

gross income of any amount received as a prize or award, if (1) such prize or award was made primarily in recognition of past achievements of the recipient in religious, charitable, scientific, educational, artistic, literary, or civic fields; (2) the recipient was selected without any action on his part to enter the contest or proceedings; and (3) the recipient is not required to render substantial future services as a condition to receiving the prize or award. Thus, such awards as the Nobel prize and the Pulitzer prize would qualify for the exclusion. Section 74(b) does not exclude prizes or awards from an employer to an employee in recognition of some achievement in connection with his employment.

(c) *Scholarships and fellowship grants.* See section 117 and the regulations thereunder for provisions relating to scholarships and fellowship grants.

**§ 1.75-1 Treatment of bond premiums in case of dealers in tax-exempt securities.**

(a) *In general.* (1) Section 75 requires certain adjustments to be made by dealers in securities with respect to premiums paid on municipal bonds which are held for sale to customers in the ordinary course of the trade or business. The adjustments depend upon the method of accounting used by the taxpayer in computing the gross income from the trade or business. See paragraphs (b) and (c) of this section.

(2) The term "municipal bond" under section 75 means any obligation issued by a government or political subdivision thereof if the interest on the obligation is excludable from gross income under section 103. However, such term does not include an obligation—

(i) If the earliest maturity or call date of the obligation is more than 5 years from the date of acquisition by the taxpayer or the obligation is sold or otherwise disposed of by the taxpayer within 30 days after the date of acquisition by him, and

(ii) If, in case of an obligation acquired after December 31, 1957, the amount realized upon its sale (or, in the case of any other disposition, its fair market value at the time of disposition) is higher than its adjusted basis.

For purposes of this subparagraph, the amount realized on the sale of the obligation, or the fair market value of the obligation, shall not include any amount attributable to interest, and the adjusted basis shall be computed without regard to any adjustment for amortization of bond premium required under section 75 and section 1016(a)(6). For purposes of determining whether the obligation is sold or otherwise disposed of by the taxpayer within 30 days after the date of its acquisition by him, it is immaterial whether or not such 30-day period is entirely within one taxable year.

(3) The term "cost of securities sold" means the amount ascertained by subtracting the inventory value of the closing inventory of a taxable year from the sum of the inventory value of the opening inventory for such year and the cost of securities and other property purchased during such year which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

(b) *Inventories not valued at cost.* (1) In the case of a dealer in securities who computes gross income from his trade or business by the use of inventories and values such inventories on any basis other than cost, the adjustment required by section 75 is, except as provided in subparagraph (2) of this paragraph, the reduction of "cost of securities sold" by the amount equal to the amortizable bond premium which would be disallowed as a deduction under section 171(a)(2) with respect to the municipal bond if the dealer were an ordinary investor holding such bond. Such amortizable bond premium is computed under section 171(b) by reference to the cost or other original basis of the bond on the date of acquisition (determined without regard to section 1013, relating to inventory value on a subsequent date).

(2) With respect to an obligation acquired after December 31, 1957, which has as its earliest maturity or call date a date more than five years from the date on which it was acquired by the taxpayer, the following rules shall apply:

(i) If the taxpayer holds the obligation at the end of the taxable year, he is not required by section 75 to reduce

the "cost of securities sold" for such year with respect to the obligation.

(ii) If the taxpayer sells or otherwise disposes of the obligation during the taxable year, he shall reduce the "cost of securities sold" for the taxable year of the sale or disposition unless he sold the obligation for more than its adjusted basis or otherwise disposed of it when its fair market value was more than its adjusted basis. For purposes of determining whether or not the taxpayer sold the obligation for more than its adjusted basis, or otherwise disposed of it when its fair market value was more than its adjusted basis, the amount realized on the sale of the obligation, or the fair market value of the obligation, shall not include any amount attributable to interest, and the adjusted basis shall be computed without regard to any adjustment for amortization of bond premium required under sections 75 and 1016(a)(6). The amount of the reduction referred to in the first sentence of this subdivision is the total amount by which the ad-

justed basis of the obligation would be required to be reduced under section 1016(a)(5) were the obligation subject to the amortizable bond premium provisions of section 171; that is, the amount of the amortizable bond premium attributable to the period during which the obligation was held which would be disallowed as a deduction under section 171(a)(2) if the taxpayer were an ordinary investor.

