the fiscal year.

(b) (1) The taxpayer may elect to pay the tax in four equal installments, in which case the first installment shall be paid on or before the latest date prescribed in subdivision (a) for the payment of the tax by the taxpayer, the second installment shall be paid on or before the fifteenth day of the third month, the third installment on or before the fifteenth day of the sixth month, and the fourth installment on or before the fifteenth day of the ninth month, after such date.

(2) If any installment is not paid on the date fixed for its payment, the whole amount of the tax unpaid shall be paid upon notice and demand from the collector.

(c) (1) At the request of the taxpayer, the Commissioner may extend the time for payment of the amount determined as the tax by the taxpayer, or any installment thereof, for a period not to exceed six months from the date prescribed in subdivision (a) or (b) for the payment of the tax or an installment thereof. In such case the amount in respect of which the extension is granted shall be paid on or before the date of the expiration of the period of the extension.

(2) If the time for payment is thus extended there shall be collected, as a part of such amount, interest thereon at the rate of 6 per centum per annum from the date when such payment should have been made if no extension had been granted, until the expiration of the period of the extension.

(d) The provisions of this section shall not apply to the payment of a tax required to be withheld at the source under section 221 or 237.

ART. 1201. **Date on which tax shall be paid.**—The tax, unless it is required to be withheld at the source or unless it is to be paid by a nonresident alien individual or a foreign corporation not having an office or place of business in the United States, is to be paid on or before the 15th day of March following the close of the calendar year, or, where the return is made on the basis of a fiscal year, on or before the 15th day of the third month following the close of such fiscal year. In the case of a nonresident alien individual, and of a foreign corporation not having an office or place of business in the United States, the tax is to be paid on or before the 15th day of June following the close of the calendar year, or, where the return is made on the basis of a fiscal year, on or before the 15th day of the sixth month following the close of the fiscal year. The tax may, at the option of the taxpayer, be paid in four equal installments instead of in a single payment, in which case the first installment is to be paid on or before the date prescribed for the payment of the tax as a single payment; the second installment on or before the 15th day of the third month; the third installment on or before the 15th day of the sixth month; and the fourth installment on or before the 15th day of the ninth month after such date.

The Commissioner, at the request of the taxpayer, may extend the time for payment of the amount determined as the tax by the taxpayer, or any part or installment thereof, for a period not to exceed six months from the date prescribed for the payment of such amount, part, or installment. A request by the taxpayer for

an extension of time for payment of one installment does not operate to procure an extension of time for payment of subsequent installments. Nor does an extension of time for filing a return operate to extend the time for payment of the tax or any part thereof. If an extension of time for payment of the tax or any installment is granted, the amount, time for payment of which is so extended, shall be paid on or before the expiration of the period of the extension, together with interest at the rate of 6 per cent per annum on such amount from the date when the payment should have been made if no extension had been granted until the expiration of the period of the extension. If an installment is not paid on the date fixed for its payment, either by the statute itself or by the Commissioner in accordance with the terms of an extension, the whole amount of the tax unpaid shall be paid upon notice and demand from the collector. For payment of taxes required to be withheld at the source see sections 221 and 237 of the statute and articles 371 and 601.

ART. 1202. **Collection of tax by suit.**—If any person liable to pay any tax fails to pay it on or before the date prescribed for its payment, such tax, with interest and additions thereto as prescribed in the Act, may be recovered in the name of the United States at any time after such tax becomes due by suit or proceeding in the district courts of the United States. Such suit or proceeding must be brought within the period prescribed for the institution of such suit or proceeding by sections 277 and 278 of the statute. See articles 1271–1273. A suit or proceeding may also be brought in the name of the United States for the recovery of fines, penalties, and forfeitures. For limitations on prosecutions, see section 1010 of the statute.

It is provided in section 3214 of the Revised Statutes that no such suit shall be commenced unless the Commissioner of Internal Revenue authorizes or sanctions the institution of the suit. Collectors are accordingly required to advise the Commissioner of any willful violation of the revenue laws that may come to their knowledge. See section 3164 of the Revised Statutes as amended by section 1317 of the Revenue Act of 1918 and reenacted without change by section 1018, of the Revenue Act of 1924, which provides:

> SEC. 3164. It shall be the duty of every collector of internal revenue having knowledge of any willful violation of any law of the United States relating to the revenue, within thirty days after coming into possession of such knowledge, to file with the district attorney of the district in which any fine, penalty, or forfeiture may be incurred, a statement of all the facts and circumstances of the case within his knowledge, together with the names of the witnesses, setting forth the provisions of law believed to be so violated on which reliance may be had for condemnation or conviction.

See also sections 3212, 3213, 3215, and 3216 of the Revised Statutes, Regulations No. 2 (Revised) and Regulations No. 12 (Revised).

ART. 1203. **Collection of tax by distraint.**—If any person liable to pay any tax neglects or refuses to pay such tax within ten days after notice and demand, it shall be lawful for the collector or his deputy to collect such tax with any interest or additional amounts assessed in connection therewith, together with interest as provided by section 276 of the statute (see article 1261) by distraint and sale of the goods, chattels, or effects, including stocks, certificates, bank accounts, and evidences of debt, or other property or rights to property, of the person delinquent. When goods, chattels, or effects sufficient to satisfy the tax, interest, penalties, and additions to tax imposed upon any person are not found by the collector or deputy collector, he is authorized to collect such tax by seizure and sale of real estate. If the tax is not payable on notice and demand from the collector but on a date prescribed by the statute, the collector should nevertheless make notice and demand for the payment of such tax upon receipt from the Commissioner of the assessment list on which such tax appears, and if the tax is not paid within ten days from such notice and demand, the collector should proceed to collect such tax by distraint, as outlined above. See sections 3184 and 3186 (as amended by the Act of March 3, 1913) of the Revised Statutes. The penalty and interest provided by section 3184 of the Revised Statutes in case of failure to pay the tax within ten days after notice and demand does not apply to income tax. For interest in the case of delinquency in payment of income tax, see section 276 of the statute and article 1261. See further sections 3187 (as amended by section 1016 of the Revenue Act of 1924), 3188–3194, 3195 (as amended by section 1031 of the Revenue Act of 1924), 3196, 3197 (as amended by the Act of March 1, 1879), 3198–3202, 3203 (as amended by the Act of March 1, 1879), 3204–3206, 3207 (as amended by section 1030 of the Revenue Act of 1924), 3208 (as amended by the Act of March 1, 1879), and 3209 of the Revised Statutes and Regulations No. 12 (Revised). Distraint may also be used against a delinquent collector. See section 3217 of the Revised Statutes.

ART. 1204. **Liens and enforcement of tax liens by bill in equity.**—In the event of nonpayment of a tax and penalties after demand, the amount becomes a lien in favor of the United States from the time when the assessment list was received by the collector upon all property and rights to property belonging to the taxpayer, except that the lien is not valid as against any bona fide mortgagee, purchaser, or judgment creditor until notice thereof is filed in the proper public office or offices on Form 668. The collector may file such notice of

lien upon making demand for payment of the tax, unless payment is made immediately upon demand. What is immediate payment will depend upon the nature of the demand. Where the collector contemplates filing such notice of lien on demand, whenever practicable, the demand should be made upon the taxpayer in person. In any case where there has been refusal or neglect to pay the tax and it has become necessary to seize and sell real estate to satisfy it, a bill in equity may be filed in a district court of the United States to enforce the lien of the United States for tax upon any real estate in which the delinquent has any right, title, or interest subject to the lien. This remedy does not supersede distraint but is cumulative.

It is further provided where any person has a lien upon such real estate prior to the lien of the United States, that such person may request the Commissioner to file a bill in equity to enforce the lien of the United States, and in the event the Commissioner fails to file such bill within six months after the request, the person having such prior lien may petition the district court of the United States for the district in which such real estate is located for permission to file a bill. After a hearing on the petition, the court may in its discretion grant leave to the petitioner to file such a bill and upon the filing of the bill the court shall proceed to adjudicate all matters involved in the same manner as in cases where a bill is filed by the Commissioner. See section 3207 of the Revised Statutes, as amended by section 1030 of the Revenue Act of 1924.

ART. 1205. **Compromise of tax cases.**—The Commissioner, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon, and with the advice and consent of the Secretary and the recommendation of the Attorney General may compromise any such case after suit thereon has been commenced by the United States. Accordingly, the power to compromise extends to (*a*) civil and criminal cases; (*b*) cases whether before or after suit; and (*c*) taxes and penalties, except that taxes legally due from a solvent taxpayer may not be compromised. Refunds can not be made of accepted offers in compromise in cases where it is subsequently ascertained that no violation of law was involved. See further section 3229 of the Revised Statutes.

EXAMINATION OF RETURN AND DETERMINATION OF TAX

SEC. 271. As soon as practicable after the return is filed the Commissioner shall examine it and shall determine the correct amount of the tax.

ART. 1211. **Examination of return and determination of tax by the Commissioner.**—When the returns are received at the collectors' offices, they are given a summary examination and listed. These lists

and all returns, except returns made on Form 1040 A and such other returns as the collector is authorized by the Commissioner to audit, are then forwarded to the Commissioner. As soon as practicable thereafter, the returns are audited in the Income Tax Unit. If, as a result of such audit, it appears that a deficiency exists (see section 273 of the statute and article 1231) the taxpayer will be notified by a letter and will be afforded an opportunity to be heard within the Bureau prior to the final determination by the Commissioner. Thirty days from the mailing (not receipt) of the letter of notification will be given the taxpayer within which to present a protest against the assessment of the deficiency disclosed by the audit of the return in the Unit. If the taxpayer desires to enter a protest against the assessment of such deficiency, prior to final determination by the Commissioner, a letter must be addressed to the Commissioner of Internal Revenue, Washington, D. C., and must be filed in his office within 30 days from the mailing of the notice, but if it is mailed in time to be received by the Commissioner within such period in the ordinary course of the mail it will be considered as having been filed within such period. The letter of protest should contain (*a*) the name and address of the taxpayer (in the case of an individual the residence, and in the case of a corporation the principal office or place of business); (*b*) in the case of a corporation the name of the State of incorporation; (*c*) the designation by date and symbol of the letter advising of the tentative deficiency with respect to which the protest is made; (*d*) the designation of the year or years involved and a statement of the amount of tax in dispute for each year; (*e*) an itemized schedule of the findings of the Unit to which the taxpayer takes exception; (*f*) a summary statement of the grounds upon which the taxpayer relies in connection with each exception; and (*g*) in case the taxpayer desires a hearing, a statement to that effect. The letter of protest may be supported by additional evidence or a brief or both.

Upon receipt of the letter of protest it will be referred to the Income Tax Unit in Washington. The taxpayer may in the letter of protest request a conference before the Income Tax Unit to be held within a period of 30 days after the time for filing the letter of protest. All data relied upon by the taxpayer in connection with the protest, including evidence as to facts and briefs of argument, must be filed with the Income Tax Unit five days prior to the date fixed for such conference; but if no such conference is requested, such data must be filed with the Income Tax Unit prior to the expiration of 25 days after the time for the filing of the letter of protest. Upon cause shown the taxpayer may obtain from the Income Tax

Unit a reasonable extension of time for holding such conference or filing such data beyond the periods of limitation herein specified. Any requests for such additional time must state specifically the reasons therefor. If pursuant to conference the Income Tax Unit and the taxpayer reach an agreement respecting the amount of such deficiency, such amount will be assessed and collected forthwith; and in case the Unit concedes upon examination, without conference, of the data submitted by the taxpayer that no additional tax is due, the taxpayer shall be so notified. If the Income Tax Unit and the taxpayer are unable to reach an agreement respecting the amount of the deficiency, or if the taxpayer files a protest but fails to request a conference before the Income Tax Unit, and the Unit, upon examination of the data submitted by the taxpayer, does not agree as to his contentions, the letter of protest, together with the files of the case, will be transmitted by the Income Tax Unit to the Solicitor of Internal Revenue for consideration. The files of the case will be accompanied by a letter of transmittal (of which a copy will be sent contemporaneously to the taxpayer) containing the following information and data: (*a*) A designation of the division of the Income Tax Unit from which the case is transferred; (*b*) the name and address of the taxpayer; (*c*) a designation of the taxable period or periods involved and of the additional assessment proposed for each such period; (*d*) a statement of such issues raised by the letter of protest as are not conceded by the Unit, together with a brief summary of the Unit's grounds for not conceding such issues, including a reference to the law, regulations, and rulings upon which the Unit relies in support of its position; and (*e*) a statement of the dates of any conferences between the Income Tax Unit and the taxpayer, and specifically a statement as to whether any conference was requested by and granted to the taxpayer subsequent to the letter advising of the deficiency. Opportunity for a hearing before the Solicitor of Internal Revenue or before such representative of his office as he may designate will be granted if requested in the letter of protest or within 20 days after the mailing of the copy of the letter of transmittal to the taxpayer. The Solicitor of Internal Revenue, after consideration of the case, will submit his recommendations to the Commissioner, and the taxpayer will be notified by registered mail of the Commissioner's final determination.

If the taxpayer presents no protest within 30 days from the date of the letter advising of the deficiency disclosed upon the audit of the return, final determination will be made and the taxpayer will be notified thereof by registered mail in accordance with the provisions of section 274(a) of the statute. See article 1232. If in any case the taxpayer acquiesces in the tentative or final determina-

tion of a deficiency or any part thereof, the form of agreement consenting to assessment which will be forwarded with the letter of notification should be executed and returned to the Commissioner of Internal Revenue.

If a deficiency is disclosed as the result of the audit of a return in the collector's office, the taxpayer will be notified by letter and the same period given in which to file a letter of protest and to show cause or reason why such deficiency should not be assessed. The procedure in connection therewith will be the same as hereinbefore provided in the case of deficiency letters originating in respect of returns audited in the Income Tax Unit, except that the taxpayer's letter of protest should be addressed to the collector of internal revenue who has the return under consideration, and the taxpayer's conference prior to any reference of the matter to the Solicitor of Internal Revenue should be a conference with the collector or his representative.

OVERPAYMENTS

SEC. 272. If the taxpayer has paid as an installment of the tax more than the amount determined to be the correct amount of such installment, the excess shall be credited against the unpaid installments, if any. If the amount already paid, whether or not on the basis of installments, exceeds the amount determined to be the correct amount of the tax, the excess shall be credited or refunded as provided in section 281.

ART. 1221. **Overpayments.**—If upon examination of the return the Commissioner finds that the taxpayer has paid as an installment an amount greater than the correct amount of such installment, the excess of such payment over the correct amount of such installment shall be credited against any unpaid installments. If the amount already paid exceeds the amount determined to be the correct amount of the tax, the excess shall be credited against any other income, war-profits, or excess-profits tax or installment due from the taxpayer, or, if there is no such tax or installment against which such credit may be made, the excess shall be refunded in accordance with the provisions of section 281 of the statute. See article 1302.

DEFICIENCY IN TAX

SEC. 273. As used in this title the term "deficiency" means—

(1) The amount by which the tax imposed by this title exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or

(2) If no amount is shown as the tax by the taxpayer upon his return, or if no return is made by the taxpayer, then the amount by which the tax exceeds the amounts previously assessed (or collected without assessment) as a de-

ficiency; but such amounts previously assessed, or collected without assessment, shall first be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax.

SEC. 274. (a) If, in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the taxpayer, except as provided in subdivision (d), shall be notified of such deficiency by registered mail, but such deficiency shall be assessed only as hereinafter provided. Within 60 days after such notice is mailed the taxpayer may file an appeal with the Board of Tax Appeals established by section 900.

(b) If the Board determines that there is a deficiency, the amount so determined shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the Board shall be assessed, but a proceeding in court may be begun, without assessment, for the collection of any part of the amount so disallowed. The court shall include in its judgment interest upon the amount thereof at the rate of 6 per centum per annum from the date prescribed for the payment of the tax to the date of the judgment. Such proceeding shall be begun within one year after the final decision of the Board, and may be begun within such year even though the period of limitation prescribed in section 277 has expired.

(c) If the taxpayer does not file an appeal with the Board within the time prescribed in subdivision (a) of this section, the deficiency of which the taxpayer has been notified shall be assessed, and shall be paid upon notice and demand from the collector.

(d) If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay such deficiency shall be assessed immediately and notice and demand shall be made by the collector for the payment thereof. In such case the assessment may be made (1) without giving the notice provided in subdivision (a) of this section, or (2) before the expiration of the 60-day period provided in subdivision (a) of this section even though such notice has been given, or (3) at any time prior to the final decision by the Board upon such deficiency even though the taxpayer has filed an appeal. If the taxpayer does not file a claim in abatement as provided in section 279 the deficiency so assessed (or, if the claim so filed covers only a part of the deficiency, then the amount not covered by the claim) shall be paid upon notice and demand from the collector.

(e) If the taxpayer has elected to pay the tax in installments and a deficiency has been assessed, the deficiency shall be prorated to the four installments. Except as provided in subdivision (d) of this section, that part of the deficiency so prorated to any installment the date for payment of which has not arrived, shall be collected at the same time as and as part of such installment. That part of the deficiency so prorated to any installment the date for payment of which has arrived, shall be paid upon notice and demand from the collector.

(f) Interest upon the amount determined as a deficiency, or, if the tax is paid in installments, upon the part of the deficiency prorated to each installment, shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax, at the rate of 6 per centum per annum from the date prescribed for the payment of the tax, or the payment of such installment, to the date the deficiency is assessed.

(g) Where it is shown to the satisfaction of the Commissioner that the payment of a deficiency upon the date prescribed for the payment thereof will

result in undue hardship to the taxpayer the Commissioner, with the approval of the Secretary (except where the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax), may grant an extension for the payment of such deficiency or any part thereof for a period not in excess of eighteen months. If an extension is granted, the Commissioner may require the taxpayer to furnish a bond in such amount, not exceeding double the amount of the deficiency, and with such sureties, as the Commissioner deems necessary, conditioned upon the payment of the deficiency in accordance with the terms of the extension. In such case there shall be collected, as a part of the tax, interest on the part of the deficiency the time for payment of which is so extended, at the rate of 6 per centum per annum for the period of the extension, and no other interest shall be collected on such part of the deficiency for such period. If the part of the deficiency the time for payment of which is so extended is not paid in accordance with the terms of the extension, there shall be collected, as a part of the tax, interest on such unpaid amount at the rate of 1 per centum a month for the period from the time fixed by the terms of the extension for its payment until it is paid, and no other interest shall be collected on such unpaid amount for such period.

ART. 1231. **Deficiency defined.**—Section 273 of the statute by its definition of the word "deficiency" provides a term which will apply to any additional amount of tax determined to be due in respect of any taxable year or taxable period in excess of the amount of tax reported by the taxpayer for such year or period; or in excess of the amount reported by the taxpayer as adjusted by way of assessments, credits, refunds, or collections without assessment resulting from any previous determination. In defining the term "deficiency" section 273 recognizes two classes of cases—one, where the taxpayer makes a return showing some tax liability; the other, where the taxpayer makes a return showing no tax liability or where the taxpayer fails to make a return.

When a case is considered for the first time the deficiency is the excess of the amount determined to be the correct amount of the tax over the amount shown as the tax by the taxpayer on his return, or if it is a case where no tax was reported by the taxpayer, the deficiency is the amount determined to be the correct amount of the tax. Subsequent information sometimes discloses that the amount previously determined to be the correct amount of the tax is less than the correct amount, and that a redetermination of the tax is necessary. In such a case the deficiency on redetermination is the excess of the amount determined to be the correct amount of the tax over the sum of the amount of tax reported by the taxpayer and the deficiency disclosed by the previous determination. Or if it is a case where no tax was reported by the taxpayer, the deficiency is the excess of the amount determined to be the correct amount of the tax over the amount of the deficiency disclosed by the previous determination. If the previous determination resulted in a credit or

refund to the taxpayer, the deficiency upon the second determination is the excess of the amount determined to be the correct amount of the tax over the amount of tax reported by the taxpayer decreased by the amount of the credit or refund.

To restate the definition, a deficiency is the excess of the amount determined to be the correct amount of the tax over the amount of tax reported by the taxpayer. If, however, there have been one or more determinations of the tax, the amount reported as the tax by the taxpayer must be increased by the deficiency or deficiencies previously determined and decreased by any credits or refunds previously made or amounts otherwise repaid in respect of such tax, in which case the deficiency is the excess of the amount determined to be the correct amount of the tax over the amount of tax reported by the taxpayer as adjusted by such previous determinations. If it is a case where the taxpayer reported no tax, the deficiency is the excess of the amount determined as the correct amount of the tax over the sum of any deficiency or deficiencies previously determined decreased by the sum of all credits, refunds, and amounts otherwise repaid in respect of such tax.

ART. 1232. **Assessment of a deficiency.**—If the Commissioner determines there is a deficiency in respect of the income tax imposed by this title (see sections 271 and 273 of the statute and articles 1211 and 1231; and with respect to assessments under prior acts, section 280 and article 1291), the taxpayer, except in the cases where the Commissioner believes the assessment and collection of the deficiency will be jeopardized by delay (see section 274 (d)), shall be notified of the deficiency by registered mail and advised that an appeal from the determination of the Commissioner to the Board of Tax Appeals (see section 900 of the statute) may be filed within 60 days after such notice is mailed. If an appeal is filed with the Board within that period and the Board after hearing the taxpayer and the Commissioner (see section 900 (h) of the statute) determines there is a deficiency, the amount so determined shall be assessed by the Commissioner. No part of the amount determined as a deficiency by the Commissioner; but disallowed as such by the Board, shall be assessed. Where an appeal is filed with the Board the taxpayer should notify the Commissioner that an appeal has been taken in order to prevent assessment by the Commissioner of the amount determined by him as the deficiency. If, however, no appeal is filed with the Board of Tax Appeals within the period prescribed, the Commissioner shall assess the amount determined by him as the deficiency and of which he has notified the taxpayer. If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, the deficiency

as determined by him shall be assessed immediately and in sucn cases the assessment may be made (1) without giving the notice provided in section 274 (a) of the statute as outlined in this article, or (2) before the expiration of the 60-day period provided in section 274 (a) even though such notice has been given, or (3) at any time prior to the final decision of the Board upon such deficiency, even though the taxpayer has filed an appeal.

ART. 1233. **Collection of a deficiency.**—Where a deficiency as determined by the Board has been assessed, or where the taxpayer has not filed an appeal and the deficiency as determined by the Commissioner has been assessed, the amount so assessed shall be paid upon notice and demand from the collector. If, however, the taxpayer has elected to pay his tax in installments, the deficiency assessed, except in case of jeopardy assessments, shall be prorated to the four installments and the amount prorated to installments, the dates for the payment of which have arrived, shall be paid upon notice and demand from the collector. The amount prorated to installments, dates for the payment of which have not yet arrived, shall be paid at the same time and as a part of the installments to which such amounts are prorated.

In the event that a part of the deficiency determined by the Commissioner is denied by the Board, the Commissioner may without assessment bring a proceeding in court for the collection of the whole or any part of the amount disallowed by the Board, but such a proceeding must be begun within one year after the final decision of the Board and may be begun within such year even though the period of limitation for collecting tax by a proceeding in court has expired. See section 277 of the statute and article 1272.

