Internal Revenue Bulletin

CUMULATIVE BULLETIN 1958-1

JANUARY-JUNE 1958

AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

LIBRARY
ROOM 5025
JAN 1 4 1959

TREASURY DEPARTMENT

LIBRARY
ROOM 5026

TREASURY DEPARTMENT

KF
6301
.A15
I3
1958

Internal Revenue Bulletin

Cumulative Bulletin 1958–1

January–June 1958

U.S. Treasury Dept. Internal Revenue Service

LIBRARY
ROOM 5025
JAN 1 4 1959
TREASURY DEPARTMENT
LIBRARY
ROOM 5030
AUG 2
TREASURY DEPARTMENT

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1958

For sale by the Superintendent of Documents, U. S. Government Printing Office
Washington 25, D. C. Price $2 (paper)

in this issue

	Page
Finding List	V
Abbreviations	XI
Foreword	XII
Introduction	1
Tax Court of the United States, The	3–6
Part I.—Rulings and Decisions Under the Internal Revenue Code of 1954	9–499
Part II.—Rulings and Decisions Under the Internal Revenue Code of 1939, and Other Public Laws:	
Subpart A.—Rulings and Decisions Under the Internal Revenue Code of 1939	501–564
Subpart B.—Rulings and Decisions Under the Federal Firearms Act	565
Subpart C.—Rulings and Decisions Under Other Public Laws	566
Part III.—Alcohol Tax Rulings and Decisions:	
Subpart A.—Rulings and Decisions Under the Internal Revenue Code of 1954	567–607
Subpart B.—Rulings and Decisions Under the Internal Revenue Code of 1939	608
Subpart C.—Rulings and Decisions Under the Federal Alcohol Administration Act or Other Related Laws	609–618
Part IV.—Legislation and Treaties:	
Table of Contents	619
Subpart A.—Tax Conventions	621–625
Subpart B.—Legislation	626–635
Subpart C.—Committee Reports	636–659
Part V.—Administrative and Miscellaneous Matters	663–693
Table of Contents	661
Index	695–724

FINDING LIST

	Page
Committee Reports:	
House:	
1159 (P. L. 85–380)	636
1296 (P. L. 85–345)	652
Senate:	
1180 (P. L. 85–318)	637
1181 (P. L. 85–319)	638
1182 (P. L. 85–321)	640
1183 (P. L. 85–320)	644
1184 (P. L. 85–323)	647
1283 (P. L. 85–380)	650
1368 (P. L. 85–345)	653
1402 (P. L. 85–367)	656
Court Decisions:	
1813	609
1814	535
1815	573
1816	567
1817	540
1818	611
1819	502
1820	505
1821	506
1822	508
1823	516
1824	557
1825	549
Delegation Orders:	
56	679
57	680
58	680
60	681
61	683
62	683
Presidential Proclamations:	
3214	677
3229	678
Public Laws:	
85–300	626
85–318	627
85–319	628
85–320	628
85–321	629
85–323	630
85–345	632
85–367	633
85–380	633
85–395	634
Revenue Procedures:	
58–1	683
58–2	684
58–3	685
58–4	687
58–5	688
58–6	689

	Page
Revenue Procedures—Continued	
58–7	689
58–8	690
58–9	692
Revenue Rulings:	
58–1	173
58–2	236
58–3	263
58–4	268
58–5	322
58–6	440
58–7	497
58–8	154
58–9	190
58–10	246
58–11	273
58–12	317
58–13	342
58–14	358
58–15	390
58–16	405
58–17	11
58–18	237
58–19	251
58–20	587
58–21	589
58–22	597
58–23	604
58–24	318
58–25	95
58–26	354
58–27	414
58–28	415
58–29	466
58–30	584
58–31	595
58–32	391
58–33	314
58–34	333
58–35	412
58–36	420
58–37	370
58–38	376
58–39	598
58–40	275
58–41	86
58–42	555
58–43	45
58–44	98
58–45	99
58–46	347
58–47	422
58–48	408
58–49	457
58–50	461
58–51	465