(3) This paragraph may be illustrated by the following examples:

*Example 1.* X, a dealer in securities who values his inventories on a basis other than cost, makes his income tax returns on the calendar year basis. On July 1, 1954, he bought, for \$1,060 each, three municipal bonds (A, B, and C) having a face obligation of \$1,000, and maturing on July 1, 1959. Bond A is sold on December 31, 1954, bond B is sold on December 31, 1955, and bond C is sold on June 30, 1956. For each bond the amortizable bond premium to maturity is \$60, the period from date of acquisition to maturity is 60 months, and the amortizable bond premium per month is \$1. The adjustment for each of the years 1954, 1955, and 1956 is as follows:

| Bond        | Date acquired      | Date sold           | Adjustment to "cost of securities sold" for— |      |      |
|-------------|--------------------|---------------------|--|------|------|
|             |                    |                     | 1954   | 1955 | 1956 |
| A .....     | July 1, 1954 ..... | Dec. 31, 1954 ..... | \$6  |      |      |
| B .....     | July 1, 1954 ..... | Dec. 31, 1955 ..... | 6  | \$12 |      |
| C .....     | July 1, 1954 ..... | Jun. 30, 1956 ..... | 6  | 12   | \$6  |
| Total ..... |                    |                     | 18   | 24   | 6    |

*Example 2.* Y is a dealer in securities who values his inventories on a basis other than cost. He makes his income tax returns on the calendar year basis. On January 1, 1958, Y bought five bonds (D, E, F, G, and H) issued by various municipalities. Each bond has a face obligation of \$1,000 and was purchased for \$1,060. The interest on each is excludable from gross income under section 103. Bonds D, E, and F mature on December 31, 1962, and

bonds G and H mature on December 31, 1967. The amortizable bond premium per month is \$1 with respect to bonds D, E, and F, and is \$.50 with respect to bonds G and H. The following table indicates the reduction in "cost of securities sold" which Y should make for the years shown, assuming that he sells the bonds on the dates and for the prices set forth:

| Bond        | Date sold           | Sale price | Adjustment to "cost of securities sold" for— |      |      |
|-------------|---------------------|------------|--|------|------|
|             |                     |            | 1958   | 1959 | 1960 |
| D .....     | Feb. 1, 1959 .....  | \$1,090    | \$12   | \$1  |      |
| E .....     | Jan. 30, 1958 ..... | 1,100      | None   |      |      |
| F .....     | Jan. 30, 1958 ..... | 1,000      | 1  |      |      |
| G .....     | Dec. 31, 1960 ..... | 1,065      | None   | None | None |
| H .....     | Dec. 31, 1960 ..... | 1,050      | None   | None | \$18 |
| Total ..... |                     |            | 13   | 1    | 18   |

An adjustment to "cost of securities sold" must be made with respect to bond D (even though it was ultimately sold at a gain) because the bond neither had an earliest maturity or call date of more than 5 years from the date on which Y acquired it, nor was it disposed of within 30 days after such date. An adjustment must be made for the years 1958 and 1959 since section 75(a)(1) requires that an adjustment be made with respect to such a bond at the close of each taxable year in which it is held. On the other hand, since bonds E, F, G, and H either were disposed of within 30 days after the date of such acquisition or had an earliest maturity or call date more than 5 years from the date of acquisition, and were acquired after December 31, 1957, it is necessary to determine whether Y disposed of them at a loss so as to require an adjustment under section 75. No adjustment is necessary with respect to bonds E and G because they were sold at a gain. An adjustment to "cost of securities sold" is required with respect to bonds F and H because they were sold at a loss. As in the case of bond D, an adjustment with respect to bond F is made in 1958 in accordance with section 75(a)(1); however, the adjustment with respect to bond H is made entirely in 1960, the taxable year in which Y sold that bond, in accordance with the last sentence of section 75(a). If Y had acquired bonds before January 1, 1958, it would be unnecessary to determine whether they were disposed of at a loss since that factor is significant only with respect to bonds acquired on or after that date.

(c) *Inventories not used or inventories valued at cost.* (1) In the case of a dealer in securities who computes gross in-

come from his trade or business without the use of inventories or by use of inventories valued at cost, the adjustment required by section 75 is a reduction of the adjusted basis of each municipal bond sold or otherwise disposed of during the taxable year. The amount of such reduction is the total amount by which the adjusted basis of the bond would be required to be reduced under section 1016(a)(5) were the bond subject to the amortizable bond premium provisions of section 171; that is, the amount of the amortizable bond premium attributable to the period during which the bond was held which would be disallowed as a deduction under section 171(a)(2) if the taxpayer were an ordinary investor.

(2) Subparagraph (1) of this paragraph may be illustrated by the following example:

*Example.* Z, a dealer in securities who values his inventories on the basis of cost, makes his income tax returns on the calendar year basis. On January 1, 1954, he buys, for \$1,060 each, three municipal bonds (I, J, and K) having a face obligation of \$1,000, and maturing on January 1, 1959. Bond I is sold on December 31, 1954, bond J is sold on June 30, 1955, and bond K is sold on December 31, 1956. For each bond, the amortizable bond premium to maturity is \$60, the period from the date of acquisition to maturity is 60 months, and the amortizable bond premium per month is \$1.

| Bond    | Date acquired      | Date sold           | Adjustment for— |      |      |
|---------|--------------------|---------------------|-----------------|------|------|
|         |                    |                     | 1954            | 1955 | 1956 |
| I ..... | Jan. 1, 1954 ..... | Dec. 31, 1954 ..... | \$12            |      |      |
| J ..... | Jan. 1, 1954 ..... | June 30, 1955 ..... | None            | \$18 |      |
| K ..... | Jan. 1, 1954 ..... | Dec. 31, 1956 ..... | None            | None | \$36 |