Where the Commissioner makes an assessment as provided in section 274(d) of the statute because he believes that the assessment and collection of the deficiency will be jeopardized by delay, notice and demand shall be made by the collector for the payment of the deficiency. The taxpayer may then file a claim for the abatement of the assessment of the deficiency or any part thereof. If, however, the taxpayer acquiesces in the assessment or a part thereof, the amount so acquiesced in by the taxpayer shall be paid upon notice and demand from the collector. If the taxpayer files a claim for the abatement of the whole or a part of such assessment, such amount shall not be collected until the claim is adjudicated, and then only in the amount the claim for which was denied. This amount shall be paid on notice and demand from the collector. See section 279 of the statute and article 1281.

ART. 1234. **Extension of time.**—Where it is shown to the satisfaction of the Commissioner that the payment of a deficiency upon the

date or dates prescribed for payment thereof will result in undue hardship to the taxpayer, the Commissioner, with the approval of the Secretary, may grant an extension of time for the payment of the deficiency or any part thereof for a period not in excess of 18 months. The term "undue hardship" means more than an inconvenience to the taxpayer. It must appear that substantial financial loss or sacrifice will result to the taxpayer from making payment of the deficiency at the due date. No extension will be granted where the deficiency is due to negligence or intentional disregard of the rules and regulations or to fraud with intent to evade the tax.

Any application for an extension of time for the payment of a deficiency must be made under oath on Form 1127 in accordance with instructions printed thereon, and must be accompanied by evidence showing that undue hardship to the taxpayer would result if the extension were refused. The extension will not be granted on a general statement of hardship, but in each case there must be furnished a statement of the specific facts showing what, if any, financial loss or sacrifice will result if the extension is not granted. Wherever practicable a certified statement of assets and liabilities of the taxpayer should be submitted. The application, with the evidence, must be filed with the collector who will at once transmit it to the Commissioner with his recommendations as to the extension. When it is received by the Commissioner it will be examined and within thirty days rejected, approved, or tentatively approved subject to certain conditions of which the taxpayer will be immediately notified.

As a condition to the granting of such an extension, the Commissioner may require the taxpayer to furnish a bond in an amount not exceeding double the amount of the deficiency. If a bond is required it must be filed with the collector within 10 days after notification by the Commissioner that such bond is required. It shall be conditioned upon the payment of the deficiency, interest, and additional amounts assessed in connection therewith in accordance with the terms of the extension granted, and shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds, and shall be subject to the approval of the Commissioner. In lieu of such a bond, the taxpayer may file a bond secured by deposit of Liberty bonds or other bonds or notes of the United States equal in their total par value to the amount of the deficiency, interest, and additional amounts assessed in connection therewith, as provided in section 1029 of the Act. The amount of the deficiency and additions thereto shall be paid on or before the expiration of the period of the extension without the necessity of notice and demand from the collector.

Extensions of time for the payment of a deficiency may be made in respect of the tax imposed by this title and in respect of deficiencies assessed after the enactment of the Revenue Act of 1924 (in accordance with the provisions of section 280 of the statute), in respect of income, war-profits or excess-profits taxes imposed by the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or any of these acts as amended. See section 280 of the statute and article 1291.

ART. 1235. **Interest on a deficiency.**—Interest upon the amount assessed as a deficiency under this title shall be assessed at the same time as the deficiency, at the rate of 6 per cent per annum from the date prescribed for the payment of the tax to the date the deficiency is assessed. If the taxpayer has elected to pay his tax in installments, the interest shall be assessed on the amount of the deficiency prorated to each installment from the date prescribed for the payment of the installment to the date the deficiency is assessed. If the time for the payment of a deficiency, or any part of the deficiency, is extended (see section 274(g) and article 1234), interest shall be collected as a part of the tax on that part of the deficiency, time for payment of which is so extended, at the rate of 6 per cent per annum for the entire period of the extension. If the deficiency or a part thereof, the time for payment of which is so extended, is not paid on or before the expiration of the period of the extension, interest on such unpaid amount shall be collected at the rate of 1 per cent a month from the date of the expiration of the period of extension until it is paid. The additions to tax in case of delinquency imposed by section 276(b) of the statute (see article 1261) do not apply in case of a deficiency the time for payment of which has been extended under section 274(g).

If the Commissioner institutes a proceeding in court for the collection of an amount determined by him as a deficiency, or a part thereof, which is disallowed by the Board, and procures a judgment in the proceeding, the court shall include in its judgment interest on the amount recovered at the rate of 6 per cent per annum from the date prescribed for the payment of the tax until the date of the judgment.

ADDITIONS TO THE TAX IN CASE OF DEFICIENCY

SEC. 275. (a) If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of subdivisions (e) and (f) of section 274 shall not be applicable.

(b) If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such

deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

ART. 1251. **Additions to tax in case of a deficiency.**—If a deficiency or any part of a deficiency is due to negligence or intentional disregard of rules and regulations but without intent to defraud, 5 per cent of the total amount of the deficiency shall be assessed, collected, and paid in the same manner as if it were a deficiency. This amount shall be in addition to the deficiency but shall not be subject to the interest imposed on the deficiency by section 274(f) nor shall such amount be prorated to the installments as provided in section 274(e) of the statute. See articles 1233 and 1235. If a deficiency or any part thereof is due to fraud with intent to evade the tax, there shall be assessed, collected, and paid in the same manner and subject to the same provisions as those mentioned in the first sentence of this article an addition of 50 per cent of the total amount of the deficiency. This addition shall be in lieu of the 50 per cent addition to the tax provided in section 3176 of the Revised Statutes as amended.

ADDITIONS TO THE TAX IN CASE OF DELINQUENCY

SEC. 276. (a) (1) Where the amount determined by the taxpayer as the tax imposed by this title, or any installment thereof, or any part of such amount or installment, is not paid at the time prescribed for its payment, there shall be collected as a part of the tax, interest upon such unpaid amount at the rate of 1 per centum a month from the date prescribed for its payment until it is paid.

(2) Where an extension of time for payment of the amount so determined as the tax by the taxpayer, or any installment thereof, has been granted, and the amount the time for payment of which has been extended, and the interest thereon determined under paragraph (2) of subdivision (c) of section 270, is not paid in full prior to the expiration of the period of the extension, then, in lieu of the interest provided for in paragraph (1) of this subdivision, interest at the rate of 1 per centum a month shall be collected on such unpaid amount from the date of the expiration of the period of the extension until it is paid.

(b) Where a deficiency, or any interest or additional amounts assessed in connection therewith under subdivision (f) of section 274, or under section 275, or any addition to the tax in case of delinquency provided for in section 3176 of the Revised Statutes, as amended, is not paid in full within ten days from the date of notice and demand from the collector, there shall be collected as part of the tax, interest upon the unpaid amount at the rate of 1 per centum a month from the date of such notice and demand until it is paid. If any part of a deficiency prorated to any unpaid installment under subdivision (e) of section 274 is not paid in full on the date prescribed for the payment of such installment, there shall be collected as part of the tax interest upon the unpaid amount at the rate of 1 per centum a month from such date until it is paid.

(c) In the case of estates of incompetent, deceased, or insolvent persons, there shall be collected interest at the rate of 6 per centum per annum in lieu of the interest provided in subdivisions (a) and (b) of this section.

(d) If a claim in abatement is filed, as provided in section 279, the provisions of subdivisions (b) and (c) of this section shall not apply to the amount covered by the claim in abatement.

ART. 1261. **Additions to tax in case of delinquency in payment of tax.**—Where the amount determined by the taxpayer as the tax imposed by this title, or any installment thereof, or any part of such amount or installment, is not paid within the time prescribed for its payment (see section 270 of the statute and article 1201), there shall be collected as a part of the tax interest upon such unpaid amount at the rate of 1 per cent a month from the date prescribed for its payment until it is paid. Since the tax is due and payable on the dates prescribed, without notice and demand from the collector for payment, interest at the rate of 1 per cent a month begins to run, if the tax is not paid on such dates, without notice of any kind to the taxpayer from the Government. If, however, an extension of time has been granted for the payment of the amount reported by the taxpayer as the tax, or any installment thereof, or any part of such amount or installment, and such amount or installment with the interest thereon (see section 270(c) of the statute and article 1201) is not paid in full on or before the date of expiration of the period of the extension, interest shall be collected on the unpaid amount at the rate of 1 per cent a month from the date of the expiration of the period of extension until such amount is paid, and not from the date prescribed in the statute for the payment of such tax or installment thereof until paid.

Where a deficiency or any interest on such deficiency assessed under the provisions of section 274(f) (see articles 1232 and 1235), or any additions to the deficiency assessed under section 275 of the statute (see article 1251), or any addition to tax in case of delinquency in filing a return as provided by section 3176 of the Revised Statutes, as amended (see article 445), is not paid in full within ten days from the date of notice and demand from the collector, there shall be collected as a part of the tax interest upon the unpaid amount at the rate of 1 per cent a month from the date of such notice and demand until such amount is paid. If, however, any part of the deficiency is not payable on notice and demand from the collector, but on a date prescribed by the statute (as in the case where part of a deficiency is prorated to installments not yet due, and thus becomes payable at the same time as the installments), interest at the rate of 1 per cent a month shall be collected on any part remaining unpaid after the date prescribed for its payment from such date until it is paid. See section 274(e) of the statute and article 1235.

If the estate of an incompetent, deceased, or insolvent person is delinquent in the payment of the amount of tax shown on its return, or any installment thereof, or any deficiency, or any part of such tax, installment, or deficiency, the interest on such amount for the period of the delinquency in payment shall be at the rate of 6 per cent per annum and not at the rate of 1 per cent a month, as in the case of other taxpayers. The additions to tax in case of delinquency in payment of a deficiency provided by section 276(b) of the statute do not apply where the time for payment of such deficiency is extended under the provisions of section 274(g) of the statute. See article 1234. The provisions of subdivisions (b) and (c) of section 276 of the statute are also inapplicable to any amount covered by a claim in abatement filed in accordance with the provisions of section 279 of the statute. See article 1281.

PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION OF TAX

SEC. 277. (a) Except as provided in section 278 and in subdivision (b) of section 274 and in subdivision (b) of section 279—

(1) The amount of income, excess-profits, and war-profits taxes imposed by the Revenue Act of 1921, and by such Act as amended, for the taxable year 1921 and succeeding taxable years, and the amount of income taxes imposed by this Act, shall be assessed within four years after the return was filed, and no proceeding in court for the collection of such taxes shall be begun after the expiration of such period.

(2) The amount of income, excess-profits, and war-profits taxes imposed by the Act entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909, the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October 3, 1913, the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, and by any such Act as amended, shall be assessed within five years after the return was filed, and no proceeding in court for the collection of such taxes shall be begun after the expiration of such period.

(3) In the case of income received during the lifetime of a decedent, the tax shall be assessed, and any proceeding in court for the collection of such tax shall be begun, within one year after written request therefor (filed after the return is made) by the executor, administrator, or other fiduciary representing the estate of such decedent, but not after the expiration of the period prescribed for the assessment of the tax in paragraph (1) or (2) of this subdivision.

(b) The period within which an assessment is required to be made by subdivision (a) of this section in respect of any deficiency shall be extended (1) by 60 days if a notice of such deficiency has been mailed to the taxpayer under subdivision (a) of section 274 and no appeal has been filed with the Board of Tax Appeals, or, (2) if an appeal has been filed, then by the number of days between the date of the mailing of such notice and the date of the final decision by the Board.

SEC. 278. (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceed-

ing in court for the collection of such tax may be begun without assessment, at any time.

(b) Any deficiency attributable to a change in a deduction tentatively allowed under paragraph (9) of subdivision (a) of section 214, or paragraph (8) of subdivision (a) of section 234, of the Revenue Act of 1918 or the Revenue Act of 1921, may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

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

(d) Where the assessment of the tax is made within the period prescribed in section 277 or in this section, such tax may be collected by distraint or by a proceeding in court, begun within six years after the assessment of the tax. Nothing in this Act shall be construed as preventing the beginning, without assessment, of a proceeding in court for the collection of the tax at any time before the expiration of the period within which an assessment may be made.

(e) This section shall not (1) authorize the assessment of a tax or the collection thereof by distraint or by a proceeding in court if at the time of the enactment of this Act such assessment, distraint, or proceeding was barred by the period of limitation then in existence, or (2) affect any assessment made, or distraint or proceeding in court begun, before the enactment of this Act.

ART. 1271. **Period of limitation upon assessments of tax.**—The amount of tax imposed by the Revenue Act of 1921 and by such Act as amended for the taxable years 1921, 1922, and 1923, and the amount of tax imposed by the Revenue Act of 1924 for the taxable year 1924, or succeeding taxable years, must be assessed within four years after the return was filed, and the amount of tax imposed by the Act of August 5, 1909, the Act of October 3, 1913, the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, and by any such act as amended, must be assessed within five years after the return was filed, with the following exceptions:

(1) In the case of income received during the lifetime of a decedent, the tax shall be assessed within one year after written request therefor by the fiduciary or legal representative of the estate of the decedent. The effect of this provision is to limit the period in which the Government may assess the tax in such cases to a period of one year from the date the request is filed, even though more than one year still remains of the regular period (the four-year period or five-year period, as the case may be) in which the assessment may under ordinary circumstances be made. Such a request for immediate assessment does not have the effect of extending the regular period of limitation, even though the request is made less than one year before the expiration of the regular period of limitation. A request for immediate determination and assessment of the tax in such cases is of no force if it is made before the return is filed.

(2) If a notice of a deficiency has been mailed to the taxpayer under the provisions of section 274(a) of the statute (see article

1232) and no appeal is filed with the Board of Tax Appeals, then the period (the four-year period or the five-year period, as the case may be) in which the assessment may under ordinary circumstances be made shall be extended by 60 days, or, if an appeal has been filed, such period shall be extended by the number of days between the date of the mailing of the notice of the deficiency and the date of the final decision of the Board.

(3) In the case of a false or fraudulent return with intent to evade tax, the tax may be assessed at any time after such false or fraudulent return is filed.

(4) In the event the taxpayer fails to file the required return, the amount of tax due may be assessed at any time after the date prescribed for filing the return.

(5) If a deficiency is attributable to a change in a deduction tentatively allowed under paragraph (9) of subdivision (a) of section 214, or paragraph (8) of subdivision (a) of section 234 of the Revenue Act of 1918 or the Revenue Act of 1921, such deficiency may be assessed at any time.

(6) If the Commissioner and the taxpayer consent in writing to the assessment of the tax after the expiration of the four-year period or five-year period prescribed by section 277(a) of the statute as the period in which the assessment of the tax must be made, the tax may be assessed at any time prior to the expiration of the period agreed upon.

ART. 1272. **Period of limitation upon collection of tax.**—In the case of the tax imposed by the Revenue Act of 1921, by such Act as amended, or by the Revenue Act of 1924, a proceeding in court for the collection thereof must be begun within four years after the return was filed, while in the case of the tax imposed by the Act of August 5, 1909, the Act of October 3, 1913, the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, or by any such Act as amended, a proceeding in court for the collection thereof must be begun within five years after the return was filed. The tax imposed by the Acts enumerated may be collected by a proceeding in court within the period prescribed whether it has or has not been assessed.

Exceptions to the periods of limitations outlined in the preceding paragraph are prescribed in the following cases:

(1) If the tax imposed by the Acts enumerated above has been assessed within the four-year period or the five-year period as required by section 277(a) of the statute (see article 1271) a proceeding in court or distraint for the collection of such tax may be begun within six years after the assessment thereof.

(2) In the case of income received during the lifetime of a decedent, a proceeding in court for the collection of the tax must be be-

gun within one year after a written request for the immediate determination and assessment of the tax is filed by the executor, administrator or other fiduciary representing the estate of the decedent. See paragraph (3) of subdivision(a) of section 277 of the statute and article 1271. Such a request does not have the effect of extending the regular period within which a proceeding in court may be brought even though the request is made less than one year before the expiration of the regular period of limitation. A request for immediate determination and assessment of the tax in such cases is of no force if it is made before the return is filed.

(3) In case the Commissioner has determined that a deficiency exists for any year and the Board of Tax Appeals disallows such deficiency in whole or in part, the Commissioner may institute a proceeding in court for the collection of the amount disallowed by the Board at any time within one year after the final decision of the Board even though the regular period of limitation prescribed in section 277 of the statute and outlined in the first paragraph of this article has expired. Such a proceeding may not be begun after the expiration of one year from the final decision of the Board even though the regular period of limitation has not expired.

(4) If an appeal is taken to the Board of Tax Appeals from the decision of the Commissioner on a claim for the abatement of the whole or a part of a deficiency, assessed under the provisions of section 274(d) of the statute, and the Board allows the claim in whole or in part, the Commissioner may begin a proceeding in court for the collection of the amount so abated at any time within one year from the final decision of the Board even though the regular period of limitation outlined in the first paragraph of this article has expired. See section 279(b) of the statute and article 1281. Such a proceeding may not be begun after the expiration of one year from the final decision of the Board even though the regular period of limitation has not expired.

(5) A proceeding in court for the collection of the tax may be begun without assessment at any time (1) in case the taxpayer filed a false or fraudulent return with intent to evade tax; (2) in case the taxpayer failed to file a return; and (3) in case a deficiency is attributable to a change in a deduction tentatively allowed under paragraph (9) of subdivision (a) of section 214 or paragraph (8) of subdivision (a) of section 234 of the Revenue Act of 1918 or the Revenue Act of 1921. In these cases the tax may be assessed at any time (see article 1271). In the event such tax is assessed a proceeding in court or distraint for the collection thereof may be begun within six years after the assessment was made.

ART. 1273. **Cases where period of limitation on assessment and collection of tax under Revenue Act of 1924 is not retroactive.**—Subdivision (e) of section 278 of the statute provides that no provision of that section shall authorize an assessment of any tax or its collection by distraint or by proceeding in court if such assessment, distraint, or proceeding in court was barred by the period of limitation in existence at the time of the enactment of this Act. It further provides that the provisions of section 278 shall not affect any assessment made or distraint or proceeding in court begun before the enactment of this Act. Section 1100(b) of the Act provides:

> (b) The parts of the Revenue Act of 1921 which are repealed by this Act shall (except as provided in sections 280 and 316 and except as otherwise specifically provided in this Act) remain in force for the assessment and collection of all taxes imposed by such Act, and for the assessment, imposition, and collection of all interest, penalties, or forfeitures which have accrued or may accrue in relation to any such taxes, and for the assessment and collection, to the extent provided in the Revenue Act of 1921, of all taxes imposed by prior income, war-profits, or excess-profits tax acts, and for the assessment, imposition, and collection of all interest, penalties, or forfeitures which have accrued or may accrue in relation to any such taxes. In the case of any tax imposed by any part of the Revenue Act of 1921 repealed by this Act, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act.

CLAIMS IN ABATEMENT

SEC. 279. (a) If a deficiency has been assessed under subdivision (d) of section 274, the taxpayer, within 10 days after notice and demand from the collector for the payment thereof, may file with the collector a claim for the abatement of such deficiency, or any part thereof, or of any interest or additional amounts assessed in connection therewith, or of any part of any such interest or additional amounts. Such claim shall be accompanied by a bond, in such amount, not exceeding double the amount of the claim, and with such sureties as the collector deems necessary, conditioned upon the payment of so much of the amount of the claim as is not abated, together with interest thereon as provided in subdivision (c) of this section. Upon the filing of such claim and bond, the collection of so much of the amount assessed as is covered by such claim and bond shall be stayed pending the final disposition of the claim.

(b) If a claim is filed as provided in subdivision (a) of this section the collector shall transmit the claim immediately to the Commissioner who shall by registered mail notify the taxpayer of his decision on the claim. The taxpayer may within 60 days after such notice is mailed file an appeal with the Board of Tax Appeals. If the claim is denied in whole or in part by the Commissioner (or by the Board in case an appeal has been filed) the amount, the claim for which is denied, shall be collected as part of the tax upon notice and demand from the collector, and the amount, the claim for which is allowed, shall be abated. A proceeding in court may be begun for any part of the amount, claim for which is allowed by the Board. Such proceeding

shall be begun within one year after the final decision of the Board, and may be begun within such year even though the period of limitation prescribed in section 277 has expired.

(c) If the claim in abatement is denied in whole or in part, there shall be collected, at the same time as the part of the claim denied, and as a part of the tax, interest at the rate of 6 per centum per annum upon the amount of the claim denied, from the date of notice and demand from the collector under subdivision (d) of section 274 to the date of the notice and demand under subdivision (b) of this section. If the amount included in the notice and demand from the collector under subdivision (b) of this section is not paid in full within 10 days after such notice and demand, then there shall be collected, as part of the tax, interest upon the unpaid amount at the rate of 1 per centum a month (or, in the case of estates of incompetent, deceased, or insolvent persons, at the rate of 6 per centum per annum) from the date of such notice and demand until it is paid.

(d) Except as provided in this section, no claim in abatement shall be filed in respect of any assessment made after the enactment of this Act in respect of any income, war-profits, or excess-profits tax.

ART. 1281. **Claims in abatement.**—If a deficiency is assessed under the provisions of section 274(d) of the statute, (which provides that if the Commissioner believes that the assessment and collection of the deficiency will be jeopardized by delay, he may assess the deficiency before the taxpayer is given an opportunity to be heard by the Board of Tax Appeals (see article 1232)), the taxpayer may file a claim for the abatement of the deficiency or any part thereof or any interest or additional amounts assessed in connection therewith which he believes to have been erroneously or illegally assessed. The claim must be accompanied by a bond in such an amount, not exceeding double the amount of the claim, as the collector deems necessary, conditioned upon payment of so much of the amount of the claim as is not abated, and interest thereon provided by section 279(c). The bond shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds, and shall be subject to the approval of the collector. In lieu of such a bond, the taxpayer may file, under the provisions of section 1029 of the statute, a bond secured by deposit of Liberty bonds or other bonds or notes of the United States sufficient in the amount of their total par value to equal the amount of the claim and such interest as may accrue under the provisions of section 279(c) of the statute. The claim and bond must be filed with the collector within 10 days after notice and demand from the collector for payment of the deficiency. Upon the filing of such claim and bond, the collection of so much of the amount assessed as is covered by the claim and bond shall be stayed pending the final disposition of the claim. A claim for abatement of a deficiency alleged to have been illegally or erroneously assessed shall be made on Form 843. It must

be sustained by affidavits of the party against whom the deficiency was assessed or of other parties cognizant of the facts. The affidavits must contain full and explicit statements of all material facts relating to the claim in support of which they are offered, and to the proper consideration of which they are essential.

The collector, except in the case of a claim in respect of a return audited by him, shall transmit the claim to the Commissioner without delay. The claim shall be considered in accordance with the procedure outlined in article 1211 in connection with protests filed in respect of deficiencies of which the taxpayer is advised prior to assessment. The Commissioner shall make his final decision thereon and shall notify the taxpayer of such decision by registered mail, advising him that if he is not satisfied with the adjudication he may file an appeal to the Board of Tax Appeals within 60 days after the mailing of such notice. If, after considering the appeal the Board denies the claim in whole or in part, the amount the claim for which is denied shall be collected on notice and demand from the collector, and the amount the claim for which is allowed shall be abated. The Commissioner may, however, begin a proceeding in court for the collection of the amount so abated at any time within one year from the final decision of the Board, even though the period in which suits for the collection of the tax may be begun under section 277 of the statute has expired. See article 1272.