FINDING LIST—Continued

	Page
Revenue Rulings—Continued	
58–52	29
58–53	152
58–54	181
58–55	266
58–56	335
58–57	363
58–58	408
58–59	428
58–60	436
58–61	456
58–62	513
58–63	624
58–64	12
58–65	13
58–66	60
58–67	62
58–68	183
58–69	254
58–70	341
58–71	393
58–72	393
58–73	458
58–74	148
58–75	599
58–76	56
58–77	118
58–78	148
58–79	177
58–80	345
58–81	406
58–82	421
58–83	451
58–84	581
58–85	583
58–86	592
58–87	598
58–88	600
58–89	40
58–90	88
58–91	49
58–92	174
58–93	188
58–94	194
58–95	197
58–96	200
58–97	201
58–98	202
58–99	202
58–100	31
58–101	233
58–102	364
58–103	394
58–104	394
58–105	402
58–106	406
58–107	429
58–108	599
58–109	565
58–110	155
58–111	173
58–112	323
Revenue Rulings—Continued	
58–113	362
58–114	424
58–115	409
58–116	410
58–117	423
58–118	490
58–119	491
58–120	498
58–121	609
58–122	613
58–123	587
58–124	606
58–125	561
58–126	13
58–127	42
58–128	89
58–129	93
58–130	121
58–131	124
58–132	257
58–133	277
58–134	395
58–135	519
58–136	612
58–137	320
58–138	593
58–139	14
58–140	15
58–141	101
58–142	147
58–143	239
58–144	260
58–145	360
58–146	387
58–147	396
58–148	397
58–149	442
58–150	443
58–151	192
58–152	32
58–153	43
58–154	125
58–155	156
58–156	389
58–157	444
58–158	562
58–159	444
58–160	446
58–161	462
58–162	234
58–163	50
58–164	184
58–165	209
58–166	324
58–167	340
58–168	343
58–169	386
58–170	397
58–171	428
58–172	465
58–173	468

FINDING LIST—Continued

	Page
Revenue Rulings—Continued	
58–174	492
58–175	28
58–176	349
58–177	351
58–178	51
58–179	57
58–180	153
58–181	238
58–182	365
58–183	383
58–184	397
58–185	398
58–186	410
58–187	416
58–188	434
58–189	511
58–190	15
58–191	149
58–192	34
58–193	208
58–194	240
58–195	329
58–196	366
58–197	368
58–198	383
58–199	384
58–200	399
58–201	403
58–202	416
58–203	431
58–204	432
58–205	447
58–206	448
58–207	594
58–208	603
58–209	19
58–210	523
58–211	529
58–212	103
58–213	368
58–214	399
58–215	439
58–216	489
58–217	585
58–218	185
58–219	492
58–220	26
58–221	53
58–222	54
58–223	156
58–224	242
58–225	258
58–226	318
58–227	449
58–228	460
58–229	331
58–230	204
58–231	247
58–232	261
58–233	271
58–234	279

	Page
Revenue Rulings—Continued	
58–235	26
58–236	37
58–237	534
58–238	90
58–239	94
58–240	141
58–241	179
58–242	251
58–243	255
58–244	265
58–245	274
58–246	339
58–247	623
58–248	621
58–249	384
58–250	423
58–251	467
58–252	494
58–253	581
58–254	417
58–255	91
58–256	215
58–257	9
58–258	605
58–259	116
58–260	126
58–261	143
58–262	143
58–263	146
58–264	144
58–265	127
58–266	520
58–267	327
58–268	353
58–269	344
58–270	356
58–271	418
58–272	435
58–273	463
58–274	495
58–275	22
58–276	23
58–277	41
58–278	92
58–279	145
58–280	157
58–281	235
58–282	238
58–283	388
58–284	400
58–285	401
58–286	404
58–287	426
58–288	430
58–289	494
58–290	596
58–291	104
58–292	106
58–293	146
58–294	244
58–295	249