(d) *Bonds acquired before July 1, 1950.* Under section 203(c) of the Revenue Act of 1950, adjustment is required for a municipal bond acquired before July 1, 1950, only with respect to taxable years beginning on or after that date. Accordingly, if the municipal bond was acquired before July 1, 1950, then for purposes of section 75 the amortizable bond premium under section 171 must be computed after adjusting the bond premium to the extent proper to reflect unamortized bond premium for so much of the holding period (as determined under section 1223) as precedes

the taxable year of the dealer beginning on or after July 1, 1950. Thus, in example (1) of paragraph (b) and in the example in paragraph (c) of this section, the first taxable year beginning on or after July 1, 1950, is, for each dealer, the taxable year beginning January 1, 1951. If each dealer had purchased for \$1,060 on April 1, 1950, a municipal bond having a face obligation of \$1,000 and maturing April 1, 1955, and had sold such bond on February 28, 1955, the adjustment under section 75 would be computed as follows:

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|  | Dealer X | Dealer Z |
|--|----------|----------|
| Bond premium .....   | \$60     | \$60     |
| Adjustment for holding period prior to Jan. 1, 1951 .....            | 9        | 9        |
| Amortizable bond premium to maturity, as adjusted .....              | 51       | 51       |
| Amortizable bond premium per month ..                                | 1        | 1        |
| Total adjustments under sec. (o), 1939 Code, for years 1951-53 ..... | 36       | None     |
| Adjustment under sec. 75 for 1954 .....                              | 12       | None     |
| Adjustment under sec. 75 for 1955 .....                              | 2        | 50       |

[T.D. 6647, 28 FR 3519, Apr. 11, 1963]

**§ 1.77-1 Election to consider Commodity Credit Corporation loans as income.**

A taxpayer who receives a loan from the Commodity Credit Corporation may, at his election, include the amount of such loan in his gross income for the taxable year in which the loan is received. If a taxpayer makes such an election (or has made such an election under section 123 of the Internal Revenue Code of 1939 or under section 223(d) of the Revenue Act of 1939 (53 Stat. 897)), then for subsequent taxable years he shall include in his gross income all amounts received during those years as loans from the Commodity Credit Corporation, unless he secures the permission of the Commissioner to change to a different method of accounting. Application for permission to change such method of accounting and the basis upon which the return is made shall be filed with the Commission of Internal Revenue, Washington, D.C. 20224, within 90 days after the beginning of the taxable year to be covered by the return.

**§ 1.77-2 Effect of election to consider commodity credit loans as income.**

(a) If a taxpayer elects or has elected under section 77, section 123 of the Internal Revenue Code of 1939, or section 223(d) of the Revenue Act of 1939 (53 Stat. 897), as amended, to include in his gross income the amount of a loan from the Commodity Credit Corporation for the taxable year in which it is received, then—

(1) No part of the amount realized by the Commodity Credit Corporation upon the sale or other disposition of the commodity pledged for such loan shall be recognized as income to the taxpayer, unless the taxpayer receives

an amount in addition to that advanced to him as the loan, in which event such additional amount shall be included in the gross income of the taxpayer for the taxable year in which it is received, and

(2) No deductible loss to the taxpayer shall be recognized on account of any deficiency realized by the Commodity Credit Corporation on such loan if the taxpayer was relieved from liability for such deficiency.

(b) The application of paragraph (a) of this section may be illustrated by the following example:

*Example.* A, a taxpayer who elected for his taxable year 1952 to include in gross income amounts received as loans from the Commodity Credit Corporation, received as loans \$500 in 1952, \$700 in 1953, and \$900 in 1954. In 1956 all the pledged commodity was sold by the Commodity Credit Corporation for an amount \$100 and \$200 less than the loans with respect to the commodity pledged in 1952 and 1953, respectively, and for an amount \$150 greater than the loan with respect to the commodity pledged in 1954. A, in making his return for 1956, shall include in gross income the sum of \$150 if it is received during that year, but will not be allowed a deduction for the deficiencies of \$100 and \$200 unless he is required to satisfy such deficiencies and does satisfy them during that year.

**§ 1.78-1 Dividends received from certain foreign corporations by certain domestic corporations choosing the foreign tax credit.**

(a) *Taxes deemed paid by certain domestic corporations treated as a section 78 dividend.* Any reduction under section 907(a) of the foreign income taxes deemed to be paid with respect to foreign oil and gas extraction income does not affect the amount treated as a section 78 dividend. If a domestic corporation chooses to have the benefits of the foreign tax credit under section 901 for any taxable year, an amount which is equal to the foreign income taxes deemed to be paid by such corporation for such year under section 902(a) in accordance with §§ 1.902-1 and 1.902-2 and § 1.902(b)(2), or under section 960(a)(1) in accordance with § 1.960-7, shall, to the extent provided by this section, be treated as a dividend (hereinafter referred to as a section 78 dividend) received by such domestic corporation from the foreign corporation described in section 902(a) in accordance with