If a claim in abatement is denied in whole or in part, there shall be collected at the same time and as a part of the tax interest upon the amount, the claim for which was denied, at the rate of 6 per cent per annum from the date of notice and demand for payment of the tax, made immediately upon assessment of the deficiency (see section 274(d) of the statute and article 1233), to the date of notice and demand made after the decision on the claim. If the amount included in notice and demand for payment after the claim is adjudicated is not paid within 10 days after such notice and demand there shall be collected as a part of the tax interest upon the unpaid amount at the rate of 1 per cent a month from the date of notice and demand until the amount is paid. If, however, the taxpayer is the estate of an insolvent, incompetent, or deceased person, the interest shall be at the rate of 6 per cent per annum. See subdivisions (b) and (c) of section 276 of the statute and article 1261.

Except in the case of deficiencies assessed under the provisions of section 274(d) of the statute, because the Commissioner believes the assessment and collection of such deficiencies will be jeopardized by delay, no claim for abatement of any assessment of any income, war-profits, or excess-profits tax shall be filed. This provision is a limitation on the filing of claims in abatement by taxpayers and does not

affect the filing of blanket claims in abatement by collectors. See section 3218 of the Revised Statutes and section 3220 of the Revised Statutes, as amended by the Revenue Act of 1918 and reenacted by section 1011 of the statute. Also see articles 1302 and 1303. This limitation on the filing of claims in abatement by taxpayers does not apply with reference to assessments made prior to the enactment of the Revenue Act of 1924.

TAXES UNDER PRIOR ACTS

SEC. 280. If after the enactment of this Act the Commissioner determines that any assessment should be made in respect of any income, war-profits, or excess-profits tax imposed by the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, or the Revenue Act of 1921, or by any such Act as amended, the amount which should be assessed (whether as deficiency or as interest, penalty, or other addition to the tax) shall be computed as if this Act had not been enacted, but the amount so computed shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including the provisions in case of delinquency in payment after notice and demand) as in the case of the taxes imposed by this title, except as otherwise provided in section 277.

ART. 1291. **Assessment and collection of taxes under prior acts.**—If after the enactment of the Revenue Act of 1924, the Commissioner determines that any assessment should be made in respect of any income, war-profits, or excess-profits tax imposed by the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or by any such Act as amended, the amount which should be assessed (whether as deficiency or as interest, penalty, or addition to tax) shall be computed as if the Revenue Act of 1924 had not been enacted; but the amount so computed shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including the provisions in case of delinquency in payment after notice and demand) as in the case of taxes imposed by this title, except as otherwise provided in section 277 of the statute. Section 280 contains two provisions with reference to assessments to be made after the enactment of the Revenue Act of 1924 in respect of any income, war-profits, or excess-profits tax imposed by any of the revenue acts enumerated. In the first place, the amount of the assessment is to be computed under the rates of tax, interest, and penalties applicable to the tax for the year in question before the Revenue Act of 1924 was enacted. In the second place, the procedure in assessing the tax is the same as that provided for the assessment of the tax imposed by Title II of the Revenue Act of 1924, except in the case of the limitation on assessment and collection specifically provided in section 277 of this statute in the case of taxes imposed by the Acts in question. The taxpayer will have the same right of appeal to

the Board of Tax Appeals in such cases as he does under the provisions of section 274 in the case of a deficiency determined in respect of taxes imposed by Title II of this Act. These provisions apply only in respect of assessments made under the revenue acts enumerated above, and in those cases only where such assessments are made after June 2, 1924, the date of the enactment of the Revenue Act of 1924.

CREDITS AND REFUNDS

SEC. 281. (a) Where there has been an overpayment of any income, war-profits, or excess-profits tax imposed by this Act, the Act entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909, the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October 3, 1913, the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, or the Revenue Act of 1921, or any such Act as amended, the amount of such overpayment shall be credited against any income, war-profits, or excess-profits tax or installment thereof then due from the taxpayer, and any balance of such excess shall be refunded immediately to the taxpayer.

(b) Except as provided in subdivisions (c) and (e) of this section, (1) no such credit or refund shall be allowed or made after four years from the time the tax was paid, unless before the expiration of such four years a claim therefor is filed by the taxpayer, nor (2) shall the amount of the credit or refund exceed the portion of the tax paid during the four years immediately preceding the filing of the claim or, if no claim was filed, then during the four years immediately preceding the allowance of the credit or refund.

(c) If the invested capital of a taxpayer is decreased by the Commissioner, and such decrease is due to the fact that the taxpayer failed to take adequate deductions in previous years, with the result that there has been an overpayment of income, war-profits, or excess-profits taxes in any previous year or years, then the amount of such overpayment shall be credited or refunded, without the filing of a claim therefor, notwithstanding the period of limitation provided for in subdivision (b) has expired.

(d) Where there has been an overpayment of tax under section 221 or 237 any refund or credit made under the provisions of this section shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent.

(e) If the taxpayer has, within five years from the time the return for the taxable year 1917 was due, filed a waiver of his right to have the taxes due for such taxable year determined and assessed within five years after the return was filed, or if he has, on or before June 15, 1924, filed such a waiver in respect of the taxes due for the taxable year 1918, then such credit or refund relating to the taxes for the year in respect of which the waiver was filed shall be allowed or made if claim therefor is filed either on or before April 1, 1925, or within four years from the time the tax was paid.

(f) This section shall not (1) bar from allowance a claim for credit or refund filed prior to the enactment of this Act which but for such enactment would have been allowable, or (2) bar from allowance a claim in respect of a tax for the taxable year 1919 or 1920 if such claim is filed before the expiration of five years after the date the return was due.

ART. 1301. **Authority for abatement, refund, and credit of tax.**—Authority for the credit and refund of any income, war-profits, or excess-profits tax imposed by the Revenue Act of 1924, the Act of August 5, 1909, the Act of October 3, 1913, the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, or the Revenue Act of 1921, or any such Act as amended, which has been erroneously assessed and collected, is contained in section 281 of the statute. Authority for the abatement of such taxes is contained in section 279 of the statute. See article 1281. General authority for the credit, refund or abatement of any such tax is found in section 3220 of the Revised Statutes as amended by the Revenue Act of 1918, and reenacted by section 1011 of the Revenue Act of 1924 which provides:

> The Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized to remit, refund, and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any manner wrongfully collected; also to repay to any collector or deputy collector the full amount of such sums of money as may be recovered against him in any court, for any internal revenue taxes collected by him, with the cost and expenses of suit; also all damages and costs recovered against any assessor, assistant assessor, collector, deputy collector, agent, or inspector, in any suit brought against him by reason of anything done in the due performance of his official duty, and shall make report to Congress at the beginning of each regular session of Congress of all transactions under this section.

In the case of taxpayers the authority to file a claim for the abatement of an assessment of any income, war-profits, or excess-profits taxes imposed by the Acts enumerated in this article is limited to assessments made in accordance with the provisions of section 274(d) of the statute. See section 279(d) and article 1281. The provisions of section 279(d) do not impair the authority of the collectors to file claims with the Commissioner for relief from charges against them for uncollectible items in accordance with section 3218 of the Revised Statutes as amended, which provides:

> Every collector shall be charged with the whole amount of taxes, whether contained in lists transmitted to him by the Commissioner of Internal Revenue, or by other collectors, or delivered to him by his predecessor in office, and with the additions thereto, with the par value of all stamps deposited with him, and with all moneys collected for penalties, forfeitures, fees, or costs; and he shall be credited with all payments into the Treasury made as provided by law, with all stamps returned by him uncanceled to the Treasury, and with the amount of taxes contained in the lists transmitted in the manner heretofore provided to other collectors, and by them receipted as aforesaid; also with the amount of the taxes of such persons as may have absconded, or become insolvent, prior to the day when the tax ought, according to the

provisions of law, to have been collected, and with all uncollected taxes transferred by him or by his deputy acting as collector to his successor in office: *Provided*, That it shall be proved to the satisfaction of the Commissioner of Internal Revenue, who shall certify the facts to the (First) Comptroller of the Treasury, that due diligence was used by the collector. And each collector shall also be credited with the amount of all property purchased by him for the use of the United States, provided he faithfully account for and pay over the proceeds thereof upon a resale of the same as required by law.

ART. 1302. **Refund, credit, and abatement adjustments.**—Reduction of internal revenue assessments and adjustments of overpayments of revenues will be accomplished in one of three ways:

(1) On the basis of a claim submitted by a taxpayer on Form 843 for the abatement, credit, or refund of the tax. The claim, together with appropriate supporting evidence, must be filed in the office of the collector of internal revenue charged with the collection of the tax or, if the tax has been paid, in the office of the collector for the district in which the tax was paid.

(2) On the basis of a certificate of overassessment prepared by the appropriate administrative unit in the Bureau in each case in which an overassessment of tax is disclosed through audit of a return.

(3) On the basis of a blanket claim, a schedule of taxes found to be uncollectible, or a schedule of duplicate payments and overpayments due to obvious errors on all forms of taxable returns submitted by a collector of internal revenue.

In cases covered by paragraph (2) the taxpayer need not file a claim. Proper adjustment will be made in the Bureau and notice thereof forwarded to the taxpayer. Such adjustments will not be made, however, after the expiration of four years from the date the tax was paid. See article 1307. Where an amount of tax in excess of that properly due has been paid by a withholding agent, the refund or credit of such excess amount shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent.

ART. 1303. **Claims by collectors.**—A collector may present blanket claims on Form 843 for the abatement of certain items which were erroneously assessed. A large part of these items fall in a class where the error in assessment is apparent and the abatement of such assessment by use of blanket claims serves to relieve the collector of the charge against him for such amounts and to relieve him in an expeditious manner of the duty of collecting from the taxpayer certain amounts which a summary examination clearly shows are not due from the taxpayer. Some of the items included in this class of cases are duplicate assessments, amounts assessed as unidentified collections and later identified, assessments resulting from errors in computation, and amounts entered as excess collections which are

subsequently credited against taxes later found to be due. The collector may also include in such claims overassessments discovered by him in the audit of returns on Form 1040A and such other returns as he is authorized by the Commissioner to audit.

In the event any such assessment has been paid the collector may file a blanket claim on Form 843 for credit of such amounts against any unpaid assessments standing against the taxpayer upon the assessment lists held by the collector. If there are no such unpaid assessments against which credit may be taken, the collector shall submit refund schedules to cover such amounts in accordance with instructions issued by the Commissioner.

The collector may also present claims for the abatement of taxes not erroneously assessed but found to be uncollectible. In such cases the collector or deputy collector who made the demand for payment and is conversant with the facts may prepare the claim for abatement on Form 53. Although credits allowed on account of insolvency or absconding release the collector from the obligation created by his receipt for the amount credited, the obligation to pay still remains upon the person assessed. It is the duty of the collector to use the same diligence to collect the tax after it has been abated as uncollectible as before the abatement. Collectors should therefore keep a record of all taxes thus credited and of the persons from whom they are due and should enforce payment whenever it is in their power to do so.

ART. 1304. **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 charged with the assessment of the tax against which the credit is desired a claim on Form 843 which shall be sworn to and shall contain the following statements: (*a*) business engaged in by the claimant, (*b*) character of assessment of tax, (*c*) amount of tax claimed as a credit, (*d*) unpaid assessment against which credit is asked and for what taxable year, and (*e*) 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 Form 843, stating thereon the respective amounts claimed as a credit or as a refund. See article 1306. All facts regarding the total overpayment should be stated in the claim.

ART. 1305. **Action on claims for credit.**—Upon receipt by the collector of a claim for credit on Form 843, he will make proper record thereof in his office and, except in the case of claims covering taxes assessed on the basis of returns on Form 1040 A and on the basis of such other returns as the collector is authorized by the Commissioner to audit, forward the claim immediately to the Commissioner, irrespective of whether or not a claim for refund of the tax now claimed as a credit has previously been filed. Due notice will be given the collector and the taxpayer of the action taken on the claim. Claims for credit covering taxes assessed on the basis of returns which the Commissioner has authorized the collector to audit shall be examined by the collector. He shall then notify the taxpayer of his action on the claim and the taxpayer may, upon receipt of such notice, appeal to the Commissioner from the action of the collector.

If a claim is allowed against additional taxes due for other years, but such other taxes have not yet been assessed, the amount of the excess of such taxes over the overpayment shall be assessed or the excess of the overpayment of such taxes due shall be refunded as the case may be. The effective date of the filing of the claim for credit shall be the actual date of presentation to the collector.

Under no circumstances will a taxpayer be entitled to credit for an alleged overpayment of tax prior to the allowance of such credit by the Commissioner.

ART. 1306. **Claims for refund of taxes erroneously collected.**—Claims by the taxpayer for the refunding of taxes, interest, penalties and additions to tax erroneously or illegally collected shall be made on Form 843. All facts relied upon in support of the claim should be clearly set forth under oath. In the case of the taxpayer's death, certified copies of the letters of administration or letters testamentary or other similar evidence must be annexed to the claim to show the authority of the administrator or executor. The affidavit may be made by the agent of the person assessed, but in such case a power of attorney must accompany the claim. Checks in payment of claims allowed will be drawn in the names of the persons entitled to the money and will be sent directly to the proper persons. The Commissioner has no authority to refund on equitable grounds penalties legally collected. As to claims for refund of sums recovered by suit, see article 1353.

ART. 1307. **Limitations upon the crediting and refunding of taxes paid.**—Section 281 of the statute authorizes the Commissioner to credit or refund any amount of income, war-profits, or excess-profits tax paid in excess of that properly due under any return against any such tax due from the taxpayer under any other return. With a few exceptions the Commissioner is prohibited from making such

credits or refunds after four years from the time the tax was paid, unless before the expiration of such period the taxpayer files a claim for such credit or refund. The amount of such credit or refund shall not exceed the portion of the tax paid during the four years immediately preceding the date of the allowance of the credit or refund, or if the credit or refund is based upon a claim the amount of the credit or refund shall not exceed the portion of the tax paid during the four years immediately preceding the date of filing the claim for credit or refund.

If the invested capital of a taxpayer is decreased by the Commissioner and such decrease is due to the fact that the taxpayer failed to take adequate deductions in previous years, with the result that there has been an overpayment of income, war-profits, or excess-profits taxes in any previous year or years, then the amount of such overpayment shall be credited or refunded regardless of the possible expiration of the four-year period of limitation. This provision applies to returns filed under the Revenue Acts of 1917, 1918, and 1921. The Commissioner is directed to grant this relief without requiring the filing of a claim.

Where the taxpayer has within five years from the date the return for the taxable year 1917 was due, filed a waiver of his right to have the taxes due for such taxable year determined and assessed within five years after the return was filed, or if he has, on or before June 15, 1924, filed such a waiver in respect of the taxes due for the taxable year 1918, then such credit or refund relating to the taxes for the year in respect of which the waiver was filed shall be allowed or made if claim therefor is filed either on or before April 1, 1925, or within four years from the time the tax was paid. The effect of this provision is to grant to those taxpayers who, prior to the expiration of the period within which an additional assessment could be made, filed a waiver for the year 1917, an additional period in which to present their claims for refund or credit of the excess amount of the tax paid for the year 1917, with the result that in such cases the claim may be entertained if filed either on or before April 1, 1925, or within four years from the time the tax was paid. An additional period to April 1, 1925, within which the taxpayer may file his claim for the credit or refund of taxes imposed under the Revenue Act of 1918 for the year 1918 is also provided in the event the taxpayer has on or before June 15, 1924, filed a waiver of his right to have the taxes due for such taxable year determined and assessed within five years after the return was filed.

ART. 1308. **Refunds or credits under prior acts.**—Subdivision (f) of section 281 of the statute provides that any claim filed prior to the enactment of the Revenue Act of 1924, which but for the provisions

of the other subdivisions of section 281 would have been allowable, shall not be barred by the provisions of such subdivisions, nor shall they bar from allowance a claim for the credit or refund of taxes for the taxable year 1919 or 1920, if such claim is filed within five years after the return was due, even though it is filed after the expiration of four years from the date the tax was paid.

CLOSING BY COMMISSIONER OF TAXABLE YEAR

SEC. 282. (a) If the Commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then last past or the taxable year then current unless such proceedings be brought without delay, the Commissioner shall declare the taxable period for such taxpayer immediately terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any proceeding in court brought to enforce payment of taxes made due and payable by virtue of the provisions of this section the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design.

(b) A taxpayer who is not in default in making any return or paying income, war-profits, or excess-profits tax under any Act of Congress may furnish to the United States, under regulations to be prescribed by the Commissioner, with the approval of the Secretary, security approved by the Commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The Commissioner may approve and accept in like manner security for return and payment of taxes made due and payable by virtue of the provisions of this section, provided the taxpayer has paid in full all other income, war-profits, or excess-profits taxes due from him under any Act of Congress.

(c) If security is approved and accepted pursuant to the provisions of this section and such further or other security with respect to the tax or taxes covered thereby is given as the Commissioner shall from time to time find necessary and require, payment of such taxes shall not be enforced by any proceedings under the provisions of this section prior to the expiration of the time otherwise allowed for paying such respective taxes.

(d) In the case of a citizen of the United States about to depart from the United States the Commissioner may, at his discretion, waive any or all of the requirements placed on the taxpayer by this section.

(e) No alien shall depart from the United States unless he first procures from the collector or agent in charge a certificate that he has complied with all the obligations imposed upon him by the income, war-profits, and excess-profits tax laws.

(f) If a taxpayer violates or attempts to violate this section there shall, in addition to all other penalties, be added as part of the tax 25 per centum of the total amount of the tax or deficiency in the tax, together with interest at the rate of 1 per centum a month from the time the tax became due.

ART. 1311. Termination of the taxable period by Commissioner.—Section 282 provides that in the case of a taxpayer who designs by immediate departure from the country or otherwise to avoid the payment of the tax for the preceding or current taxable year, the Commissioner may, upon evidence satisfactory to him, declare the taxable period for such taxpayer immediately terminated and cause the service upon him of a notice and demand for immediate payment of the tax for the taxable period declared terminated, and of the tax for the preceding taxable year, or so much of such tax as is unpaid. In such a case the taxpayer is entitled to the personal exemption and credit for dependents, if otherwise allowable under section 216 of the statute (see articles 301–306), but such personal exemption and credit for dependents shall be reduced proportionately to the length of the period for which the return is made. See section 226(e) and article 431. If suit is necessary to collect a tax made due and payable by the provisions of section 282 of the statute, the Commissioner's finding is presumptive evidence of the taxpayer's design. A taxpayer who is not in default in making the returns or in paying other taxes may procure the postponement until the usual time of the payment of taxes which are or may be due pursuant to this article by depositing with the Commissioner United States bonds of a principal amount double the estimated amount of taxes due for the taxable period, or by furnishing such other securities as may be approved by the Commissioner. See section 1029 of the statute.

Aliens departing from the United States will be required to obtain certificates of compliance with income tax obligations from the collector or revenue agent in charge. Aliens, whether resident or nonresident, who intend to depart from this country should appear before the collector or revenue agent in charge for the district in which they reside and satisfy all income tax obligations with respect to income received up to and including the calendar month next preceding that of their intended departure. Upon payment of such obligations, or upon satisfactory evidence that no tax is due and payable, the collector or revenue agent in charge will issue a certificate of compliance to the applicant. A properly executed certificate of compliance issued by the collector or revenue agent in charge must be presented at the pier, where it will be taken up. Aliens presenting themselves at the point of departure without such certificates of compliance will be examined by internal revenue officers at that point and such taxes as appear to be due and owing will be collected. American citizens departing from the United States will not be required to procure certificates of compliance or to present any other evidence of compliance with income tax obligations.

If a taxpayer violates or attempts to violate the provisions of section 282 of the statute there shall, in addition to all other penalties, be added as a part of the tax 25 per cent of the tax or deficiency in the tax, together with interest at the rate of 1 per cent a month from the time the tax became due.

EFFECTIVE DATE OF TITLE

SEC. 283. This title shall take effect as of January 1, 1924.

BOARD OF TAX APPEALS

SEC. 900. (a) There is hereby established a board to be known as the Board of Tax Appeals (hereinafter referred to as the "Board"). The Board shall be composed of seven members, except that for a period of two years after the enactment of this Act the Board shall be composed of such number of members, not more than twenty-eight, as the President determines to be necessary.

(b) Each member of the Board shall be appointed by the President, by and with the advice and consent of the Senate, solely on the grounds of fitness to perform the duties of the office. The term of office of all members who are to compose the Board during the period of two years after the enactment of this Act, shall expire at the end of such period. The terms of office of the first seven members who are thereafter to compose the Board shall expire, two at the end of the fourth year, two at the end of the sixth year, two at the end of the eighth year, and one at the end of the tenth year, after the expiration of such two-year period. The term of office of each such member shall be designated by the President, and the terms of office of their successors shall expire ten years after the expiration of their predecessors' terms, except that any individual appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed only for the unexpired term of his predecessor, and a member in office at the expiration of the term for which he was appointed may continue in office until his successor is qualified. Any member of the Board may be removed by the President for inefficiency, neglect of duty, or malfeasance in office, but for no other reason. Each member shall receive a salary at the rate of $7,500 per annum.

(c) No member of the Board appointed for a term beginning after the expiration of two years after the enactment of this Act shall be permitted to practice before the Board or any official of the Bureau of Internal Revenue for a period of two years after leaving office.

(d) The Board shall at least biennially designate a member to act as chairman. The Board shall have a seal which shall be judicially noticed.

(e) The Board and its divisions shall hear and determine appeals filed under sections 274, 279, 308, and 312. A majority of the members of the Board or of any division thereof shall constitute a quorum for the transaction of the business of the Board or of the division, respectively. A vacancy in the Board or in any division thereof shall not impair the powers nor affect the duties of the Board or division, nor of the remaining members of the Board or division, respectively.

(f) The chairman may from time to time divide the Board into divisions and assign the members thereto, and designate a chief thereof. If a division, as a result of a vacancy or the absence or inability of a member assigned thereto to serve thereon, is composed of less than three members, the chairman may assign other members thereto, or he may direct the division to proceed

with the transaction of business. A division shall hear and determine appeals filed with the Board and assigned to such division by the chairman. Upon the expiration of thirty days after a decision by a division, such decision, and the findings of fact made in connection therewith, shall become the final decision and findings of the Board, unless within such period the chairman has directed that such decision shall be reviewed by the Board.

(g) In any proceeding in court under sections 274, 279, 308, or 312, and in any suit or proceeding by a taxpayer to recover any amounts paid in pursuance of a decision of the Board, the findings of the Board shall be prima facie evidence of the facts therein stated.