FINDING LIST—Continued

	Page
Revenue Rulings—Continued	
58–296	276
58–297	401
58–298	410
58–299	436
58–300	454
58–301	23
58–302	62
58–303	61
58–304	110
58–305	117
58–306	123
58–307	206
58–308	211
58–309	245
58–310	262
58–311	369
58–312	418
58–313	427
58–314	453
58–315	473
58–316	583
58–317	586
58–318	590
58–319	593
58–320	24
58–321	35
58–322	59
58–323	111
58–324	214
58–325	212
58–326	287
58–327	316
58–328	327
58–329	337
58–330	370
58–331	385
58–332	401
58–333	413
58–334	432
58–335	474
58–336	588
Treasury Decisions:	
57 (Narcotics)	470
6281	159
6282	215
6283	601
6284	595
6285	127
6286	191
6287	572
6288	613
6289	618
6290	590
6291	63
6292	476
6293	114
6294	288
6295	554
Treasury Department Order:	
150–46	679

FINDING LIST OF PREVIOUSLY PUBLISHED RULINGS CURRENTLY MENTIONED

Previous ruling	Action	Current ruling	Page
G. C. M. 8446, C. B. IX–2, 370	Modified	58–190	15
G. C. M. 450, C. B. V–2, 49 (1926)	Modified	58–243	255
G. C. M. 433, C. B. V–2, 177 (1926)	Modified	58–243	255
G. C. M. 2448, C. B. VI–2, 69 (1927)	Modified	58–243	255
G. C. M. 3034, C. B. VII–1, 104 (1928)	Modified	58–243	255
G. C. M. 3421, C. B. VII–1, 106 (1928)	Modified	58–243	255
G. C. M. 5761, C. B. VIII–1, 109 (1929)	Modified	58–243	255
G. C. M. 21496, C. B. 1939–2, 169	Clarified	58–210	523
I. T. 1365, C. B. 1–1, 151 (1922)	Amplified	58–210	523
I. T. 1744, C. B. II–2, 179 (1923)	Modified	58–243	255
I. T. 1371, C. B. I–1, 208 (1922)	Modified	58–243	255
I. T. 1785, C. B. II–2, 258 (1923)	Cited	58–56	335
I. T. 1881, C. B. II–2, 200 (1923)	Revoked	58–190	15
I. T. 1988, C. B. III–1, 198 (1924)	Revoked	58–240	141
I. T. 2022, C. B. III–1, 9 (1924)	Modified	58–243	255
I. T. 2240, C. B. IV–2, 60 (1925)	Modified	58–243	255
I. T. 2266, C. B. V–1, 13 (1926)	Modified	58–234	279
I. T. 2305, C. B. V–2, 108 (1926)	Cited	58–266	520
I. T. 2321, C. B. V–2, 52 (1926)	Modified	58–243	255
I. T. 2636, C. B. XI–2, 102 (1932)	Revoked	58–194	240
I. T. 2672, C. B. XII–1, 72 (1933)	Clarified	58–210	523
I. T. 3669, C. B. 1944, 112	Revoked	58–44	98
I. T. 3829, C. B. 1946–2, 38	Distinguished.	58–25	95
I. T. 3835, C. B. 1947–1, 53	Modified	58–234	279
Mimeograph 5987, C. B. 1946–1, 300	Revoked	58–227	449
O. D. 1028, C. B. No. 5, 83 (1926)	Modified	58–234	279
Rev. Proc. 57–36, C. B. 1957–2, 1109	Modified	*58–4	687
Rev. Rul. 235, C. B. 1953–2, 23	Modified	58–302	62
Rev. Rul. 54–54, C. B. 1954–1, 273	Modified	58–83	451
Rev. Rul. 54–312, C. B. 1954–2, 327	Distinguished.	58–177	351
Rev. Rul. 54–356, C. B. 1954–2, 82	Amplified	58–278	92
Rev. Rul. 54–386, C. B. 1954–2, 414	Amplified	58–115	409
Rev. Rul. 54–471, C. B. 1954–2, 348	Distinguished.	58–26	354
Rev. Rul. 54–576, C. B. 1954–2, 472	Modified	58–86	592
Rev. Rul. 54–576, C. B. 1954–2, 472	Superseded.	58–138	593
Rev. Rul. 54–598, C. B. 1954–2, 121	Distinguished.	58–25	95
Rev. Rul. 55–85, C. B. 1955–1, 15	Distinguished.	58–178	51
Rev. Rul. 55–198, C. B. 1955–1, 510	Amplified	58–188	434
Rev. Rul. 55–261, item 13, C. B. 1955–1, 307, at 311.	Modified	58–8	154
Rev. Rul. 55–261, C. B. 1955–1, 307	Modified	58–280	157
Rev. Rul. 55–362, C. B. 1955–1, 577	Superseded.	58–138	593
Rev. Rul. 55–468, C. B. 1955–2, 501	Amplified	58–7	497
Rev. Rul. 55–590, C. B. 1955–2, 483	Modified	*58–8	690
Rev. Rul. 55–593, C. B. 1955–2, 610	Distinguished.	58–46	347

*Denotes Revenue Procedure.