(h) Notice and an opportunity to be heard shall be given to the taxpayer and the Commissioner and a decision shall be made as quickly as practicable. Hearings before the Board and its divisions shall be open to the public. The proceedings of the Board and its divisions shall be conducted in accordance with such rules of evidence and procedure as the Board may prescribe. It shall be the duty of the Board and of each division to make a report in writing of its findings of fact and decision in each case, and a copy of its report shall be entered of record and a copy furnished the taxpayer. If the amount of tax in controversy is more than $10,000 the oral testimony taken at the hearing shall be reduced to writing and the report shall contain an opinion in writing in addition to the findings of fact and decision. All reports of the Board and its divisions and all evidence received by the Board and its divisions (including, in cases where the oral testimony is reduced to writing, the transcript thereof) shall be public records open to the inspection of the public. The Board shall provide for the publication of its reports at the Government Printing Office in such form and manner as may be best adapted for public information and use, and such authorized publication shall be competent evidence of the reports of the Board therein contained in all courts of the United States and of the several States without any further proof or authentication thereof. Such reports shall be subject to sale in the same manner and upon the same terms as other public documents. The principal office of the Board shall be in the District of Columbia, but the Board or any of its divisions may sit at any place within the United States. The times and places of the meetings of the Board, and of its divisions, shall be prescribed by the chairman with a view to securing reasonable opportunity to taxpayers to appear before the Board or any of its divisions, with as little inconvenience and expense to taxpayers as is practicable.

(i) For the efficient administration of the functions vested in the Board or any division thereof, any member of the Board may administer oaths, examine witnesses, and require, by subpœna ordered by the Board or any division thereof and signed by the member, (1) the attendance and testimony of witnesses, and the production of all necessary returns, books, papers, documents, correspondence, and other evidence, from any place in the United States at any designated place of hearing, (2) the taking of a deposition before any designated individual competent to administer oaths under this Act, and (3) the answer in writing under oath to any question of fact submitted. In the case of a deposition the testimony shall be reduced to writing by the individual taking the deposition or under his direction and shall then be subscribed by the deponent. Any witnesses summoned or whose deposition is taken under this subdivision shall be paid the same fees and mileage as are paid witnesses in the courts of the United States.

(j) The Secretary shall furnish the Board with such clerical assistance, quarters, stationery, furniture, office equipment, and other supplies as may be necessary for the efficient execution of the functions vested in it by this section.

(k) The members and employees of the Board and employees assigned thereto shall receive their necessary traveling expenses, and their actual expenses incurred for subsistence while traveling on duty and away from their designated stations in an amount not to exceed $7 per day in the case of members, and $4 per day in the case of employees. The Board is authorized in accordance with the civil service laws to appoint, and in accordance with the Classification Act of 1923 to fix the compensation of, such employees, and to make such expenditures, including expenditures for personal services and rent at the seat of the government and elsewhere, and for law books, books of reference, and periodicals, as may be necessary efficiently to execute the functions vested in the Board, in case such assistants and such expenditures are not suitably provided for by the Secretary under subdivision (j). All expenditures of the Board shall be allowed and paid upon the presentation of itemized vouchers therefor, signed by the chairman, out of any moneys appropriated for the collection of internal-revenue taxes and allotted to the Board, or out of any moneys specifically appropriated for the purposes of the Board. The Board shall be an independent agency in the executive branch of the Government.

LAWS MADE APPLICABLE

SEC. 1000. All administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this Act.

RECORDS, STATEMENTS, AND SPECIAL RETURNS

SEC. 1002. (a) Every person liable to any tax imposed by this Act, or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

(b) Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return, render under oath such statements, or keep such records as the Commissioner deems sufficient to show whether or not such person is liable to tax.

(c) The Commissioner, with the approval of the Secretary, may by regulation prescribe that any return required by Titles IV, V, VI, or VII to be under oath may, if the amount of the tax covered thereby is not in excess of $10, be signed or acknowledged before two witnesses instead of under oath.

(d) Any oath or affirmation required by the provisions of this Act or regulations made under authority thereof, may be administered by any officer authorized to administer oaths for general purposes by the law of the United States or of any State, Territory, or possession of the United States, wherein such oath or affirmation is administered, or by any consular officer of the United States.

ART. 1321. **Aids to collection of tax.**—In assessing and collecting income taxes the Commissioner has the benefit of all existing internal revenue laws in so far as such laws are applicable. As an aid in

assessing and collecting the tax the Commissioner may require any person liable to tax to keep specific records, render under oath such statements and returns, and comply with such rules and regulations as the Commissioner with the approval of the Secretary may prescribe. In accordance with this provision, every taxpayer carrying on the business of producing, manufacturing, purchasing, or selling any commodities or merchandise, except the business of growing and selling products of the soil, shall for the purpose of determining the amount of income under the Revenue Act of 1924 keep such permanent books of account or records, including inventories, as are necessary to establish the amount of gross income and deductions, credits, and other information required by an income tax return.

The Commissioner may also require any person, by notice served upon him, to make a return, render under oath such statements, or keep such records as the Commissioner deems sufficient to show whether any such person is liable to tax. For time and place for filing returns of income see sections 227 and 241 of the statute and articles 441–446 and 651.

ART. 1322. **Officers authorized to administer oaths.**—In any case where an oath is required in connection with any returns or statements, made in accordance with the provisions of any section of the Revenue Act of 1924 or any regulations prescribed by the Commissioner and approved by the Secretary under the provisions of any section of such Act, such oath may be administered by any officer authorized to administer oaths for general purposes by the law of the United States or of any State, Territory, or possession of the United States, wherein such oath or affirmation is administered, or by any consular officer of the United States. Section 3165 of the Revised Statutes, as amended by section 1317 of the Revenue Act of 1918 and reenacted without change by section 1018 of the Revenue Act of 1924, authorizes collectors, deputy collectors, internal-revenue agents, and internal-revenue officers assigned to duty under an internal-revenue agent to administer oaths in connection with the administration of the internal-revenue laws. See article 1331.

Any officer who executes a jurat indicating that he has administered an oath when no oath has actually been administered, or reciting any other fact which is untrue, is liable to prosecution under section 106 of the United States Penal Code, which provides:

> Whoever, being a public officer or other person authorized by any law of the United States to make or give a certificate or other writing, shall knowingly make and deliver as true such a certificate or writing, containing any statement which he knows to be false, in a case where the punishment thereof is not elsewhere expressly provided by law, shall be fined not more than five hundred dollars or imprisoned not more than one year, or both.

Such misconduct will be deemed sufficient reason for requesting the cancellation of the oath-administering authority of any officer guilty of the offense and, in the case of an officer or employee of the United States, may result in a request for his dismissal from the service, in addition to the penalties prescribed by law.

EXAMINATION OF BOOKS AND WITNESSES

SEC. 1004. The Commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is hereby authorized, by any revenue agent or inspector designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons.

ART. 1331. **Examination of records and witnesses.**—Section 1004 of the Revenue Act of 1924 provides that any revenue agent or inspector designated by the Commissioner may examine any books, papers, records, or memoranda bearing upon the matters required by law to be included in the return for the purpose of ascertaining the correctness of such return or for the purpose of making a return where none has been made. Any such agent or inspector is further authorized to administer oaths to the person making the return, any officer or employee of such person, or any other person having knowledge of the facts, and to require such person or persons to appear before him and testify with reference to such matters.

General authority to administer oaths and take evidence in connection with the administration of the internal revenue laws is found in section 3165 of the Revised Statutes as amended by section 1317 of the Revenue Act of 1918 and reenacted without change by section 1018 of the Revenue Act of 1924, which provides:

SEC. 3165. Every collector, deputy collector, internal-revenue agent, and internal-revenue officer assigned to duty under an internal-revenue agent is authorized to administer oaths and to take evidence touching any part of the administration of the internal-revenue laws with which he is charged, or where such oaths and evidence are authorized by law or regulation authorized by law to be taken.

See also section 1002(d) of the statute and article 1322.

UNNECESSARY EXAMINATIONS

SEC. 1005. No taxpayer shall be subjected to unnecessary examinations or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Commissioner, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

FINAL DETERMINATIONS AND ASSESSMENTS

SEC. 1006. If after a determination and assessment in any case the taxpayer has paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is made in writing between the taxpayer and the Commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States.

ART. 1341. **Final determination of tax or penalty.**—Section 1006 provides a method whereby a determination by the Commissioner of the amount of tax or penalty due may become final and conclusive, upon the making of an agreement in writing to that effect between the taxpayer and the Commissioner with the approval of the Secretary. Such agreement may be made if, after a determination and assessment in any case, the taxpayer has (1) paid in whole any tax or penalty, (2) accepted any abatement, (3) accepted any credit, or (4) accepted any refund, based upon a determination and assessment by the Commissioner. It is not essential to such an agreement that the tax or penalty was paid under protest or duress. When such agreement is entered into, the case shall not be reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made. In case the taxpayer is a corporation a certified copy of the minutes of the board of directors authorizing an officer or officers of such corporation to enter into such agreement shall be filed with such agreement at the time of the execution thereof. Such agreements shall be executed in duplicate, one to be placed in the files of the case in the bureau and one to be given to the taxpayer.

ADMINISTRATIVE REVIEW

SEC. 1007. In the absence of fraud or mistake in mathematical calculation, the findings of facts in and the decision of the Commissioner upon (or in case the Secretary is authorized to approve the same, then after such approval) the merits of any claim presented under or authorized by the internal-revenue laws shall not, except as provided in section 900, be subject to review by any other administrative or accounting officer, employee, or agent of the United States.

RETROACTIVE REGULATIONS

SEC. 1008. (a) In case a regulation or Treasury decision relating to the internal-revenue laws, made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

(b) No tax shall be levied, assessed, or collected under the provisions of Title VI of this Act on any article sold or leased by the manufacturer, producer, or importer, if at the time of the sale or lease there was an existing ruling, regulation, or Treasury decision holding that the sale or lease of such article was not taxable, and the manufacturer, producer, or importer parted with possession or ownership of such article, relying upon the ruling, regulation, or Treasury decision.

LIMITATION ON PROSECUTIONS BY THE UNITED STATES

SEC. 1010. (a) The Act entitled "An Act to limit the time within which prosecutions may be instituted against persons charged with violating internal-revenue laws," approved July 5, 1884, as amended, is amended to read as follows:

"That no person shall be prosecuted, tried, or punished for any of the various offenses arising under the internal-revenue laws of the United States unless the indictment is found or the information instituted within three years next after the commission of the offense: *Provided*, That for offenses involving the defrauding or attempting to defraud the United States or any agency thereof, whether by conspiracy or not, and in any manner, the period of limitation shall be six years, but this proviso shall not apply to acts, offenses, or transactions which were barred by law at the time of the enactment of the Revenue Act of 1924: *Provided further*, That the time during which the person committing the offense is absent from the district wherein the same is committed shall not be taken as any part of the time limited by law for the commencement of such proceedings: *Provided further*, That the provisions of this Act shall not apply to offenses committed prior to its passage: *Provided further*, That where a complaint shall be instituted before a commissioner of the United States within the period above limited, the time shall be extended until the discharge of the grand jury at its next session within the district: *And provided further*, That this Act shall not apply to offenses committed by officers of the United States."

(b) Any prosecution or proceeding under an indictment found or information instituted prior to the enactment of the Revenue Act of 1921 shall not be affected in any manner by this section, nor by the amendment by the Revenue Act of 1921 of such Act of July 5, 1884, but such prosecution or proceeding shall be subject to the limitations imposed by law prior to the enactment of the Revenue Act of 1921.

REFUNDS

SEC. 1013. (a) The second proviso of the first section of the Act entitled "An Act Authorizing the Commissioner of Internal Revenue to redeem or make allowance for internal-revenue stamps," approved May 12, 1900, as amended, is amended to read as follows: "*Provided further*, That no claim

for the redemption of or allowance for stamps shall be allowed unless presented within four years after the purchase of such stamps from the Government."

(b) The exemption provided in paragraph (10) of subdivision (a) of section 11 of the Revenue Act of 1916, and in subdivision (10) of section 231 of the Revenue Act of 1918, and in subdivision (10) of section 231 of the Revenue Act of 1921, shall be granted to farmers' or other mutual hail, cyclone, or fire insurance companies (if otherwise exempt under such paragraphs), whether or not such organizations were of a purely local character. Any taxes assessed against such organizations shall, subject to the statutory period of limitations properly applicable thereto, be abated, credited or refunded.

LIMITATIONS UPON SUITS AND PROCEEDINGS BY THE TAXPAYER

SEC. 1014. (a) Section 3226 of the Revised Statutes, as amended, is amended to read as follows:

"SEC. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress. No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of five years from the date of the payment of such tax, penalty, or sum, unless such suit or proceeding is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates. The Commissioner shall within 90 days after any such disallowance notify the taxpayer thereof by mail."

(b) This section shall not affect any proceeding in court instituted prior to the enactment of this Act.

SEC. 1015. Section 3225 of the Revised Statutes, as amended, is repealed and any claim for credit or refund of taxes imposed by the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or any such Act as amended, heretofore denied in whole or in part because of the provisions of such section may be reopened and decided without reference to its provisions.

ART. 1351. **Suits for recovery of taxes erroneously collected.**—Under the provisions of section 3226 of the Revised Statutes as amended by section 1014 of the Revenue Act of 1924, no suit or proceeding by the taxpayer for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, can be maintained until a claim for refund or credit has been duly filed with the Commissioner (see section 281 of the Statute and articles 1301-1308) and six months have elapsed from

the date of filing such claim, unless the Commissioner renders a decision within six months, in which case suit may be brought upon the rendition of the decision. No suit or proceeding can be brought after the expiration of five years from the date of the payment of such tax, penalty, or sum, unless such suit or proceeding is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates. The statute requires that the Commissioner shall notify the taxpayer by mail of the disallowance of the claim for refund or credit within 90 days after such disallowance. Payment of the tax, penalty, or other sum under protest or duress is not a prerequisite to the bringing of such suit or proceeding.

Section 3226 of the Revised Statutes as amended outlines the only manner in which a suit may be brought by the taxpayer for the recovery of taxes erroneously or illegally assessed or collected or penalties collected without authority, or any sums excessive or in any manner erroneously collected, and strict compliance with these provisions by any taxpayer bringing such suit or proceeding is required. No suit for the purpose of restraining the assessment or collection of any taxes shall be maintained in any court. The word "restraining" is used in its broad, popular sense of hindering or impeding, as well as prohibiting or staying, and the provision is not limited in its application to suits for injunctive relief. The prohibition of such suits can not be waived by any officer of the Government. See section 3224 of the Revised Statutes.

Section 1014 does not affect any proceeding in court instituted prior to the enactment of the Act.

ART. 1352. **Effect of repeal of section 3225 of the Revised Statutes, as amended, on claims previously denied under its provisions.**—Section 1015 of the statute repeals section 3225 of the Revised Statutes (as amended by the Revenue Act of 1918), and provides that any claim for credit or refund of taxes imposed by the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or any such act as amended, previously denied in whole or in part because of the provisions of such section, may be reopened and decided without reference to its provisions. Section 3225 of the Revised Statutes as amended provided that when a second assessment was made in the case of any list, statement, or return which in the opinion of the collector or his deputy was false or fraudulent, or contained any understatement or undervaluation, such assessment should not be remitted, refunded, paid back, or recovered by any suit unless it was proved that the list, statement, or return was not willfully false or fraudulent and did not contain any willful understatement or undervaluation. In repealing this section of the Revised Statutes, section 1015 of the

Revenue Act of 1924 removes only the limitation placed on the claim by such section of the Revised Statutes, and does not in any way affect the limitations imposed by the other existing provisions of any internal revenue law on the allowance of a claim for credit or refund or the recovery of tax by suit. In the case of claims which have been previously denied because of the provisions of section 3225 of the Revised Statutes as amended, and the allowance of which is not otherwise barred, the taxpayer may request the Commissioner to reconsider such claim or claims and in the event of a refusal or an adverse decision by the Commissioner, the claim shall be sufficient basis for the institution of a suit within the meaning of section 3226 of the Revised Statutes as amended by section 1014 of the Revenue Act of 1924. See article 1351.

ART. 1353. **Claims for refund of sums recovered by suit.**—(*a*) Claims by taxpayers for the amount of a judgment representing taxes or penalties erroneously collected should be made on Form 843. The claimant should state the grounds of his claim under oath, giving the names of all the parties to the suit, the cause of action, the date of its commencement, the date of the judgment, the court in which it was recovered, and its amount. To this affidavit there should be annexed a certified copy of the final judgment, a certificate of probable cause, and an itemized bill of the costs paid receipted by the clerk or other proper officer of the court, together with a certified copy of the docket entries of the court in the case or so much thereof as may be required by the Commissioner. When a recovery is had in any suit or proceeding against a collector or other internal revenue officer for any act done by him, or for the recovery of any money exacted by or paid to him and by him paid into the Treasury, in the performance of his official duty, and the court certifies that there was probable cause for the act done by the collector or other officer, or that he acted under the directions of the Secretary of the Treasury, or other proper officer of the Government, no execution shall issue against such collector or other officer, but the amount so recovered shall, upon final judgment, be provided for and paid out of the proper appropriation from the Treasury. See section 989 of the Revised Statutes. (*b*) If the judgment debtor shall have already paid the amount recovered against him, the claim should be made in his name. There should also be a certificate of the clerk of the court in which the judgment was recovered (or other satisfactory evidence), showing that the judgment has been satisfied and specifying the exact sum paid in its satisfaction, with a detail of all items of costs which were paid by the judgment debtor or for which he is liable. See further articles 1302 and 1381.

PENALTIES

SEC. 1017. (a) Any person required under this Act to pay any tax, or required by law or regulations made under authority thereof to make a return, keep any records, or supply any information, for the purposes of the computation, assessment, or collection of any tax imposed by this Act, who willfully fails to pay such tax, make such return, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than one year, or both, together with the costs of prosecution.

(b) Any person required under this Act to collect, account for and pay over any tax imposed by this Act, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this Act or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

(c) Any person who willfully (1) aids or assists in the preparation or presentation of a false or fraudulent return, affidavit, claim, or document, authorized or required by the internal revenue laws, or (2) procures, counsels, or advises the preparation or presentation of such return, affidavit, claim, or document, shall (whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document) be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

(d) Any person who willfully fails to pay, collect, or truthfully account for and pay over, any tax imposed by Titles IV, V, VI, VII, and VIII, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty of the amount of the tax evaded, or not paid, collected or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected. No penalty shall be assessed under this subdivision for any offense for which a penalty may be assessed under authority of section 3176 of the Revised Statutes, as amended, or for any offense for which a penalty has been recovered under section 3256 of the Revised Statutes.

(e) The term "person" as used in this section includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

ART. 1361. **Specific penalties.**—Section 1017 of the Act provides that a penalty of not more than $10,000 or imprisonment for not more than one year or both shall, upon conviction, be imposed on any person required by the Act to pay any tax or required by law or regulations made under authority of law to make a return, keep any records, or supply information, for the purposes of the computation, assessment, or collection of any tax imposed by the Act, who willfully fails to pay such tax, make such return, keep the required records or supply the required information at the time or

times fixed by law or regulations. Any person required by the Act to collect, account for, and pay over any tax imposed by the Act, who willfully fails to collect or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat such tax or the payment thereof, is, in addition to other penalties provided by law, guilty of a felony, and upon conviction, shall be fined not more than $10,000 or imprisoned for not more than five years, or both. The section further provides that any person who willfully (1) aids or assists in the preparation or presentation of a false or fraudulent return, affidavit, claim, or document, authorized or required by the internal revenue laws, or (2) procures, counsels, or advises the preparation or presentation of such return, affidavit, claim, or document, shall be guilty of a felony, and upon conviction thereof shall be fined not more than $10,000 or imprisoned for not more than five years or both, together with the costs of prosecution. This provision makes the aiding or assisting in the preparation or presentation, or the procuring or advising the preparation or presentation of such return, affidavit, claim, or document, a separate and distinct offense from the preparation or presentation of such return, affidavit, claim, or document, and it is not an essential element of the offense that the acts constituting such offense are done with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document. The term "person," as used in this article, includes an officer or employee of a corporation, or a member or employee of a partnership who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

A specific penalty is enforceable only by suit or prosecution. For limitations on such prosecutions, see the Act of July 5, 1884, as amended by section 1010 of the Revenue Act of 1924.

INTEREST ON REFUNDS AND CREDITS

SEC. 1019. Upon the allowance of a credit or refund of any internal-revenue tax erroneously or illegally assessed or collected, or of any penalty collected without authority, or of any sum which was excessive or in any manner wrongfully collected, interest shall be allowed and paid on the amount of such credit or refund at the rate of 6 per centum per annum from the date such tax, penalty, or sum was paid to the date of the allowance of the refund, or in case of a credit, to the due date of the amount against which the credit is taken, but if the amount against which the credit is taken is an additional assessment, then to the date of the assessment of that amount. The term "additional assessment" as used in this section means a further assessment for a tax of the same character previously paid in part.

ART. 1371. Interest on refunds and credits.—Section 1019 of the act provides that upon the allowance of a credit or refund of any internal-revenue tax erroneously or illegally assessed or collected,

or any penalty collected without authority, or of any sum which was excessive or in any manner wrongfully collected, interest upon such credits or refund shall be paid at the rate of 6 per cent per annum. A claim for credit or refund is " allowed " within the meaning of the statute when the Commissioner approves the schedule in whole or in part for transmission to the proper accounting officer for credit or refund. The interest runs in the case of a refund from the date the tax, penalty, or sum was paid, to the date of the allowance of the refund, and in the case of a credit, from the date such tax, penalty, or sum was paid to the due date of the amount against which the credit is taken, but if the amount against which the credit is taken is an additional assessment, then to the date of the assessment of that amount. The term " additional assessment " as here used means a further assessment for a tax of the same character previously paid in part. Thus, an income tax is not of the " same character " as a capital-stock tax.

INTEREST ON JUDGMENTS

SEC. 1020. Section 177 of the Judicial Code, as amended, is reenacted without change, as follows:

" SEC. 177. No interest shall be allowed on any claim up to the time of the rendition of judgment by the Court of Claims, unless upon a contract expressly stipulating for the payment of interest, except that interest may be allowed in any judgment of any court rendered after the passage of the Revenue Act of 1921 against the United States for any internal-revenue tax erroneously or illegally assessed or collected, or for any penalty collected without authority or any sum which was excessive or in any manner wrongfully collected under the internal-revenue laws."

ART. 1381. **Interest on judgments.**—Section 177 of the Judicial Code, as amended by section 1324 of the Revenue Act of 1921 and reenacted without change by section 1020 of the Revenue Act of 1924, provides that interest may be allowed in any judgment of any court rendered after the passage of the Revenue Act of 1921 against the United States for any internal-revenue tax erroneously or illegally assessed or collected, or for any penalty collected without authority, or any sum which was excessive or in any manner wrongfully collected under the internal-revenue laws.

PAYMENT OF AND RECEIPTS FOR TAXES

SEC. 1021. (a) Collectors may receive, at par with an adjustment for accrued interest, notes or certificates of indebtedness issued by the United States and uncertified checks in payment of income, war-profits, and excess-profits taxes and any other taxes payable other than by stamp, during such time and under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions to the same extent as if such check had not been tendered.

(b) Every collector to whom any payment of any income tax is made shall upon request give to the person making such payment a full written or printed receipt, stating the amount paid and the particular account for which such payment was made; and whenever any debtor pays taxes on account of payments made or to be made by him to separate creditors the collector shall, if requested by such debtor, give a separate receipt for the tax paid on account of each creditor in such form that the debtor can conveniently produce such receipts separately to his several creditors in satisfaction of their respective demands up to the amounts stated in the receipts; and such receipt shall be sufficient evidence in favor of such debtor to justify him in withholding from his next payment to his creditor the amount therein stated; but the creditor may, upon giving to his debtor a full written receipt acknowledging the payment to him of any sum actually paid and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt.