FINDING LIST OF PREVIOUSLY PUBLISHED RULINGS CURRENTLY MENTIONED—Continued

Previous ruling	Action	Current ruling	Page
Rev. Rul. 55–603, C. B. 1955–2, 709	Modified	58–39	598
Rev. Rul. 55–603, C. B. 1955–2, 709	Modified	58–108	599
Rev. Rul. 55–741, C. B. 1955–2, 702	Superseded.	58–138	593
Rev. Rul. 56–22, C. B. 1956–1, 588	Modified	58–267	327
Rev. Rul. 56–73, C. B. 1956–1, 539	Modified	*58–7	689
Rev. Rul. 56–81, C. B. 1956–1, 746	Superseded.	58–138	593
Rev. Rul. 56–102, C. B. 1956–1, 90	Amplified	58–128	89
Rev. Rul. 56–163, C. B. 1956–1, 658	Revoked	58–42	555
Rev. Rul. 56–249, C. B. 1956–1, 488	Amplified	58–128	89
Rev. Rul. 56–316, C. B. 1956–2, 597	Amplified	58–56	335
Rev. Rul. 56–337, C. B. 1956–2, 1025	Superseded.	58–123	587
Rev. Rul. 56–342, C. B. 1956–2, 29	Amplified	58–64	12
Rev. Rul. 56–357, C. B. 1956–2, 14	Modified	58–257	9
Rev. Rul. 56–446, C. B. 1956–2, 1065	Modified	58–247	623
Rev. Rul. 56–496, C. B. 1956–2, 17	Modified	58–257	9
Rev. Rul. 56–519, C. B. 1956–2, 123	Amplified	58–130	121
Rev. Rul. 56–538, C. B. 1956–2, 1005	Revoked	58–125	561
Rev. Rul. 56–608, C. B. 1956–2, 878	Distinguished.	58–215	439
Rev. Rul. 57–163, Part 5 (f), C. B. 57–1, 128 at 149.	Modified	58–151	192
Rev. Rul. 57–227, C. B. 1957–1, 433	Modified	*58–8	690
Rev. Rul. 57–479, C. B. 1957–2, 977	Modified	58–258	605
Rev. Rul. 57–483, C. B. 1957–2, 92	Revoked	58–153	43
Rev. Rul. 58–86, page 592	Superseded.	58–138	593
Rev. Rul. 58–138, page 593	Superseded.	58–319	593
S. M. 1781, C. B. III–1, 459 (1924)	Cited	58–273	463
S. M. 2964, C. B. IV–1, 171 (1925)	Modified	58–243	255
S. M. 3391, C. B. IV–1, 42 (1925)	Modified	58–243	255
S. M. 4277, C. B. IV–2, 58 (1925)	Modified	58–243	255
S. M. 5411, C. B. V–1, 271 (1926)	Modified	58–243	255
S. R. 2863, C. B. IV–1, 174 (1925)	Modified	58–243	255
S. M. 3917, C. B. IV–2, 189 (1925)	Modified	58–243	255
S. R. 6998, C. B. V–1, 268 (1926)	Modified	58–243	255
S. R. 7199, C. B. V–1, 269 (1926)	Modified	58–243	255
S. T. 448, C. B. III–1, 462 (1924)	Cited	58–147	396
S. S. T. 301, C. B. 1938–1, 455	Distinguished.	58–168	343
T. D. 3112, C. B. 4, 76 (1921)	Cited	58–141	101

*Denotes Revenue Procedure.

ABBREVIATIONS

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, *B*, *C*, etc.—The names of individuals.
A. T.—Alcohol and tobacco tax ruling.
B. T. A.—Board of Tax Appeals.
C. B.—Cumulative Bulletin.
C. F. R.—Code of Federal Regulations.
Ct. D.—Court Decision.
Del. Order.—Delegation Order.
D. C.—Treasury Department circular.
E. O.—Executive Order.
E. T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F. A. A. A.—Federal Alcohol Administration Act.
F. R.—Federal Register.
G. C. M.—Chief Counsel's memorandum (formerly General Counsel's memorandum.
I. R. B.—Internal Revenue Bulletin.
IR.-Mim.—Published IR-Mimeograph.
I. T.—Income Tax ruling.
M, *N*, *X*, *Y*, *Z*, *etc.*—The names of corporations, places or businesses according to context.
M. T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
O. D.—Office Decision.
P. L.—Public Law.
P. S.—Pension, profit-sharing, stock bonus, or annuity plan ruling.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R. S.—Revised Statute.
S. M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S. P. R.—Statement of Procedural Rules.
S. R.—Solicitor's Recommendation.
S. S. T.—Social Security tax.
S. T.—Sales tax ruling.
Stat.—Statutes at Large.
T. C.—The Tax Court of the United States.
T. D.—Treasury Decision.
U. S. C.—United States Code.
x and *y* used to represent certain numbers and when used with the word "dollars" represent sums of money.

FOREWORD

The Cumulative Bulletin is prepared in five parts, as follows:

I. Part I includes rulings and decisions which are based on the application of provisions of the Internal Revenue Code of 1954 and, unless otherwise stated in the ruling or decision, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1939 or other related public laws.

II. Part II includes rulings and decisions which are based on the application of the Internal Revenue Code of 1939, the Federal Firearms Act, and other public laws except those pertaining to the various alcohol taxes; and, unless otherwise noted therein, they are published without consideration as to any application of the provisions of the Internal Revenue Code of 1954. Part II is subdivided into two subparts according to matters issued under the Internal Revenue Code of 1939 (Subpart A) and the Federal Firearms Act (Subpart B).

III. Part III contains rulings and decisions pertaining to the various alcohol taxes. This part is subdivided into three subparts according to matters issued under the Internal Revenue Code of 1954 (Subpart A), the Internal Revenue Code of 1939 (Subpart B), and the Federal Alcohol Administration Act (Subpart C).

IV. Part IV contains treaties and tax legislation, including related Committee and Conference Reports. This part is subdivided into three subparts according to tax conventions, Treasury Decisions and Revenue Rulings issued with respect thereto (Subpart A), legislation (Subpart B), and Committee Reports (Subpart C). House, Senate and Conference Committee Reports printed in the Bulletin do not include the portion entitled "Changes in Existing Law."

V. Part V is devoted to administrative, procedural, and miscellaneous matters. The weekly Internal Revenue Bulletins contained Part VI consisting of some items of general interest: those items are not reproduced herein.

INTRODUCTION

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for the announcement of official rulings and procedures of the Internal Revenue Service, and for the publication of Treasury Decisions, Executive Orders, tax conventions, legislation, and court decisions pertaining to internal revenue matters. Other items considered to be of general interest are also published in the Bulletin, such as announcements relating to proposed regulations published with notice of proposed rulemaking, announcements relating to decisions of the Tax Court of the United States, announcements of the disbarment and suspension of attorneys and agents from practice before the Treasury Department, Delegation Orders, etc.

It is the policy of the Service to publish in the Bulletin all substantive and procedural rulings of importance or general interest, the publication of which is considered necessary to promote a uniform application of the laws administered by the Service. It is also the policy to publish all rulings and statements of procedures which supersede, revoke, modify, or amend any published ruling or procedure. Except where otherwise indicated, published rulings and procedures apply retroactively. Rulings and statements of procedures relating solely to matters of internal management are not published. However, statements of internal practices and procedures affecting rights or duties of taxpayers, or industry regulation, which appear in internal management documents, are published. Revenue Rulings and Revenue Procedures are based upon rulings and internal management documents prepared in the various divisions of the National Office, including the Office of the Chief Counsel for the Internal Revenue Service. In the preparation of these, caution is exercised to conceal the identity of the taxpayer, as well as any confidential personal and business information. All Revenue Rulings published in the Bulletin have received the consideration and concurrence of the Chief Counsel.