(c) In the payment of any tax under this Act not payable by stamp a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent.

(d) Section 37 of the Act of August 27, 1894, entitled "An Act To reduce taxation, to provide revenue for the Government, and for other purposes," is hereby repealed.

ART. 1391. **Payment of tax by Treasury certificates of indebtedness and Treasury notes.**—Collectors of internal revenue are authorized and directed to receive in payment of income and profits taxes payable at the maturity of the certificates, respectively, Treasury certificates of indebtedness of any series which may be issued maturing on March 15, June 15, September 15, or December 15 of each year, respectively, and expressed to be acceptable in payment of income and profits taxes. Collectors are further authorized and directed to receive at par with an adjustment of accrued interest, in payment of income and profits taxes payable at or within six months before their respective maturities, Treasury notes of the United States expressed to be acceptable in payment of income and profits taxes. Where the taxes are due on Sunday they may be accepted on the following day. Collectors are not authorized hereunder to receive in payment of income and profits taxes any Treasury certificates of indebtedness or Treasury notes not expressed to be acceptable in payment of income and profits taxes, nor any Treasury certificates maturing on a date other than the date on which the taxes are payable. Collectors are authorized to receive Treasury certificates of indebtedness and Treasury notes which are acceptable as herein provided in payment of income and profits taxes in advance of the respective tax-payment dates. Treasury certificates acceptable in payment of income and profits taxes have one or more interest coupons attached, including as to each series a coupon payable at the maturity

of the certificates, but all interest coupons must in each case be detached by the taxpayer before presentation to the collector and collected in ordinary course when due. All matured coupons attached to Treasury notes must be detached by the taxpayer before presentation to the collector, and collected in ordinary course when due, but all coupons that have not matured must be attached to the notes when presented. Accrued interest from the last interest-payment date to the tax-payment date on any notes accepted will be remitted by the Federal reserve bank with which the collector makes a deposit, on the basis of schedules to be furnished by the collector to the Federal reserve bank. Receipts given by collectors to taxpayers should show the amount and description of the certificates or notes received in payment of taxes. The amount, at par, of the Treasury certificates of indebtedness or notes presented by any taxpayer in payment of income and profits taxes must not exceed the amount of the taxes to be paid by him, and collectors shall in no case pay interest on the certificates or notes, or accept them for an amount other or greater than their face value.

ART. 1392. **Procedure with respect to Treasury certificates of indebtedness and Treasury notes.**—Deposits of Treasury certificates of indebtedness and Treasury notes received in payment of income and profits taxes must be made by collectors, unless otherwise specifically instructed by the Secretary of the Treasury, with the Federal reserve bank of the district in which the collector's head office is located, or, in case such head office is located in the same city with a branch Federal reserve bank, with such branch Federal reserve bank. Specific instructions may be given to collectors by the Secretary of the Treasury in certain instances for the deposit of the certificates and notes with Federal reserve banks of other districts and branch Federal reserve banks. The term "Federal reserve bank" where it appears herein, unless otherwise indicated by the context, includes branch Federal reserve banks. Treasury certificates and Treasury notes accepted by the collector prior to the dates with respect to which they are acceptable in payment of taxes should be forwarded by the collector to the Federal reserve bank to be held for account of the collector until the tax-payment date and for deposit on such date.

Collectors of internal revenue are not authorized, unless express instructions otherwise are given by the Secretary of the Treasury, to receive in payment of income or profits taxes interim receipts issued by Federal reserve banks in lieu of definitive certificates or definitive notes.

Treasury certificates of indebtedness and Treasury notes should in all cases be indelibly stamped on the face thereof, as follows, by

the collector, and when so stamped should be delivered to the Federal reserve bank in person if the collector is located in the same city and in all other cases forwarded by registered mail uninsured:

___________________, 192__.

This note/certificate has been accepted in payment of income and profits taxes and will not be redeemed by the United States except for credit of the undersigned.

____

Collector of Internal Revenue

for the ______________________ district of ______________________

Each unmatured coupon attached to such note must be indelibly stamped across the face by the collector with the word "Paid," followed by his name and title.

When Treasury certificates of indebtedness or Treasury notes are delivered to the Federal Reserve Bank in person rather than by registered mail, uninsured, where the collector's head office and the Federal Reserve Bank are located in the same city, collectors should make, in tabular form, a schedule in duplicate of the certificates of indebtedness or notes to be presented to the Federal Reserve Bank, showing the serial number of each certificate or note, the date of issue and maturity, with serial designation, and face value. Certificates of indebtedness and Treasury notes accepted hereunder prior to the tax-payment date must be scheduled separately. At the bottom of each schedule there should be written or stamped "Income and Profits Taxes, $________," which amount must agree with the total shown on the schedule. One copy of this schedule must accompany certificates or notes presented to the Federal Reserve Bank and the other be retained by the collector. The income and profits tax deposits resulting from the deposits of such certificates or notes must in all cases be shown on the face of the certificate of deposit (National Bank Form 15), separate and distinct from the item of miscellaneous internal-revenue collections (formerly called Ordinary).

Where the collector's head office and the Federal Reserve Bank are not located in the same city, and it is necessary to transmit the certificates or notes to the Federal Reserve Bank by registered mail uninsured, the following requirements, with respect to the preparation of shipments, must be observed. The certificates or notes must in all cases be stamped on the face thereof and the schedule of certificates or notes transmitted should be prepared as prescribed in the case of certificates or notes delivered to the Federal Reserve Bank in person, except that the schedule of securities should be prepared in *triplicate*. The original copy of such schedule should be forwarded to the Federal Reserve Bank by *separate* registered mail, and should bear a certificate signed by two employees of the office of the collector, stating (*a*) that they inspected and checked the shipment

before sealing; (*b*) that each certificate or note listed was properly canceled by stamping on the face thereof the prescribed legend; (*c*) that the shipment was sealed in their presence before it left their immediate control; and (*d*) that each and every security listed was in the package when mailed. The duplicate copy of the schedule should be enclosed with the securities, and the triplicate retained by the collector. It is important that the collector's retained copy be carefully preserved, and in this connection it is recommended that the certificate of the two employees be entered also on the retained copy, in order that no complication may arise in the event that the original copy should be lost or destroyed.

Until certificates of deposit are received from the Federal Reserve Banks, the amounts represented by the certificates of indebtedness or notes forwarded for deposit must be carried by collectors as cash on hand or in banks, and not credited as collections, as the dates of certificates of deposit determine the dates of collections.

For the purpose of saving taxpayers the expense of transmitting such certificates or notes as are held in Federal Reserve cities or Federal Reserve branch bank cities to the office of the collector in whose district the taxes are payable, taxpayers desiring to pay income and profits taxes by such Treasury certificates of indebtedness or Treasury notes acceptable in payment of taxes, should communicate with the collector of the district in which the taxes are payable and request from him authority to deposit such certificates or notes with the Federal Reserve Bank in the city in which the certificates or notes are held. Collectors are authorized to permit deposits of Treasury certificates of indebtedness or Treasury notes in any Federal Reserve Bank, with the distinct understanding that the Federal Reserve Bank is to issue a certificate of deposit in the collector's name covering the amount of the certificates of indebtedness or notes, at par, and to state on the face of the certificate of deposit that the amount represented thereby is in payment of income and profits taxes. The Federal Reserve Banks should forward the original certificate of deposit to the Treasurer of the United States, with its daily transcript, and transmit the duplicate to the Commissioner of Internal Revenue, Accounts and Collections Unit, Washington, D. C., and the triplicate to the collector, accompanied by a statement giving the name of the taxpayer for whom the payment is made, in order that the collector may make the necessary record.

ART. 1393. **Payment of tax by uncertified checks.**—Collectors may accept uncertified checks in payment of income, war-profits and excess-profits taxes, 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.

ART. 1394. **Procedure with respect to dishonored checks.**—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, since no deduction can be made from amounts received in payment of taxes. See section 3210 of the Revised Statutes as amended by section 1031 of the statute. 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. See chapter 191 of the Act of March 2, 1911.

ART. 1395. **Receipts for tax payments.**—Upon request a collector will give a receipt for each tax payment. In the case of payments made by check or money order the canceled check or the money order receipt is usually a sufficient receipt. In the case of payments in cash, however, the taxpayer should in every instance require and the collector should furnish a receipt.

ART. 1396. **When fractional part of cent may be disregarded.**—In the payment of taxes a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent. Fractional parts of a cent should not be disregarded in the computation of taxes.

JURISDICTION OF COURTS

SEC. 1025. (a) If any person is summoned under this Act to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

(b) The district courts of the United States at the instance of the United States are hereby invested with such jurisdiction to make and issue, both in

actions at law and suits in equity, writs and orders of injunction, and of ne exeat republica, orders appointing receivers, and such other orders and process, and to render such judgments and decrees, granting in proper cases both legal and equitable relief together, as may be necessary or appropriate for the enforcement of the provisions of this Act. The remedies hereby provided are in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such provisions.

(c) The paragraph added by section 1310 of the Revenue Act of 1921 at the end of paragraph Twentieth of section 24 of the Judicial Code, relating to the jurisdiction of district courts, is reenacted without change, as follows:

"Concurrent with the Court of Claims, of any suit or proceeding, commenced after the passage of the Revenue Act of 1921, for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected, under the internal-revenue laws, even if the claim exceeds $10,000, if the collector of internal-revenue by whom such tax, penalty, or sum was collected is dead at the time such suit or proceeding is commenced."

DEPOSIT OF UNITED STATES BONDS OR NOTES IN LIEU OF SURETY

Sec. 1029. Wherever by the laws of the United States or regulations made pursuant thereto, any person is required to furnish any recognizance, stipulation, bond, guaranty, or undertaking, hereinafter called "penal bond," with surety or sureties, such person may, in lieu of such surety or sureties, deposit as security with the official having authority to approve such penal bond, United States Liberty bonds or other bonds or notes of the United States in a sum equal at their par value to the amount of such penal bond required to be funished, together with an agreement authorizing such official to collect or sell such bonds or notes so deposited in case of any default in the performance of any of the conditions or stipulations of such penal bond. The acceptance of such United States bonds or notes in lieu of surety or sureties required by law shall have the same force and effect as individual or corporate sureties, or certified checks, bank drafts, post-office money orders, or cash, for the penalty or amount of such penal bond. The bonds or notes deposited hereunder and such other United States bonds or notes as may be substituted therefor from time to time as such security, may be deposited with the Treasurer of the United States, a Federal reserve bank, or other depositary duly designated for that purpose by the Secretary, which shall issue receipt therefor, describing such bonds or notes so deposited. As soon as security for the performance of such penal bond is no longer necessary, such bonds or notes so deposited shall be returned to the depositor: *Provided*, That in case a person or persons supplying a contractor with labor or material as provided by the Act of Congress, approved February 24, 1905 (33 Stat. 811), entitled "An Act to amend an Act approved August thirteenth, eighteen hundred and ninety-four, entitled 'An Act for the protection of persons furnishing materials and labor for the construction of public works,'" shall file with the obligee, at any time after a default in the performance of any contract subject to said Acts, the application and affidavit therein provided, the obligee shall not deliver to the obligor the deposited bonds or notes nor any surplus proceeds thereof until the expiration of the time limited by said Acts for the institution of suit by such person or persons, and, in case suit shall be instituted within such time, shall hold said bonds or notes or proceeds subject to the order of the court having

jurisdiction thereof: *Provided further*, That nothing herein contained shall affect or impair the priority of the claim of the United States against the bonds or notes deposited or any right or remedy granted by said Acts or by this section to the United States for default upon any obligation of said penal bond: *Provided further*, That all laws inconsistent with this section are hereby so modified as to conform to the provisions hereof: *And provided further*, That nothing contained herein shall affect the authority of courts over the security, where such bonds are taken as security in judicial proceedings, or the authority of any administrative officer of the United States to receive United States bonds for security in cases authorized by existing laws. The Secretary may prescribe rules and regulations necessary and proper for carrying this section into effect.

ENFORCEMENT OF TAX LIENS

SEC. 1030. Section 3207 of the Revised Statutes is amended to read as follows:

"SEC. 3207. (a) In any case where there has been a refusal or neglect to pay any tax, and it has become necessary to seize and sell real estate to satisfy the same, the Commissioner of Internal Revenue may direct a bill in chancery to be filed, in a district court of the United States, to enforce the lien of the United States for tax upon any real estate, or to subject any real estate owned by the delinquent, or in which he has any right, title, or interest, to the payment of such tax. All persons having liens upon or claiming any interest in the real estate sought to be subjected as aforesaid, shall be made parties to such proceedings, and be brought into court as provided in other suits in chancery therein. And the said court shall, at the term next after the parties have been duly notified of the proceedings, unless otherwise ordered by the court, proceed to adjudicate all matters involved therein, and finally determine the merits of all claims to and liens upon the real estate in question, and, in all cases where a claim or interest of the United States therein is established, shall decree a sale of such real estate, by the proper officer of the court, and a distribution of the proceeds of such sale according to the findings of the court in respect to the interests of the parties and of the United States.

"(b) Any person having a lien upon or any interest in such real estate, notice of which has been duly filed of record in the jurisdiction in which the real estate is located, prior to the filing of notice of the lien of the United States as provided by section 3186 of the Revised Statutes as amended, or any person purchasing the real estate at a sale to satisfy such prior lien or interest, may make written request to the Commissioner of Internal Revenue to direct the filing of a bill in chancery as provided in subdivision (a), and if the Commissioner fails to direct the filing of such bill within six months after receipt of such written request, such person or purchaser may, after giving notice to the Commissioner, file a petition in the district court of the United States for the district in which the real estate is located, praying leave to file a bill for a final determination of all claims to or liens upon the real estate in question. After a full hearing in open court, the district court may in its discretion enter an order granting leave to file such bill, in which the United States and all persons having liens upon or claiming any interest in the real estate shall be made parties. Service on the United States shall be had in the manner provided by sections 5 and 6 of the Act of March 3, 1887, entitled 'An Act to provide for the bringing of suits against the Government of the United States.' Upon the filing of such bill the district court shall proceed to adjudicate the matters involved therein, in the same manner as in the case of

bills filed under subdivision (a) of this section. For the purpose of such adjudication, the assessment of the tax upon which the lien of the United States is based shall be conclusively presumed to be valid, and all costs of the proceedings on the petition and the bill shall be borne by the person filing the bill."

SPECIAL DEPOSITS

SEC. 1031. (a) Section 3195 of the Revised Statutes is amended to read as follows:

"SEC. 3195. When any property liable to distraint for taxes is not divisible, so as to enable the collector by sale of a part thereof to raise the whole amount of the tax, with all costs and charges, the whole of such property shall be sold, and the surplus of the proceeds of the sale, after making allowance for the amount of the tax, interest, penalties, and additions thereto, and for the costs and charges of the distraint and sale, shall be deposited with the Treasurer of the United States as provided in subdivision (b) of section 3210."

(b) Section 3210 of the Revised Statutes is amended to read as follows:

"SEC. 3210. (a) Except as provided in subdivision (b) the gross amount of all taxes and revenues received under the provisions of this Act, and collections of whatever nature received or collected by authority of any internal-revenue law, shall be paid daily into the Treasury of the United States under instructions of the Secretary of the Treasury as internal-revenue collections, by the officer receiving or collecting the same, without any abatement or deduction on account of salary, compensation, fees, costs, charges, expenses, or claims of any description. A certificate of such payment, stating the name of the depositor and the specific account on which the deposit was made, signed by the treasurer, assistant treasurer, designated depositary, or proper officer of a deposit bank, shall be transmitted to the Commissioner of Internal Revenue.

"(b) Sums offered in compromise under the provisions of section 3229 of the Revised Statutes and section 35 of Title II of the National Prohibition Act, sums offered for the purchase of real estate under the provisions of section 3208 of the Revised Statutes, and surplus proceeds in any distraint sale, after making allowance for the amount of the tax, interest, penalties, and additions thereto, and for costs and charges of the distraint and sale, shall be deposited with the Treasurer of the United States in a special deposit account in the name of the collector making the deposit. Upon acceptance of such offer in compromise or offer for the purchase of such real estate, the amount so accepted shall be withdrawn by the collector from his special deposit account with the Treasurer of the United States and deposited in the Treasury of the United States as internal-revenue collections. Upon the rejection of any such offer, the Commissioner shall authorize the collector, through whom the amount of such offer was submitted, to refund to the maker of such offer the amount thereof. In the case of surplus proceeds from distraint sales the Commissioner shall, upon application and satisfactory proof in support thereof, authorize the collector through whom the amount was received to refund the same to the person or persons legally entitled thereto."

REPEALS

SEC. 1100. (a) The following parts of the Revenue Act of 1921 are repealed, to take effect (except as otherwise provided in this Act) upon the enactment of this Act, subject to the limitations provided in subdivisions (b) and (c):

Title II (called "Income Tax") as of January 1, 1924;

Title IV (called "Estate Tax");

Title V (called "Tax on Telegraph and Telephone Messages") except subdivision (d) of section 500, effective on the expiration of thirty days after the enactment of this Act;

Sections 602 and 603 of Title VI (being the taxes on certain beverages and constituent parts thereof);

Title VII (called "Tax on Cigars, Tobacco, and Manufactures Thereof");

Title VIII (called "Tax on Admissions and Dues"), effective on the expiration of thirty days after the enactment of this Act;

Sections 901, 902, 903, and 904 of Title IX (being certain excise taxes);

Section 900 of Title IX (being certain excise taxes) and section 905 of Title IX (being the tax on jewelry and similar articles), effective on the expiration of thirty days after the enactment of this Act;

Title X (called "Special Taxes") effective on June 30, 1924;

Title XI (called "Stamp Taxes") effective on the expiration of thirty days after the enactment of this Act;

Title XII (called "Tax on Employment of Child Labor");

Sections 1307, 1308, 1309, subdivision (c) of section 1310, sections 1311, 1312, 1313, 1314, 1315, 1316, 1318, 1320, 1321, 1322, 1323, 1324, 1325, 1326, 1328, 1329, and 1330 (being certain administrative provisions).

(b) The parts of the Revenue Act of 1921 which are repealed by this Act shall (except as provided in sections 280 and 316 and except as otherwise specifically provided in this Act) remain in force for the assessment and collection of all taxes imposed by such Act, and for the assessment, imposition, and collection of all interest, penalties, or forfeitures which have accrued or may accrue in relation to any such taxes, and for the assessment and collection, to the extent provided in the Revenue Act of 1921, of all taxes imposed by prior income, war-profits, or excess-profits tax acts, and for the assessment, imposition, and collection of all interest, penalties, or forfeitures which have accrued or may accrue in relation to any such taxes. In the case of any tax imposed by any part of the Revenue Act of 1921 repealed by this Act, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act.

(c) The repeal of Title II and Title IV of the Revenue Act of 1921 shall not be construed to take away the retroactive benefits allowed by paragraph (12) of subdivision (a) of section 214 or paragraph (14) of subdivision (a) of section 234, of the Revenue Act of 1921, or by section 401 or 403 of such Act.

SAVING CLAUSE IN EVENT OF UNCONSTITUTIONALITY

SEC. 1103. If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act, and the application of such provision to other persons or circumstances, shall not be affected thereby.

EFFECTIVE DATE OF ACT

SEC. 1104. Except as otherwise provided, this Act shall take effect upon its enactment.

PART IV

DEFINITIONS AND GENERAL PROVISIONS

GENERAL DEFINITIONS

SECTION 1. This Act may be cited as the "Revenue Act of 1924."

SEC. 2. (a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

(3) The term "domestic" when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State or Territory.

(4) The term "foreign" when applied to a corporation or partnership means a corporation or partnership which is not domestic.

(5) The term "United States" when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

(6) The term "Secretary" means the Secretary of the Treasury.

(7) The term "Commissioner" means the Commissioner of Internal Revenue.

(8) The term "collector" means collector of internal revenue.

(9) The term "taxpayer" means any person subject to a tax imposed by this Act.

(10) The term "military or naval forces of the United States" includes the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, and the Navy Nurse Corps, Female.

(b) The terms "includes" and "including" when used in a definition contained in this Act shall not be deemed to exclude other things otherwise within the meaning of the term defined.

ART. 1501. **Person.**—The statute recognizes four classes of persons—individuals, trusts and estates, partnerships, and corporations. Corporations include associations, joint-stock companies, and insurance companies, but not partnerships properly so called. A taxpayer is any person subject to a tax imposed by the Act.

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 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. A corporation which has ceased to exist in contemplation of law but continues its business in corporate form is an association or corporation within the meaning of section 2, but if it continues its business in the form of a trust, it becomes subject to the provisions of section 219.

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 interest of whose members can not be so transferred is a partnership.

ART. 1504. **Association distinguished from trust.**—Holding trusts, in which the trustees are merely holding property for the collection of the income and its distribution among the beneficiaries, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, are not associations within the meaning of the law. The trust and the beneficiaries thereof will be subject to tax as provided in articles 341–347. Operating trusts, whether or not of the Massachusetts type, in which the trustees are not restricted to the mere collection of funds and their payments to the beneficiaries, but are associated together in much the same manner as directors in a corporation for the purpose of carrying on some business enterprise, are to be deemed associations within the meaning of the Act, regardless of the control exercised by the beneficiaries.

ART. 1505. **Limited partnership as partnership.**—So-called limited partnerships of the type authorized by the statutes of New York and most of the States are partnerships and not corporations within the meaning of the statute. Such limited partnerships, which can not limit the liability of the general partners, although the special partners enjoy limited liability so long as they observe the statutory conditions, which are dissolved by the death or attempted transfer of the interest of a general partner, and which can not take real estate or sue in the partnership name, are so like common law partnerships as to render impracticable any differentiation in their treatment for tax purposes. Michigan and Illinois limited partnerships are partnerships. A California special partnership is a partnership.

ART. 1506. **Limited partnership as corporation.**—On the other hand, limited partnerships of the type of partnerships with limited liability or partnership associations authorized by the statutes of Pennsylvania and of a few other States are only nominally partnerships. Such so-called limited partnerships, offering opportunity for limiting the liability of all the members, providing for the transferability of partnership shares, and capable of holding real estate and bringing suit in the common name, are more truly corporations than partnerships and must make returns of income and pay the tax as corporations. The income received by the members out of the earnings of such limited partnerships will be treated in their personal returns in the same manner as distributions on the stock of corporations. In all doubtful cases limited partnerships will be treated as corporations unless they submit satisfactory proof that they are not in effect so organized. A Michigan partnership association is a corporation.

ART. 1507. **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.

ART. 1508. **Insurance company.**—Insurance companies include both stock and mutual companies, as well as mutual benefit insurance companies. A voluntary unincorporated association of employees formed for the purpose of relieving sick and aged members and the dependents of deceased members is an insurance company, whether the fund for such purpose is created wholly by membership dues or partly by contributions from the employer. But a corporation which merely sets aside a fund for the insurance of its employees is not required to file a separate return for such fund if the income and disbursements therefrom are included in the corporation's own return.

ART. 1509. **Domestic and foreign persons.**—A domestic corporation or partnership is one organized or created in the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, or under the law of the United States or of any State or Territory. A foreign corporation or partnership is one which is not domestic. A domestic corporation is a resident cor-

poration even though it does no business and owns no property in the United States. The nationality or residence of members of a partnership does not affect its status. A partnership created by articles entered into in San Francisco between residents of the United States and residents of China is a domestic partnership. A foreign corporation engaged in trade or business within the United States or having an office or place of business therein is sometimes referred to in the regulations as a resident foreign corporation and a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein as a nonresident foreign corporation. See also articles 4 and 311–314.

DEFINITIONS

SEC. 200. When used in this title—

(a) The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or 232. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. The term "taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made. The first taxable year, to be called the taxable year 1924, shall be the calendar year 1924 or any fiscal year ending during the calendar year 1924.

(b) The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

(c) The term "withholding agent" means any person required to deduct and withhold any tax under the provisions of section 221 or 237.

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

(e) The term "stock" includes the share in an association, joint-stock company, or insurance company.

(f) The term "shareholder" includes a member in an association, joint-stock company, or insurance company.

ART. 1521. **Fiduciary.**—"Fiduciary" is a term which applies to persons that occupy positions of peculiar confidence toward others, such as trustees, executors, and administrators. A fiduciary for income tax purposes is a person who holds in trust an estate to which another has the beneficial title or in which another has a beneficial interest, or receives and controls income of another, as in the case of receivers. A committee or guardian of the property of an incompe-

tent person is a fiduciary. See sections 219 and 225 of the statute and articles 341–344 and 421–425.

ART. 1522. **Fiduciary distinguished from agent.**—There may be a fiduciary relationship between an agent and a principal, but the word "agent" does not denote a fiduciary. A fiduciary relationship can not be created by a power of attorney. An agent having entire charge of property, with authority to effect and execute leases with tenants entirely on his own responsibility and without consulting his principal, merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by a power of attorney, is not a fiduciary within the meaning of the statute. In cases where no legal trust has been created in the estate controlled by the agent and attorney the liability to make a return rests with the principal.

ART. 1523. **"Taxable year," "withholding agent," "paid or incurred," and "paid or accrued."**—The taxable year is the time unit for the purpose of the tax. The term includes, in the case of a return made for a fractional part of a year under these regulations, the period for which the return is made. See section 212 of the statute and article 22. A withholding agent may be a corporation with bonds outstanding, a trustee under a corporate mortgage, or any corporation, partnership, or private individual. See section 221 and articles 361–376. The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. The deductions and credits provided for in this title must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. However, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the statute and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

DISTRIBUTIONS BY CORPORATIONS

SEC. 201. (a) The term "dividend" when used in this title (except in paragraph (9) of subdivision (a) of section 234 and paragraph (4) of subdivision (a) of section 245) means any distribution made by a corporation to its share-

holders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 204.

(c) Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 202, but shall be recognized only to the extent provided in section 203. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of subdivision (g) of section 203 of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subdivision (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

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

(e) Any distribution made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or the Revenue Act of 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or section 218 of the Revenue Act of 1921, shall be exempt from tax to the distributees.

(f) A stock dividend shall not be subject to tax, but if before or after the distribution of any such dividend the corporation proceeds to cancel or redeem its stock at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(g) As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

ART. 1541. Dividends.—Dividends for the purpose of the statute comprise any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of its earnings or profits accumulated since February 28, 1913. Although interest on State bonds

and certain other obligations is not taxable when received by a corporation, upon amalgamation with the other funds of the corporation such income loses its identity and when distributed to shareholders in dividends is taxable to the same extent as other dividends. See further article 52.

A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands. See article 52.

ART. 1542. **Source of distribution.**—For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits.

ART. 1543. **Distributions out of earnings or profits accumulated prior to March 1, 1913.**—Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of increase in value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition prior to March 1, 1913), is not a dividend within the meaning of the Act. The provisions of the preceding sentence shall be applied uniformly to cases arising under the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, and the Revenue Act of 1921, as well as the Revenue Act of 1924. A corporation can not distribute earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, exempt from tax, unless and until all earnings or profits accumulated since February 28, 1913, have been distributed. Whenever one corporation receives from another corporation distributions out of earnings or profits accumulated by such other corporation prior to March 1, 1913, or out of increase in value of its property accrued prior to March 1, 1913, and the "receiving" corporation, after having first distributed all of its earnings and profits accumulated since February 28, 1913, distributes to its stockholders the amount so received by it from such other corporation, the distribution by the "receiving" corporation to its stockholders is not a dividend within the meaning of the Act and is exempt from tax.

In determining whether a dividend is out of earnings or profits accumulated since February 28, 1913, or prior to March 1, 1913, due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive.

A tax-free distribution made by a corporation out of earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, shall be applied against the basis of the stock for the purpose of determining gain or loss from its subsequent sale. The fact that such distribution is in excess of the cost or other basis

(provided in articles 1591–1603) of the stock on which declared does not render it subject to tax. The provisions of this paragraph are also applicable to a distribution by a "receiving" corporation made under the conditions set forth in the first paragraph of this article, and to the distributees in determining gain or loss from the subsequent sale or other disposition of stock in the receiving corporation.

Example.—A purchased certain shares of stock subsequent to February 28, 1913, for $10,000. He received in 1924 a distribution of $2,000 paid out of earnings and profits of the corporation accumulated prior to March 1, 1913. This distribution is not subject to tax, if the earnings and profits of the corporation accumulated after February 28, 1913, have been distributed. If A subsequently sells the stock for $6,000, a deductible loss of $2,000 is sustained. If he sells the stock for $9,000, he realizes a taxable gain of $1,000.

ART. 1544. **Distributions other than those out of earnings or profits.**—Any distribution (not in partial or complete liquidation) made by a corporation to its shareholders otherwise than out of (1) increase in value of property accrued prior to March 1, 1913, or (2) earnings or profits, shall be taxable to the recipient only if and to the extent that such distribution exceeds the basis of his stock, as provided in section 204. See article 1591 *et seq.* Any such distribution, however, shall be applied against and reduce the cost or other basis of the stock upon which declared, for the purpose of determining the gain or loss from the subsequent sale of the stock. The amount by which such distribution exceeds the basis of the stock constitutes taxable income.

Example.—A purchased certain stock in 1915 for $10,000. (1) If he receives in 1924 a distribution thereon of $2,000 paid by the corporation otherwise than out of its earnings or profits or the increase in value of property accrued prior to March 1, 1913, this distribution does not constitute taxable income to A. If A subsequently sells the stock the difference between the amount realized therefor and $8,000 is taxable gain or deductible loss, as the case may be. (2) If, however, A receives a distribution of $12,000 in 1924 paid by the corporation otherwise than out of its earnings or profits or the increase in value of property accrued prior to March 1, 1913, A realizes taxable income to the extent of $2,000, which at his option may be taxed as a capital gain. See article 1651.

ART. 1545. **Distributions in liquidation.**—Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed. The phrase "amounts distributed in partial liquidation" means a distribution by a corpora-

tion in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. A complete cancellation or redemption of a part of the corporate stock may be accomplished, for example, (1) by the complete retirement of all shares of a particular preference or series, (2) by taking up all the old shares of a particular preference or series and issuing new shares to replace a portion thereof, or (3) by stamping on the old shares a notation of the reduction in their par value.

The gain or loss to a shareholder from a distribution in liquidation is to be determined as provided in article 1561, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 204; but the gain or loss will be recognized only to the extent provided in articles 1571–1578. Any gain to the shareholder may, at his option, be taxed as a capital net gain in the manner and subject to the conditions prescribed in section 208. In the case of amounts distributed in partial liquidation, other than a distribution in pursuance of a plan of reorganization as described in subdivision (g) of section 203, the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of section 201(b) for the purpose of determining the taxability of subsequent distributions by the corporation.

Examples.—(1) A owns 10 shares of stock in M corporation for which he paid $1,250 in 1921. He receives in 1924 a dividend of $1,500 in complete liquidation. A is subject both to the normal tax and to the surtax upon his profit of $250, or at his option, in lieu of such taxes, to the tax upon capital net gain, as provided in section 208.

(2) A owns 10 shares of preferred stock and 10 shares of common stock in M corporation which he purchased in 1915 for $1,100 and $1,000 respectively. In 1924 M corporation has on hand $225,000 of capital, earnings and profits of $25,000 accumulated prior to March 1, 1913, and earnings and profits of $125,000 accumulated after February 28, 1913. If the preferred stock is retired at $125 per share, $125,000 being used by the corporation for this purpose, A will receive $1,250 in exchange for his 10 shares of preferred stock and is therefore subject to the normal tax and the surtax on $150, or at his option, in lieu of such taxes, to the tax upon capital net gain, as provided in section 208. If M corporation then distributes a cash dividend of $25,000 on the common stock, it would be subject to the surtax. If, without any further accumulation of earnings and profits, M corporation thereafter liquidates completely, A, who will receive $2,250 in exchange for his 10 shares of common stock, will

be subject to the normal tax and the surtax on $1,250, or at his option, in lieu of such taxes, to the tax upon capital net gain, as provided in section 208.

ART. 1546. **Distributions from depletion or depreciation reserves.**—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 surplus out of which ordinary dividends may be paid. A distribution made from a depletion or a depreciation reserve based upon the cost of the property will not be considered as having been paid out of earnings or profits, but the amount thereof shall be applied against and reduce the cost or other basis of the stock upon which declared for the purpose of determining the gain or loss from the subsequent sale of the stock. If such a distribution is in excess of the basis, the excess shall be taxed as a gain from the sale or other disposition of property. A distribution made from a depletion reserve based on the discovery value of a mine shall be similarly treated (by virtue of section 201(d) of the Act), but a distribution from any other depletion reserve based upon discovery value, to the extent that such reserve represents the excess of the discovery value over cost or March 1, 1913, value, is, when received by the shareholders, taxable as an ordinary dividend. See also article 1544. A distribution made from that portion of a depletion reserve based upon a valuation as of March 1, 1913, which is in excess of the depletion reserve based upon cost, will not be considered as having been paid out of earnings or profits, but the amount of the distribution shall be applied against and reduce the cost or other basis of the stock upon which declared for the purpose of determining the gain or loss from the subsequent sale of the stock. No distribution, however, can be made from such a reserve until all the earnings or profits of the corporation have first been distributed.

ART. 1547. **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 market value of such property when receivable by the shareholders, except as provided in article 1574 below. 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 market value at the time the dividend becomes payable. See article 52. Scrip dividends are subject to tax in the year in which the warrants are issued.

ART. 1548. **Sale of stock received as dividend.**—The issuance of its own stock by a corporation as a dividend to its shareholders does not

constitute taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of taxable gain derived or deductible loss sustained from the sale of such stock, or from the sale of the stock with respect to which it is issued, shall be determined as provided in articles 1591 and 1599.

ART. 1549. **Declaration and redemption of a stock dividend.**—If a corporation, either before or after the distribution of a stock dividend, proceeds to cancel or redeem its stock at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

DETERMINATION OF AMOUNT OF GAIN OR LOSS

SEC. 202. (a) Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in subdivision (a) or (b) of section 204, and the loss shall be the excess of such basis over the amount realized.

(b) In computing the amount of gain or loss under subdivision (a) proper adjustment shall be made for (1) any expenditure properly chargeable to capital account; and (2) any item of loss, exhaustion, wear and tear, obsolescence, amortization, or depletion, previously allowed with respect to such property.

(c) The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 203.

(e) Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

ART. 1561. **Determination of the amount of gain or loss.**—Section 202 of the statute sets forth the rules for the determination of the amount of gain or loss from the sale or other disposition of property. In general, the gain from the sale or other disposition of property is the excess of the amount realized therefrom over the cost or other basis provided in section 204, and the loss is the excess of such cost or other basis over the amount realized. Whether gain or loss from a sale or exchange shall be recognized, and if so, the extent to which it is to be recognized for the purposes of this title

must be determined under the provisions of section 203. See articles 1571-1580.

The amount realized from the sale or other disposition of property is the sum of any money received plus the fair market value of the property (other than money) received. In computing the amount of gain or loss, however, the cost or other basis of the property must be increased by the cost of capital improvements and betterments made to the property since the basic date, and by carrying charges, such as taxes on unproductive property, and decreased by the depreciation and similar deductions previously allowed with respect to the property.

Examples.—(1) A purchased property in 1921 for $10,000. He subsequently expended $5,000 for improvements, which was not deducted as a business expense. If A sells the property in 1924 for $20,000, the amount of his gain will be $5,000.

(2) A purchased property for $10,000 in 1921. In 1922 and 1923 he deducted depreciation on the property amounting to a total of $1,000. If A sells the property in 1924 for $8,000, the amount of his loss will be $1,000.

ART. 1562. **Installment contracts.**—In the case of property sold under contract providing for payment in installments, article 1561 shall not be construed as preventing the taxation of that portion of any installment payment representing gain or profit, in the year in which such payment is received.

RECOGNITION OF GAIN OR LOSS FROM SALES AND EXCHANGES

SEC. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.

(b) (1) No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment, or if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(2) No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in

such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

(5) If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

(d) (1) If an exchange would be within the provisions of paragraph (1), (2), or (4) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(e) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(f) If an exchange would be within the provisions of paragraph (1), (2), (3), or (4) of subdivision (b) if it were not for the fact that the property

received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(g) The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, shall not be considered a distribution of earnings or profits within the meaning of subdivision (b) of section 201 for the purpose of determining the taxability of subsequent distributions by the corporation.

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(i) As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

ART. 1571. **Recognition of gain or loss.**—In the case of a sale or exchange, the extent to which gain or loss, the amount of which is determined under section 202 of the statute, shall be recognized, is governed by the provisions of section 203. Section 203 provides that the entire amount of the gain or loss upon any sale or exchange of property shall be recognized, with specified exceptions therein set forth, which are discussed in articles 1572 to 1580. Unless the sale or exchange falls within the provisions of these articles, therefore, the entire amount of the gain or loss thereon must be calculated and reported.

ART. 1572. **Exchanges of property.**—In the following cases no gain or loss is recognized:

(*a*) If property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment. The words "like kind" are defined as having reference to the nature or character of the property and not its grade or quality. Therefore under this paragraph

no gain or loss is realized by one other than a dealer from the exchange of real estate for other real estate. One kind or class of property may not, under this paragraph, be exchanged for property of a different kind or class, as real estate for personal property. However, a leasehold of a fee with 30 years or more to run will be considered property of like kind to real estate. The fact that any real estate involved in an exchange is improved or unimproved makes no difference, for such fact relates only to the grade or quality of the property and not to its kind or class. Unproductive real estate held by one other than a dealer, for future use or future realization of the increment in value, is held for investment and not primarily for sale.

(*b*) If common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(*c*) If property, real, personal, or mixed, is transferred to a corporation (1) by one person solely in exchange for stock or securities in such corporation, and immediately after the exchange such person is in control of the corporation, or (2) by two or more persons, solely in exchange for stock or securities in such corporation and if immediately after the exchange such persons are in control of the corporation, and if the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. See article 1577 for definition of " control."

Example.—A owns a patent right worth $25,000, and B a manufacturing plant worth $75,000. A and B organize the X corporation with a capital stock of $100,000. A transfers his patent right to X corporation for $25,000 of its stock; B transfers his plant to X for $75,000 of its stock. No gain or loss is recognized from this transaction.

ART. 1573. **Exchanges of property for other property and money.**—If an exchange would fall within the provisions of article 1572 but for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of the money and the fair market value of the other property. No loss from such an exchange will be recognized, however. (See section 203(f).)

Example.—A in 1924 exchanged real estate which he had purchased in 1915 for $5,000 for other real estate having a fair market value of $6,000 and $2,000 in cash. The gain from the transaction, that is, $3,000, is recognized only to the extent of $2,000, the amount which was received in cash. A's taxable income from the exchange

is, therefore, $2,000. See article 1596 for the basis for determining gain or loss from a subsequent sale.

ART. 1574. **Exchanges in connection with corporate reorganizations.**— Since corporate reorganizations which result only in a change in form and which do not substantially affect the property interests either of the shareholders or of the corporations may be required or may be made desirable by business conditions, State laws, or other causes, the statute provides that no gain or loss shall be recognized to the shareholders from the exchange of stock made in connection with the reorganization nor to the corporations from the exchange of property made in connection with the reorganization. If two or more corporations reorganize, for example, by either (1) the dissolution of corporation B and the sale of its assets to corporation A, or (2) the sale of its property by B to A, or (3) the sale of the stock of B to A, or (4) the merger of B into A, or (5) the consolidation of A and B, or (6) the acquisition by A of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of B or of substantially all of the properties of B, or (7) the transfer by A of all or a part of its assets to B where immediately after the transfer A or its shareholders are in control of B, then no taxable income is received from the transaction by corporation A or B if the sole consideration for the transfer of the assets is stock or securities of corporation A or B; and no taxable income is received from the transaction by the shareholders of either corporation A or corporation B if the sole consideration received by the shareholders is stock or securities of corporation A or B. Furthermore, if the reorganization is accomplished by the transfer by corporation A of a portion of its assets to corporation B in exchange for the stock of corporation B and corporation A distributes as a dividend to its shareholders the stock of corporation B, no taxable income is realized by the shareholders from the receipt of such dividends. (See art. 1576.)

In conformity with the principle of ignoring for tax purposes those reorganizations which result merely in a change in form, the statute provides further that the stock received by the shareholders in connection with the reorganization shall have the same basis for the purpose of determining gain or loss from its subsequent sale as the stock surrendered by them and that the assets acquired by a corporation a party to the reorganization shall have the same basis for the purposes of depreciation, depletion, and the determination of gain or loss from subsequent sale as they had in the hands of the corporation from which they were acquired. (See arts. 1596–1598.) The exchanges made by both the shareholders and the corporations

in connection with a reorganization are ignored and both are treated thereafter as if the reorganization had not occurred.

Adequate provision is made in the statute for cases in which income is actually realized by the shareholders in connection with the reorganization through the receipt of cash or property other than the stock of a corporation a party to the reorganization. (See art. 1575.) In such cases the gain to the shareholder is recognized and taxed, but in an amount not exceeding the amount of the money or the other property received in connection with the reorganization. If the money so distributed in connection with the reorganization has the effect of the distribution of a taxable dividend, such gain is taxed not as a capital gain but as an ordinary dividend subject to the surtax rates. While placing no obstacle in the way of genuine reorganizations, the statute does not allow the use of reorganizations to avoid the tax.

Records in substantial form, showing the basis of the stock or property exchanged, and the amount of property or money received in exchange, must be kept to enable the determination of gain or loss from a subsequent disposition of the stock or property received or exchanged.

ART. 1575. **Exchanges in reorganizations for stock or securities and other property or money.**—(*a*) If stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged for (1) stock or securities in such corporation or in another corporation a party to the reorganization, and (2) other property or money, the gain, if any, to the recipient will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property. No loss from such an exchange will be recognized, however. (See section 203(f).) If a distribution of property or money in the course of a reorganization is otherwise within the provisions of this article, but has the effect of the distribution of a taxable dividend, there will be taxed to each distributee (1) as a dividend, such an amount of the gain recognized under this article as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913; (2) as a gain from the exchange of property, the remainder of the gain recognized under this paragraph.

Examples.—(1) A, in connection with a reorganization, exchanges in 1925 a share of stock in the X company, purchased in 1918 for $100, for (1) a share of stock in the Y company (a party to the reorganization), which has a fair market value of $90, and (2) $20 cash. The gain from the transaction, $10, is recognized and taxed

to A. See article 1596 for the basis for determining gain or loss from a subsequent sale.

(2) X corporation has a capital of $100,000, and earnings and profits of $50,000 accumulated since February 28, 1913. X corporation in 1924 transfers all its assets to Y corporation, in exchange for the issuance of all Y's stock and the payment of $50,000 in cash to the stockholders of corporation X. A, who owns one share of stock in X, for which he paid $100, receives a share of stock in Y worth $100, and $50 in cash. A will be liable to the surtax on $50.

(*b*) If, in pursuance of the plan of reorganization, property is exchanged by a corporation a party to a reorganization, for (1) stock or securities in another corporation a party to the reorganization, and (2) other property or money, then if the other property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property so received which is not distributed. In either case no loss from the exchange will be recognized. (See section 203(f).)

ART. 1576. **Receipt of stock or securities in reorganization.**—If, without any surrender of his stock or securities, a shareholder in a corporation, a party to a reorganization, receives in pursuance of the plan of reorganization stock or securities in such corporation or in another corporation a party to the reorganization, no gain to the shareholder will be recognized.

ART. 1577. **Definitions.**—The term "reorganization," as used in sections 201, 203, and 204 of the statute means (1) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (2) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (3) a recapitalization, or (4) a mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in sections 201, 203, and 204 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least

a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of section 203, when owning (1) at least 80 per cent of the voting stock, and (2) at least 80 per cent of the total number of shares of all other classes of stock of the corporation.

As used in this section, as well as in other provisions of the statute, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 1572 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization, or in other corporations parties to the reorganization, are received in exchange.

ART. 1578. **Source of distribution of stock or securities.**—The general rule, provided in section 201(b) of the Act, that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to a distribution in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities, or of stock or securities in a corporation a party to the reorganization. Such a distribution will not be considered a distribution of earnings or profits in determining the amount of earnings and profits accumulated since February 28, 1913, which are available for distribution and which under section 201(b) of the Act, must be distributed before earnings and profits accumulated before March 1, 1913, may be distributed exempt from tax.

Example.—Corporation A has a capital of $100,000, earnings and profits accumulated prior to March 1, 1913, of $25,000, and earnings and profits of $50,000 accumulated thereafter. It causes the organization of corporation B, to which it transfers $50,000 of its assets in exchange for all of the stock of B. It then distributes the stock of corporation B as a dividend to its stockholders. No gain to the stockholders from the receipt of this stock will be recognized under the provisions of article 1576, nor will the distribution be considered a distribution of earnings or profits in determining the amount of earnings and profits accumulated since March 1, 1913, on hand for subsequent distribution as a dividend. The provisions of this article apply to the case in which A distributes the stock of B as a dividend,

the case in which A distributes the stock of B in retirement of a portion of A's stock, and the case in which B issues its stock direct to A's stockholders.

ART. 1579. **Involuntary conversion of property.**—Section 203(b) (5) deals with cases in which property is compulsorily or involuntarily converted into similar property, or into money, as a result of fire, shipwreck, theft, condemnation, or similar causes enumerated in the statute. If the property so destroyed, stolen, seized, or condemned is replaced in kind by similar property or property related in service or use, no gain or loss is recognized. If, however, the original property is compulsorily or involuntarily converted into money, gain or loss will be recognized, unless the money is forthwith under regulations prescribed by the Commissioner with the approval of the Secretary, either (1) expended in the acquisition of other property similar or related in service or use to the property so converted, (2) in the acquisition of control of a corporation owning such other property, or (3) in the establishment of a replacement fund. For the definition of control, see article 1577. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended. See article 1600, for the basis for determining gain or loss from the sale or other disposition of the property so acquired.

ART. 1580. **Replacement funds.**—In any case where the taxpayer elects to replace or restore the converted property, but where it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage. In such a case the taxpayer should make application to the Commissioner on Form 1114 for permission to establish such a replacement fund and in his application should recite all the facts relating to the transaction and undertake that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the Commissioner may require for an amount not less than the estimated additional income taxes assessable by the United States upon the income so carried to the replacement fund. See section 1029 of the statute. The estimated additional taxes, for the amount of which the claimant is required to furnish security, should be computed at the rates at which the claimant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties.

The application should be executed in triplicate, so that the Commissioner, the applicant, and the surety or depositary may each have a copy.

BASIS FOR DETERMINING GAIN OR LOSS, DEPLETION, AND DEPRECIATION

SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

(1) If the property should have been included in the last inventory, the basis shall be the last inventory value thereof;

(2) If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner;

(3) If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made. The provisions of this paragraph shall not apply to the acquisition of such property interests as are specified in subdivision (c) or (e) of section 402 of the Revenue Act of 1921 or in subdivision (c), (d), or (f) of section 302 of this Act;

(4) If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition;

(5) If the property was acquired by bequest, devise, or inheritance, the basis shall be the fair market value of such property at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in subdivision (c) or (e) of section 402 of the Revenue Act of 1921, or in subdivision (c), (d), or (f) of section 302 of this Act;

(6) If the property was acquired upon an exchange described in subdivision (b), (d), (e), or (f) of section 203, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by paragraph (1), (2), (3), or (4) of subdivision (b) of section 203 to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities

as the consideration in whole or in part for the transfer of the property to it;

(7) If the property (other than stock or securities in a corporation a party to the reorganization) was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 80 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made;

(8) If the property (other than stock or securities in a corporation a party to a reorganization) was acquired after December 31, 1920, by a corporation by the issuance of its stock or securities in connection with a transaction described in paragraph (4) of subdivision (b) of section 203 (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money in addition to such stock or securities), then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made;

(9) If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in subdivision (c) of section 203, the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed;

(10) If the property was acquired as the result of a compulsory or involuntary conversion described in paragraph (5) of subdivision (b) of section 203, the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made;

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

(b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property (or, in the case of such property as is described in paragraph (1), (4), or (5), of subdivision (a), the basis as therein provided), or (B) the fair market value of such property as of March 1, 1913, whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that in the case of mines, oil and gas wells, discovered by the taxpayer after February 28, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter; but such depletion allowance based on discovery value shall not exceed 50 per centum of the net income (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value.

ART. 1591. **Basis for determining gain or loss from sale.**—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, is, in general, the cost of such property. This general rule is, however, subject to the exceptions set forth in articles 1592 to 1602 below. The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, is (1) the cost of such property (or, in the case of such property as is described in articles 1592 and 1594 below, the basis therein provided), or (2) the fair market value of such property as of March 1, 1913, whichever is greater. What the fair market value of property was on March 1, 1913, is a question of fact to be established by competent evidence. In determining the fair market value of stock in a corporation due regard shall be given to the fair market value of the corporate assets on the basic date. In the case of property traded in on public exchanges, actual sales at or about the basic date afford evidence of value, but in each case the nature and extent of the sale and the circumstances under which it was made must be considered. Thus, prices received at forced sales or prices received for small lots of property may be no real indication of the value of the property in question.

If the taxpayer can not determine the cost of securities purchased prior to March 1, 1913, because of the loss or destruction of, or failure to keep records, the value of the securities at the date of acquisition may be used in determining the cost. When the approximate date of acquisition is unknown, no general rule can be stated for determining the cost of the securities.

ART. 1592. **Property included in inventory.**—If the property should have been included in the last inventory the basis for determining the gain or loss from its sale or other disposition is the last inventory value. See articles 1611–1618 with reference to the requirement of inventories.

ART. 1593. **Property acquired by gift after December 31, 1920.**—If the property was acquired by gift after December 31, 1920, the basis is the same as it would be in the hands of the donor, or the last preceding owner by whom it was not acquired by gift. See article 1591. If the donee is unable to ascertain the facts necessary to determine the basis, he shall so state upon his return, and the Commissioner will, if possible, obtain such facts from the donor, the last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of the property as found by the Commissioner, as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, the property was acquired by the donor or last preceding owner. In order to insure a fair and adequate appraisal or determination of the proper basis, persons making gifts of property should preserve an accessible record of the facts necessary to determine the cost of such property, and its fair market value as of March 1, 1913, where pertinent.

ART. 1594. **Property acquired by gift or transfer in trust on or before December 31, 1920, or by bequest, devise, or inheritance.**—In computing the gain or loss from the sale or other disposition of property acquired by gift or by a transfer in trust on or before December 31, 1920, or by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property at the time of acquisition. The term "property acquired by bequest, devise, or inheritance" as used herein includes (*a*) such property interests as the taxpayer has received as the result of a transfer, or creation of a trust, in contemplation of or intended to take effect in possession or enjoyment at or after death, (*b*) such property interests as the taxpayer has received as the result of the exercise by a person of a general power of appointment (1) by will, or (2) by deed executed in contemplation of or intended to take effect in possession or enjoyment at or after his death, and (*c*) such property interests as the taxpayer has received as the result of a transfer or creation of a trust, where the enjoyment was subject to change through the exercise of a power, by the grantor alone or in conjunction with another, to alter, amend, or revoke. In the case of property acquired by gift, bequest, devise, or inheritance, prior to March 1, 1913, the taxable gain or deductible loss from the sale or other disposition thereof shall be computed in accordance with article 1591. In the case of property acquired by bequest, devise, or inheritance, 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 shall be deemed to be its fair market value when acquired.

ART. 1595. **Property acquired by transfer in trust after December 31, 1920.**—In the case of property acquired after December 31, 1920, by a transfer in trust, other than by a transfer in trust by bequest or devise, the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made. This article is not applicable, however, to property acquired by bequest, devise, or inheritance, as defined in the preceding article.

ART. 1596. **Property acquired upon an exchange.**—In the case of property acquired upon an exchange described in subdivision (b), (d), (e), or (f) of section 203 (see articles 1572–1577), the basis is the same as in the case of the property exchanged, (1) decreased in the amount of any money received by the taxpayer, and (2) increased in the amount of gain, or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made.

Example.—A purchased a share of stock in the X company in 1918 for $100. Pursuant to a plan of reorganization, A in 1924 exchanges his share for one share in the Y company, worth $90, and $30 in cash. Under the provisions of section 203(d) (see article 1575), A realized a taxable gain of $20 from this exchange. The basis of the share of stock in Y is $90; that is, the basis of the share in X ($100) less the amount of money received by A ($30) plus the amount of gain recognized on the exchange ($20).

If the property which was acquired upon an exchange described in subdivision (b), (d), (e), or (f) of section 203 (see articles 1572–1577) consisted in part of the type of property permitted by paragraph (1), (2), (3), or (4) of subdivision (b) of section 203, to be received without the recognition of gain or loss, and in part of other property, the basis provided in the preceding paragraph of this article shall be allocated between the properties (other than money) received. For the purpose of this allocation, there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange.

Example.—A purchased a share of stock in the X company in 1920 for $100. Upon a reorganization of the X company in 1924, A receives in place of his stock in the X company a share of stock in the Y company worth $60, a Liberty bond worth $50, and $20 in cash. Under section 203 (d) A realized a gain of $30 from the exchange. The basis of the property received in exchange is the basis of the old stock ($100) decreased in the amount of money received ($20) and increased in the amount of gain that was realized ($30) which results in a basis for the property received of $110. This basis of $110 is

apportioned between the Liberty bond and the share of stock, the basis for determining gain or loss from a subsequent disposition of the Liberty bond being its fair market value at the date of the exchange, $50, and of the share of stock, the remainder, $60.

This article does not apply in ascertaining the basis for determining gain or loss of property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

ART. 1597. **Property acquired in reorganization after December 31, 1917.**—In the case of property (other than stock or securities in a corporation a party to the reorganization) which was acquired after December 31, 1917, by a corporation in connection with a reorganization, if immediately after the transfer an interest or control in such property of 80 per cent or more remained in the same persons or in any of them, the basis for determining gain or loss from the sale or other disposition of the property shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law which was applicable to the year in which the transfer was made.

Example.—A corporation owns property which it purchased in 1920 for $10,000. It causes the organization of the B corporation, transferring the property to the B corporation in exchange for shares of its stock, which the A corporation distributes to its stockholders as a dividend. Since no gain or loss from this transaction is recognized under section 203(b)(3) the basis for determining the gain or loss from the subsequent sale or other disposition of the property, and for determining depreciation and depletion is $10,000, the basis which the property would have in the hands of corporation A.

ART. 1598. **Property acquired after December 31, 1920, by a corporation.**—In the case of property other than stock or securities in a corporation a party to a reorganization, acquired after December 31, 1920, by a corporation, by the issuance of its stock or securities in exchange for such property, in accordance with the conditions specified in section 203(b)(4), the basis of such property shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon the transfer under the law applicable to the year in which the transfer was made. This article also applies to cases in which part of the consideration for the transfer of property to the corporation was property or money in addition to stock or securities, provided that the other conditions specified in section 203(b) (4) are satisfied.

It should be noted that property may be acquired in connection with a reorganization without the provisions of article 1597 being applicable, because of the fact that an interest or control of 80 per cent or more does not remain in the same persons. If, however, such a transaction falls within the provisions of this article, the limitations imposed herein upon the basis of such property are applicable.

ART. 1599. **Dividend stock.**—In the case of stock or securities acquired by a stockholder after December 31, 1923, in connection with a transaction described in article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the stockholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock issued as a dividend is all of substantially the same character or preference as the stock upon which the dividend is paid, the basis of each share will be the quotient of the cost or other basis of the old shares of the stock divided by the total number of the old and new shares.

(2) Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the dividend is paid, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new preferred stock shall in no case exceed the fair market value of such shares as of the time of their issuance.

(3) Where the stock with respect to which a dividend is issued was purchased at different times and at different prices and the identity of the lots can not be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see article 39), and any sale of dividend stock issued with respect to such stock will be presumed to have been made from the stock issued with respect to the earliest purchased stock, to the amount of the dividend chargeable to such stock.

(4) Where the stock with respect to which a dividend is declared was purchased at different times and at different prices, and the dividend stock issued with respect to such stock can not be identified as having been issued with respect to any particular lot of such stock, then any sale of such dividend stock will be presumed to have

been made from the stock issued with respect to the earliest purchased stock, to the amount of the dividend stock chargeable to such stock.

ART. 1600. **Property acquired by an involuntary conversion.**—In the case of property acquired as the result of an involuntary conversion described in article 1579, the basis of the property shall be the same as in the case of property so converted, (1) decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, (2) increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which the conversion was made.

Example.—A vessel purchased by A in 1918 for $100,000 is destroyed in 1924 and A receives insurance in the amount of $200,000. If A invests $150,000 in a new vessel, taxable gain to the extent of $50,000 would be recognized under the provisions of article 1579. If the new vessel is subsequently sold, the basis for determining gain or loss is $100,000, that is, the cost of the old vessel ($100,000), minus the money received by the taxpayer which was not expended in the acquisition of the new vessel ($50,000) plus the amount of gain recognized upon the conversion ($50,000).

ART. 1601. **Stock or securities acquired in "wash sales."**—If substantially identical property was acquired after December 31, 1920, in place of stock or securities which were sold or disposed of, and in respect of which loss was not allowed as a deduction under section 214(a)(5) or 234(a)(4) of this Act, or of the Revenue Act of 1921, the basis in the case of the new property shall be the same as the basis of the stock or securities so sold, increased in the amount of any excess of the repurchase price over the sale price, or decreased by the amount by which the sale price exceeds the repurchase price, as the case may be.

Example.—A purchased a share of stock for $100 in 1921, which he sold January 15, 1924, for $80. On February 1, 1924, he purchased a share of stock in the same corporation for $90. No loss from the sale is recognized under section 214(a)(5). The basis for determining gain or loss from the sale of the new share is $110, that is, the basis of the old share ($100) increased by $10, the amount of the difference between the price for which sold ($80) and the repurchase price ($90).

ART. 1602. **Basis for allowance of depletion and depreciation.**—The basis upon which depletion, exhaustion, wear and tear, and obsolescence will be allowed in respect of any property is the same as is

provided in subdivisions (a) and (b) of section 204 for the purpose of determining the gain or loss from the sale or other disposition of such property. In the case of mines and oil and gas wells, however, discovered by the taxpayer after February 28, 1913, and not acquired as the result of purchase of a proven tract or lease, the basis for depletion shall be the fair market value of the property at the date of discovery or within 30 days thereafter, if the fair market value is materially disproportionate to the cost. The depletion allowance based on discovery value shall not exceed 50 per cent of the net income (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value. See articles 201–239, for the methods of computing allowances for depletion, and articles 161–171 with reference to the allowance for depreciation.

ART. 1603. **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 of his interest in the partnership, including in such cost the amount of his share in any undistributed partnership net income earned since he became a partner on which the income tax has been paid. However, if such interest in the partnership was acquired prior to March 1, 1913, both the cost as hereinbefore provided and the value of such interest as of such date, plus the amount of the share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid, shall be ascertained and the taxable gain derived or the deductible loss sustained shall be computed as provided in article 1591. If 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 in liquidation. 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.

INVENTORIES

SEC. 205. Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

ART. 1611. **Need of inventories.**—In order to reflect the net income correctly, inventories at the beginning and end of each year are

necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption, or use in productive processes, together with all finished or partly finished goods. Only merchandise title to which is vested in the taxpayer should be included in the inventory. Accordingly the seller should include in his inventory goods under contract for sale but not yet segregated and applied to the contract and goods out upon consignment, but should exclude from inventory goods sold, title to which has passed to the purchaser. A purchaser should include in inventory merchandise purchased, title to which has passed to him, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should not include goods ordered for future delivery, transfer of title to which has not yet been effected. In cases where inventories are required, the taxpayer should file with his return a certificate of inventory on Form 1126.

ART. 1612. **Valuation of inventories.**—The Act provides two tests to which each inventory must conform: (1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) it must clearly reflect the income. It follows, therefore, that inventory rules can not be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order clearly to reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation so long as the method or basis used is substantially in accord with these regulations. An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.

The basis of valuation most commonly used by business concerns and which meets the requirements of the Revenue Act is (*a*) cost or (*b*) cost or market, whichever is lower. (For inventories by dealers in securities, see article 1615.) Any goods in an inventory which are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange, should be valued at bona fide selling prices less cost of selling whether basis (*a*) or (*b*) is used, or if such goods consist of raw materials or partly finished goods held for use or consumption, they shall be valued upon a reasonable basis, taking into consideration the usability and the condition of the goods, but

in no case shall such value be less than the scrap value. Bona fide selling price means actual offering of goods during a period ending not later than 30 days after inventory date. The burden of proof will rest upon the taxpayer to show that such exceptional goods as are valued upon such selling basis come within the classifications indicated above, and he shall maintain such records of the disposition of the goods as will enable a verification of the inventory to be made.

In respect to normal goods whichever basis (*a*) or (*b*) is adopted must be applied with reasonable consistency to the entire inventory. Taxpayers were given an option to adopt the basis of either (*a*) cost, or (*b*) cost or market, whichever is lower, for their 1920 inventories. The basis adopted for that year is controlling and a change can now be made only after permission is secured from the Commissioner. Goods taken in the inventory which have been so intermingled that they can not be identified with specific invoices will be deemed to be either (*a*) the goods most recently purchased or produced, and the cost thereof will be the actual cost of the goods purchased or produced during the period in which the quantity of goods in the inventory has been acquired, or (*b*) where the taxpayer maintains book inventories in accordance with a sound accounting system in which the respective inventory accounts are charged with the actual cost of the goods purchased or produced and credited with the value of goods used, transferred, or sold, calculated upon the basis of the actual cost of the goods acquired during the taxable year (including the inventory at the beginning of the year) the net value as shown by such inventory accounts will be deemed to be the cost of the goods on hand. The balances shown by such book inventories should be verified by physical inventories at reasonable intervals and adjusted to conform therewith.

Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. The inventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted.

The following methods, among others, are sometimes used in taking or valuing inventories, but are not in accord with these regulations, viz:

(*a*) Deducting from the inventory a reserve for price changes, or an estimated depreciation in the value thereof.

(*b*) Taking work in process, or other parts of the inventory, at a nominal price or at less than its proper value.

(*c*) Omitting portions of the stock on hand.

(*d*) Using a constant price or nominal value for a so-called normal quantity of materials or goods in stock.

(*e*) Including stock in transit, either shipped to or from the taxpayer, the title of which is not vested in the taxpayer.

ART. 1613. **Inventories at cost.**—Cost means:

(1) In the case of merchandise on hand at the beginning of the taxable year, the inventory price of such goods.

(2) In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts, approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

(3) In the case of merchandise produced by the taxpayer since the beginning of the taxable year (*a*) the cost of raw materials and supplies entering into or consumed in connection with the product, (*b*) expenditures for direct labor, (*c*) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit.

(4) In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry. Among such cases are (*a*) farmers and raisers of live stock (see article 1616), (*b*) miners and manufacturers who by a single process or uniform series of processes derive a product of two or more kinds, sizes or grades, the unit cost of which is substantially alike (see article 1617), and retail merchants who use what is known as the "retail method" in ascertaining approximate cost (see article 1618).

ART. 1614. **Inventories at market.**—Under ordinary circumstances, and for normal goods in an inventory, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the cases (*a*) of goods purchased and on hand, and (*b*) of basic elements of cost (materials, labor, and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. Where no open market exists or where quotations are nominal, due to stagnant market conditions, the taxpayer must use such

evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific purchases or sales by the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where the taxpayer in the regular course of business has offered for sale such merchandise at prices lower than the current price as above defined, the inventory may be valued at such prices less proper allowance for selling expense, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market.

ART. 1615. **Inventories by dealers in securities.**—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either (*a*) at cost, or (*b*) at cost or market, which ever is lower, or (*c*) at market value, may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, and not in the course of an established business, and officers of corporations and members of partnerships, who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule. A dealer in securities is not entitled to the benefits of section 208 with reference to the gain from the sale of securities.

ART. 1616. **Inventories of live-stock raisers and other farmers.**—(1) Farmers may change the basis of their returns from that of receipts and disbursements to that of an inventory basis provided adjustments are made in accordance with one of the two methods outlined in (A) and (B) below. It is optional with the taxpayer which method is used, but having elected one method the option so exercised will be binding upon the taxpayer and he will be precluded from filing amended returns upon the basis of the other method.

(A) Opening and closing inventories shall be used for the year in which the change is made. There should be included in the opening inventory all farm products (including live stock) purchased or raised which were on hand at the date of the inventory and there must be submitted with the return for the current taxable year an adjustment sheet for the preceding taxable year based on the inventory method, upon the amount of which adjustment the tax shall be assessed and paid (if any be due) at the rate of tax in effect for that year. Ordinarily an adjustment sheet for the preceding year will be sufficient but if, in the opinion of the Commissioner, such adjustment is not sufficient clearly to reflect income, adjustments for earlier years may be accepted or required. Where it is impossible to render complete inventories for the preceding year or years, the department will accept estimates which, in its opinion, substantially reflect the income on the inventory basis for such preceding year or years; but inventories must not include real estate, buildings, permanent improvements, or any other assets subject to depreciation.

(B) No adjustment sheets will be required, but the net income for the taxable year in which the change is made must be computed without deducting from the sum of the closing inventory and the sales and other receipts, the inventory of live stock, crops, and products at the beginning of the year; provided, however,

(*a*) That if any live stock, grain, or other property on hand at the beginning of the taxable year has been purchased and the cost thereof not charged to expense, only the difference between the cost and the selling price should be reported as income for the year in which sold;

(*b*) But if the cost of such property has been charged to expense for a previous year, the entire amount received must be reported as income for the year in which sold.

(2) Because of the difficulty of ascertaining actual cost of live stock and other farm products, farmers who render their returns upon an inventory basis may at their option value their inventories for the current taxable year according to the "farm-price method," which provides for the valuation of inventories at market price less cost of marketing. If the use of the "farm-price method" of valuing inventories for any taxable year involves a change in method of pricing inventories from that employed in prior years, the opening inventory for the taxable year in which the change is made should be brought in at the same value as the closing inventory for the preceding taxable year. If such valuation of the opening inventory for the taxable year in which the change is made results in an abnormally large income for that year, there may be submitted with the return for such taxable year an adjustment statement for the

preceding year based on the "farm-price method" of valuing inventories, upon the amount of which adjustments the tax, if any be due, shall be assessed and paid at the rate of tax in effect for such preceding year. If an adjustment for the preceding year is not, in the opinion of the Commissioner, sufficient clearly to reflect income, adjustment sheets for prior years may be accepted or required.

Where returns have been made in which the taxable net income has been computed upon incomplete inventories, the abnormality should be corrected by submitting with the return for the current taxable year a statement for the preceding year in which such adjustments shall be made as are necessary to bring the closing inventory for the preceding year into agreement with the opening complete inventory for the current taxable year. If necessary clearly to reflect income, similar adjustments may be made as at the beginning of the preceding year or years, and the tax, if any be due, shall be assessed at the rate of tax in effect for such year or years.

ART. 1617. **Inventories of miners and manufacturers.**—A taxpayer engaged in mining or manufacturing who by a single process or uniform series of processes derives a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike, and who in conformity to a recognized trade practice allocates an amount of cost to each kind, size, or grade of product which in the aggregate will absorb the total cost of production, may use such allocated cost as a basis for pricing inventories, provided such allocation bears a reasonable relation to the respective selling values of the different kinds of product.

ART. 1618. **Inventories of retail merchants.**—Retail merchants who employ what is known as the "retail method" of pricing inventories may make their returns upon that basis, provided that the use of such method is designated upon the return, that accurate accounts are kept, and that such method is consistently adhered to unless a change is authorized by the Commissioner. Under this method the goods in the inventory are ordinarily priced at the selling prices, and the total retail value of the goods in each department or of each class of goods is reduced to approximate cost by deducting the percentage which represents the difference between the retail selling value and the purchase price. This percentage is determined by departments of a store or by classes of goods, and should represent as accurately as may be the amounts added to the cost prices of the goods to cover selling and other expenses of doing business and for the margin of profit. In computing the percentage above mentioned, proper adjustment should be made for all mark-ups and mark-downs.

A taxpayer maintaining more than one department in his store or dealing in classes of goods carrying different percentages of gross

profit should not use a percentage of profit based upon an average of his entire business, but should compute and use in valuing his inventory the proper percentages for the respective departments or classes of goods.

NET LOSSES

SEC. 206. (a) As used in this section the term "net loss" means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations:

(1) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business;

(2) In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains;

(3) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value;

(4) The deduction provided for in paragraph (6) of subdivision (a) of section 234 of amounts received as dividends shall not be allowed;

(5) There shall be included in computing gross income the amount of interest received free from tax under this title, decreased by the amount of interest paid or accrued and losses sustained which is not allowed as a deduction by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234.

(b) If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

(c) (1) If in the second year the taxpayer (other than a corporation) sustains a capital net loss, the deduction allowed by subdivision (b) of this section shall first be applied as a deduction in computing the ordinary net income for such year. If the deduction is in excess of the ordinary net income (computed without such deduction) then the amount of such excess shall be allowed as a deduction in computing net income for the third year.

(2) If in the second year the taxpayer (other than a corporation) has a capital net gain, the deduction allowed by subdivision (b) of this section shall first be applied as a deduction in computing the ordinary net income for such year. If the deduction is in excess of the ordinary net income (computed without such deduction) the amount of such excess shall next be applied against the capital net gain for such year and if in excess of the capital net gain the amount of that excess shall be allowed as a deduction in computing net income for the third year.

(d) If any portion of a net loss is allowed as a deduction in computing net income for the third year, under the provisions of either subdivision (b) or (c), and the taxpayer (other than a corporation) has in such year a capital net

gain or a capital net loss, then the method of allowing such deduction in such third year shall be the same as provided in subdivision (c).

(e) If for the taxable year 1922 a taxpayer sustained a net loss in excess of his net income for the taxable year 1923 (such net loss and net income being computed under the Revenue Act of 1921), the amount of such excess shall be allowed as a deduction in computing net income for the taxable year 1924 in accordance with the method provided in subdivisions (b) and (c) of this section.

(f) If for the taxable year 1923 a taxpayer sustained a net loss within the provisions of the Revenue Act of 1921, the amount of such net loss shall be allowed as a deduction in computing net income for the two succeeding taxable years to the same extent and in the same manner as a net loss sustained for one taxable year is, under this Act, allowed as a deduction for the two succeeding taxable years.

(g) If a taxpayer makes return for a period beginning in one calendar year (hereinafter in this subdivision called "first calendar year") and ending in the following calendar year (hereinafter in this subdivision called "second calendar year") and the law applicable to the second calendar year is different from the law applicable to the first calendar year, then his net loss for the period ending during the second calendar year shall be the sum of: (1) the same proportion of a net loss for the entire period, determined under the law applicable to the first calendar year, which the portion of such period falling within such calendar year is of the entire period; and (2) the same proportion of a net loss for the entire period, determined under the law applicable to the second calendar year, which the portion of such period falling within such calendar year is of the entire period.

(h) The benefit of this section shall be allowed to the members of a partnership, to an estate or trust, and to insurance companies subject to the tax imposed by section 243 or 246, under regulations prescribed by the Commissioner with the approval of the Secretary.

ART. 1621. **Net losses, definition and computation.**—The term "net loss" as used in the statute applies to a net loss during the taxable year in a trade or business regularly carried on by the taxpayer. Included therein are losses from the sale or other disposition of real estate, machinery, and other capital assets used in the conduct of such trade or business. (See article 1654 with reference to the deduction of capital net losses.) In order to be entitled to claim an allowance for a "net loss" the taxpayer must have suffered an actual net loss in a trade or business during the taxable year. The amount properly allowed may be neither the loss reflected by the return filed for the purpose of the income tax nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to the statute, as follows:

(1) In the case of an individual it is the amount by which the deductions allowed under section 214, excluding:

(*a*) the amount by which the deductions otherwise allowed by law but not attributable to the operation of a trade or business regularly carried on by the taxpayer exceed the amount of gross income not derived from such trade or business;

(*b*) the amount by which the deductions for capital losses otherwise allowed by law exceed the capital gains; and

(*c*) the amount by which the deduction for depletion exceeds the amount which would be allowable if computed without reference to discovery value,

exceeds the sum of the following:

(*a*) the gross income of the taxpayer for the taxable year as computed under section 213; and

(*b*) the amount by which the interest received free from taxation under Title II of this Act exceeds the amount of interest paid or accrued which is not allowed as a deduction by section 214(a) (2);

(2) In the case of a corporation, it is the amount by which the deductions allowed under section 234, excluding:

(*a*) the amount by which the deduction for depletion exceeds the amount which would be allowable if computed without reference to discovery value; and

(*b*) the amount received as dividends and allowed as a deduction under section 234(a)(6),

exceeds the sum of the following:

(*a*) the gross income of the taxpayer for the taxable year as computed under section 233; and

(*b*) the amount by which the interest received free from tax under the provisions of Title II of the Act exceeds the amount of interest paid or accrued within the taxable year which is not allowed as a deduction by section 234(a)(2).

In computing statutory net loss the following restrictions are to be noted:

(1) Interest received by the taxpayer on obligations or securities, the interest from which is exempted from taxation, must be included in the taxpayer's income but this amount is to be reduced by the amount of any interest paid by the taxpayer on money used to purchase or carry such obligations or securities;

(2) Where depletion is computed upon the basis of discovery value, in lieu of cost or value as of March 1, 1913, the deductions are reduced, in making the computations, by that portion of the depletion representing the excess of the discovery value over actual cost or value as of March 1, 1913. (See sections 204(c) and 214(a)(9) and articles 201–239.)

ART. 1622. **Claim for allowance of net loss.**—A taxpayer sustaining for any taxable year a "net loss" as defined in article 1621 may file a claim therefor with his return for the succeeding taxable year (designated in section 206 as the "second year"). The claim should contain a concise statement setting forth the amount of the net loss,

and all pertinent facts relative thereto, including a schedule showing the computation of the net loss in accordance with section 206 and articles 1621 and 1626 of these regulations. If the evidence furnished satisfies the Commissioner that the taxpayer has sustained a "net loss" the amount of such net loss may be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year, and if such net loss is in excess of the net income for that year, the amount of the excess may be carried over and allowed as a deduction in computing the net income for the next succeeding taxable year (designated in section 206 as the "third year"). It should be noticed, however, that a "net loss" for a preceding year may not be considered in computing a "net loss" for a succeeding year. See section 206(a).

ART. 1623. **Net loss and capital net gain or capital net loss.**—If the taxpayer (other than a corporation) sustains in the second year a capital net loss, as defined in article 1654, the deduction of a net loss allowed by section 206(b) shall first be applied as a deduction in computing the ordinary net income for that year. If the ordinary net income is in excess of the net loss, the tax shall be computed as provided in article 1654. If the deduction is in excess of the ordinary net income (computed without such deduction) the amount of the excess of the net loss may be allowed as a deduction in computing net income for the third year. The capital net loss may not be carried over as a deduction into the third year.

If in the second year the taxpayer (other than a corporation) has a capital net gain, as defined in article 1651, the deduction of a net loss allowed by section 206(b) shall first be applied as a deduction in computing the ordinary net income for that year. If the ordinary net income is in excess of the net loss, the tax may be computed as provided in article 1651. If the deduction is in excess of the ordinary net income (computed without such deduction) the amount of the excess shall next be applied against the capital net gain for that year, and if in excess of the capital net gain, the amount of that excess shall be allowed as a deduction in computing net income for the third year.

If any portion of a net loss is allowed as a deduction in computing net income for the third year, under the provisions of either subdivision (b) or (c) of section 206, and the taxpayer (other than a corporation) has in the third year a capital net gain or a capital net loss, then the method of allowing the deduction in the third year is that provided in the two preceding paragraphs of this article.

ART. 1624. **Net losses under preceding act.**—If a taxpayer sustained a net loss for the taxable year 1922, in excess of his net income for the taxable year 1923 (the net loss and ordinary net income being computed under the Revenue Act of 1921) the amount of this excess

shall be allowed as a deduction in computing net income for the taxable year 1924 in accordance with the method provided in articles 1621 and 1623.

If a taxpayer sustained a net loss for the taxable year 1923, within the provisions of the Revenue Act of 1921, the amount of the net loss shall be allowed as a deduction in computing net income for the two succeeding taxable years to the same extent and in the same manner as a net loss sustained for one taxable year is, under articles 1621 and 1623, allowed as a deduction for the two succeeding taxable years.

Where a taxpayer has a fiscal year beginning in 1923 and ending in 1924, his net loss for the period ending during 1924 shall be the sum of (1) the same proportion of a net loss for the entire period, determined under the Revenue Act of 1921, which the portion of the period falling within 1923 is of the entire period, and (2) the same proportion of a net loss for the entire period determined under this Act which the portion of the period falling within 1924 is of the entire period.

ART. 1625. **Net losses of partnerships, estates and trusts, and insurance companies.**—The provisions of section 206 are applicable to the members of a partnership, to an estate or trust, and to insurance companies subject to the tax imposed by section 243 or 246.

ART. 1626. **Illustration of computation of net loss.**—The method of computation of net losses as outlined in articles 1621 and 1623 may be illustrated as follows:

A, an individual, conducting a trade or a business, finds the following facts relating to 1924:

(*a*) His deductions as computed under section 214 amount to $100,000.

(*b*) Included in the deductions is an item of $10,000 for loss by fire of property occupied by him as a residence and not used in connection with his trade or business.

(*c*) Other deductions otherwise allowed under section 214 on account of transactions entered into for profit outside of his trade or business amount to $3,000.

(*d*) His taxable gains from transactions entered into for profit and not connected with his trade or business are $5,000.

(*e*) Donations to the Red Cross amounting to $1,000 are included among the deductions.

(*f*) Depletion is claimed in the amount of $2,000, of which $500 is based upon the value of the mineral in the mine as of March 1, 1913, and $1,500 is attributable to increase in valuation on account of discovery subsequent to February 28, 1913.

(*g*) His entire gross income as computed under section 213 is $50,000.

(*h*) Interest received from municipal bonds exempted from taxation by section 213(b)(4) amounted to $10,000.

(*i*) Interest was paid upon money borrowed to carry municipal bonds in the amount of $8,000, which amount is not deductible under section 214(a)(2):

Total deductions (*a*)			$100,000
Deduct:			
Loss by fire (*b*)		$10,000	
Other deductions (*c*)		3,000	
Total deductions outside business		13,000	
Less: Gain outside business (*d*)		5,000	
Excess of deductions not sustained in trade or business over taxable gains or profits not derived from such trade or business		8,000	
Donations (*e*)		1,000	
Depletion on basis of value after discovery (*f*)	$2,000		
Less: Portion based on value as of Mar. 1, 1913	500		
Portion of depletion representing discovery value in excess of cost or value as of Mar. 1, 1913		1,500	
Total exclusion from deductions			10,500
Total expenses directly attributable to the conduct of the trade or business			89,500
Gross income (*g*)		50,000	
Add: Nontaxable interest received (*h*)	$10,000		
Less: Interest paid on money borrowed to carry municipal bonds (*i*)	8,000		
		2,000	
			52,000
Statutory net loss			$37,500

If A has an ordinary net income in 1925 of $25,000, and sustains a capital net loss of $10,000, he will pay no tax for 1925, since he had a net loss in 1924 of $37,500, and will carry over $12,500 as deduction for computing net income in 1926. If A in 1926 has ordinary net income of $10,000 and a capital net gain of $50,000, he may, at his option, pay a tax of 12½ per cent upon $47,500, under the provisions of article 1651.

FISCAL YEARS

SEC. 207. (a) If the taxpayer makes return for a period beginning in one calendar year (hereinafter in this subdivision called "first calendar year") and ending in the following calendar year (hereinafter in this subdivision called "second calendar year") and the law applicable to the second calendar year is different from the law applicable to the first calendar year, then his tax

under this title for the period ending during the second calendar year shall be the sum of: (1) the same proportion of a tax for the entire period, determined under the law applicable to the first calendar year and at the rates for such year, which the portion of such period falling within the first calendar year is of the entire period; and (2) the same proportion of a tax for the entire period, determined under the law applicable to the second calendar year and at the rates for such year, which the portion of such period falling within the second calendar year is of the entire period.

(b) If a fiscal year of a partnership begins in one calendar year and ends in another calendar year, and the law applicable to the second calendar year is different from the law applicable to the first calendar year, then (1) the rates for the calendar year during which such fiscal year begins shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year. In such cases the part of such income subject to the rates in effect for the most recent calendar year shall be added to the other income of the taxpayer subject to such rates and the resulting amount shall be placed in the lower brackets of the rate schedule applicable to such year, and the part of such income subject to the rates in effect for the next preceding calendar year shall be placed in the next higher brackets of the rate schedule applicable to such year.

(c) Any amount paid before or after the enactment of this Act on account of the tax imposed for a fiscal year beginning in 1923 and ending in 1924 by Title II of the Revenue Act of 1921 shall be credited toward the payment of the tax imposed for such fiscal year by this Act, and if the amount so paid exceeds the amount of such tax imposed by this Act, the excess shall be credited or refunded in accordance with the provisions of section 281.

ART. 1631. **Fiscal years ending in 1924.**—The tax for a period beginning in 1923 and ending in 1924 is the sum of the following:

(*a*) The tax attributable to the calendar year 1923, found by computing the tax upon the income of the taxpayer for the fiscal year under the provisions of the Revenue Act of 1921, and by taking the proportion of such tax which the portion of the period falling within the calendar year 1923 is of the entire period;

(*b*) The tax attributable to the calendar year 1924, found by computing the tax upon the income of the taxpayer for the fiscal year under the provisions of the Revenue Act of 1924, and by taking the proportion of such tax which the portion of the period falling within the calendar year 1924 is of the entire period.

CAPITAL GAINS AND LOSSES

SEC. 208. (a) For the purposes of this title—

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;

(2) The term "capital loss" means deductible loss resulting from the sale or exchange of capital assets;

(3) The term "capital deductions" means such deductions as are allowed by section 214 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year;

(4) The term "ordinary deductions" means the deductions allowed by section 214 other than capital losses and capital deductions;

(5) The term "capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gain;

(6) The term "capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain;

(7) The term "ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions; and

(8) The term "capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business.

(b) In the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:

A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(c) In the case of any taxpayer (other than a corporation) who for any taxable year sustains a capital net loss, there shall be levied, collected, and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:

A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax under this subdivision be less than the taxes imposed by sections 210 and 211 computed without regard to the provisions of this section.

(d) The total tax determined under subdivision (b) or (c) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

(e) In the case of the members of a partnership, of an estate or trust, or of the beneficiary of an estate or trust, the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership or estate or trust, and shall be taxed to the member or beneficiary or to the estate or trust as provided in sections 218 and 219, but at the rates and in the manner provided in subdivision (b) or (c) of this section.

ART. 1651. **Definition and illustration of capital net gain.**—(*a*) Section 208, which applies to sales and exchanges of capital assets consummated after December 31, 1921, provides that any taxpayer other

than a corporation may, if he so desires, state separately in his return his net gain on sales or exchanges of capital assets, and pay on such capital net gain (as defined and limited in the section) a flat tax of 12½ per cent in lieu of the tax he would otherwise pay on such income under sections 210 and 211. The tax upon his net income from other sources, termed " ordinary net income " in this section, is to be computed at the rates and in the manner provided in sections 210 and 211. The total tax will be the sum of the tax upon the ordinary net income plus 12½ per cent of the capital net gain.

The term " capital assets " is defined to mean property held by the taxpayer for more than two years, whether or not connected with his trade or business, but not including stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. (See articles 1611–1618 with reference to inventories.) The specific property sold or exchanged must in general have been held for more than two years. However, if the taxpayer has held for more than two years stock upon which a stock dividend has been declared, both the original and the dividend shares are considered to be capital assets. Likewise, if property is exchanged for other property and no gain or loss is recognized under the provisions of section 203, and if the total period during which the original property and the property received in exchange have been held by the taxpayer is more than two years, the property received in exchange is considered to be capital assets.

" Capital gain " is taxable gain from the sale or exchange of capital assets. " Capital loss " is deductible loss resulting from the sale or exchange of capital assets. (See article 1591, for the basis for determining such gain or loss, and article 1561 as to adjustments for improvements and depreciation thereon.) " Capital deductions " are deductions properly allocable to or chargeable against capital assets sold during the taxable year, including items of expense connected with the sale or exchange of a capital asset, such as commissions paid brokers or agents. " Capital net gain " is the excess of the total amount of capital gain over the sum of (1) capital deductions and capital losses, and (2) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gain.

Residential property is included within the definition of capital assets; hence, a taxpayer (other than a corporation) selling such property at a profit may elect to be taxed under section 208. A loss from the sale of such property is not a " capital loss," however, unless

the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. See section 208(a)(2) and article 141.

Example.—A in 1924 sold (1) an office building for $1,000,000, which he had bought in 1915 for $500,000 and on which there was depreciation aggregating $100,000; and (2) stock in a mining company for $10,000 which he had purchased in 1919 for $20,000. Without regard to capital deductions (such as commissions paid on these sales) his capital gain would be $600,000, his capital loss $10,000, and his capital net gain $590,000. If his other net income (ordinary net income) in 1924 was $50,000, he may, instead of paying normal tax and surtax on his total net income of $640,000, segregate these capital transactions in his return and pay a tax on his capital net gain of $590,000 plus the normal tax and surtax upon his ordinary net income of $50,000. If, on the other hand, A sustained a net loss of $50,000 in his business, had a capital gain of $600,000, and a capital loss of $10,000, his capital net gain would be $540,000. In such a case, A may, instead of paying normal tax and surtax upon his total net income of $540,000, pay a tax of 12½ per cent upon this amount.

(*b*) The credit for taxes allowed by section 222 (see articles 381–387) is a credit against the total tax, however computed, but the credits allowed by section 216 are allowed " for the purpose of the normal tax only " and may not be taken against capital net gain although they may be deducted from " ordinary net income " in computing the amount of the tax. The credit allowed by section 209 in respect of earned income may be taken against the tax computed under the capital gain section.

Example.—If B, a married person, had capital net gain of $60,000 and ordinary net income of $2,000, his $2,500 personal exemption would more than offset his ordinary net income, but he may not apply any part of it to reduce his capital net gain.

(*c*) A nonresident individual or a citizen entitled to the benefits of section 262 may elect to be taxed under section 208 with respect to sales or exchanges of property within the United States.

ART. 1652. **Returns of capital net gain.**—Segregation of capital transactions for the purposes of section 208(b) is required only where the taxpayer elects to be taxed under that subdivision. Where his total income tax for any taxable year does not exceed 12½ per cent of his net income he will not elect to be so taxed for that year. See article 1651. When a taxpayer elects to be taxed under this section for any taxable year, he must attach to his return of income for such year an accurate statement under oath showing all items of capital gain,

capital loss, and capital deductions in such manner as will clearly show the exact amount of his capital net gain for the taxable year. Each capital transaction must be separately shown and the capital items with respect thereto grouped together in order that the capital gain derived or the capital loss sustained from each capital transaction will readily appear. In the case of sales or exchanges of securities or any other property, the statement must show how long the property was held by the taxpayer immediately preceding the sale or exchange.

ART. 1653. **Partnerships, estates and trusts.**—Members of a partnership may, with respect to any capital net gain, elect to be taxed as provided in section 208. Similarly, estates or trusts or the beneficiaries thereof may elect to be taxed as provided in section 208 with respect to any capital net gain. Where the net income of a partnership, estate or trust consists in whole or in part of capital net gain, there shall be attached to the return (upon the request of any member or beneficiary, or without such request, at the election of the fiduciary of an estate) a statement showing (1) all items of capital gain, capital loss, and capital deductions, as provided in article 1652, and (2) the names of members or beneficiaries and the amounts of their respective shares in such capital net gain, or capital net loss.

ART. 1654. **Capital net losses.**—Subdivision (c) of section 208 provides for the determination of the tax in the case of any taxpayer (other than a corporation, but including the members of a partnership, an estate or trust, or the beneficiaries thereof) who in any taxable year sustains a capital net loss. A " capital net loss " is the excess of the sum of the capital losses plus the capital deductions as defined in article 1651, over the total amount of capital gain, as therein defined. It is to be noted that, although the tax provided in subdivision (b) of section 208 in the case of a capital net gain is to be imposed at the election of the taxpayer, the limitation upon the deduction of a capital net loss provided in subdivision (c) will be applied irrespective of the taxpayer's election.

In the case of any taxpayer, other than a corporation, who sustains a capital net loss for any taxable year, a tax determined as follows will be levied, collected and paid in lieu of the normal tax and the surtax provided in sections 210 and 211: A partial tax will first be computed upon the basis of the ordinary net income, as defined in article 1651, at the rates and in the manner provided in sections 210 and 211, and the total tax will be this amount minus 12½ per cent of the capital net loss, but in no case shall the tax under this article be less than the taxes imposed by sections 210 and 211 computed without regard to the provisions of this article.

EARNED INCOME

SEC. 209. (a) For the purposes of this section—

(1) The term "earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income producing factors, a reasonable allowance as compensation for the personal services actually rendered by the taxpayer, not in excess of 20 per centum of his share of the net profits of such trade or business, shall be considered as earned income.

(2) The term "earned income deductions" means such deductions as are allowed by section 214 for the purpose of computing net income, and are properly allocable to or chargeable against earned income.

(3) The term "earned net income" means the excess of the amount of the earned income over the sum of the earned income deductions. If the taxpayer's net income is not more than $5,000, his entire net income shall be considered to be earned net income, and if his net income is more than $5,000, his earned net income shall not be considered to be less than $5,000. In no case shall the earned net income be considered to be more than $10,000.

(b) In the case of an individual the tax shall, in addition to the credits provided in section 222, be credited with 25 per centum of the amount of tax which would be payable if his earned net income constituted his entire net income; but in no case shall the credit allowed under this subdivision exceed 25 per centum of his tax under section 210.

(c) In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in section 218.

ART. 1661. **Earned income.**—Under the provisions of section 209 of the Act, provision is made for an additional credit based upon the amount of the taxpayer's earned net income, with certain limitations. It is provided that in the case of an individual, the tax shall, in addition to the credits provided in section 222 (see articles 381–387) be credited with 25 per cent of the amount of the tax which would be payable if his earned net income constituted his entire net income. In no case, however, shall this credit exceed 25 per cent of his tax under section 210, as it might, for example, because of an excess of deductions and losses not related to earned income over gross income received from other sources. The earned income credit will be allowed to the members of a partnership with respect to the share of the net income belonging to each which consists of earned income. There must be included in the return of the partnership a statement showing (1) the amount of earned income as defined in article 1662, and (2) the names of the members and the amounts of their respective shares of earned income. See article 412.

ART. 1662. **Definitions and limitations.**—The term "earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, a reasonable allowance in compensation for the personal services actually rendered by the taxpayer shall be considered as earned income, but the total amount which shall be treated as the earned income of the taxpayer from such a trade or business shall, in no case, exceed 20 per cent of his share of the net profits of such trade or business. See article 106, as to what constitutes compensation for personal services. The term does not include that part of any compensation received by the taxpayer for personal services rendered by him to a corporation, which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. No general rule can be laid down defining the trades or businesses in which personal services and capital are material income-producing factors, but this question must be determined with respect to the facts of the individual cases.

The term "earned income deductions" means deductions which are properly allocable to or chargeable against earned income and which are allowed by section 214 for the purpose of computing net income. The term "earned net income" means the excess of the amount of the earned income over the sum of the earned income deductions. In no case will the earned net income be considered to be more than $10,000. If the taxpayer's net income is not more than $5,000, his entire net income shall be considered to be earned net income, and if his net income is more than $5,000, his earned net income shall not be considered to be less than $5,000.

RULES AND REGULATIONS

SEC. 1001. The Commissioner, with the approval of the Secretary, is authorized *to prescribe all needful rules and regulations for the enforcement of this* Act.

ART. 1700. **Promulgation of regulations.**—In pursuance of the statute the foregoing regulations are hereby made and promulgated. All rulings inconsistent herewith are hereby revoked.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved October 6, 1924.
A. W. MELLON,
Secretary of the Treasury.