Revenue Rulings and Revenue Procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations (including Treasury Decisions), but are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for that purpose. Since each published ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, Revenue officers and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same. In applying rulings and procedures published in the Bulletin, personnel of the Service and others concerned must consider the effect of

subsequent legislation, regulations, courts decisions, rulings and procedures.

Each published ruling is designated as a "Revenue Ruling," and each published procedure is designated as a "Revenue Procedure." These should be cited by reference to the year of issuance and the Bulletin and page where reported. Thus, Revenue Ruling No. 10 for 1958 should be cited as "Rev. Rul. 58–10, C. B. 1958–1, 246." Similarly, Revenue Procedure No. 5 for 1958 should be cited as "Rev. Proc. 58–5, C. B. 1958–1, 688." Revenue Rulings are keyed to the applicable sections of the Internal Revenue Code and regulations.

Internal Revenue Cumulative Bulletin 1958–1 contains all rulings, decisions, procedures, and legislation pertaining to Internal Revenue matters published in Internal Revenue Bulletins 1–26, inclusive, for the period January 1 to June 30, 1958. It also contains a cumulative list of announcements relating to decisions of The Tax Court of the United States published in the Internal Revenue Bulletins.

THE TAX COURT OF THE UNITED STATES

CUMULATIVE LIST OF ANNOUNCEMENTS RELATING TO DECISIONS OF THE TAX COURT OF THE UNITED STATES PUBLISHED IN THE INTERNAL REVENUE BULLETIN FROM JANUARY 1, 1958, TO JUNE 30, 1958, INCLUSIVE

It is the policy of the Internal Revenue Service to announce in the INTERNAL REVENUE BULLETIN at the earliest practicable date the determination of the Commissioner to acquiesce or not to acquiesce in a decision of The Tax Court of the United States which disallows a deficiency in tax determined by the Commissioner to be due. Notice that the Commissioner has acquiesced or nonacquiesced in a decision of The Tax Court relates only to the issue or issues decided adversely to the Government. Actions of acquiescences in adverse decisions should be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon. Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions. No announcements are made in the Bulletin with respect to memorandum opinions of The Tax Court.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
All Americas Trading Corp.	43712 63567	29	908
Bagley & Sewell Co.[1]	38146	20	983
Beck, Myron P., et ux	51228		
Beck, Myron P., et ux., transferees of Lawrence Land Co	51235		
Beck, Myron P., et ux., transferees of Rex Land Co	51232	28	756
Beck, Myron P., et ux., transferees of J. Richard Co	51238		
Beck, Myron P., et ux., transferees of Whittier Development Co	51241		
Bennett's Travel Bureau, Inc	54126	29	350
Blarek, Emil, et ux.[2]	48207	23	1037

See footnotes at end of table.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
Booher, Clyde M.[3]	38250	28	817
Breitfeller Sales, Inc	56525	28	1164
Bressner Radio, Inc	56457	28	378
Brooklyn City Railroad Co.[4] Brooklyn and Queens Transit Corp.[4]	a 20353	27	77
Carpenter, B. A	30631	20	603
Chesbro, Jack M.[5]	36439 36440	21	123
Citizens and Southern National Bank of South Carolina, executor of estate of Theodore Geddings Tarver [6]	57255	26	490
Clark, Charles A.[7]	31220	19	48
Clark, Doris V	62697	29	196
Cloutier, Harry H., executor, and Margaret S. Cloutier, surviving wife, Henri H. Cloutier estate [8]	47446		
Cloutier, Harry Handley, et ux [8]	47445	24	1006
Cloutier, Henri H., estate of [8]	47446		
Cluck, Gene, et ux	54527	29	7
Coastal Machine Works, Inc	32858 32859	28	1034
Coletto, Ralph, et ux	52557	28	845
Colony, Inc	53681	26	30
Cortese, Clara [9]	40633	22	293
Cotton States Fertilizer Co	59879	28	1169
Cristo, Joe [9]	40632	22	293
Damski, Paul	54929	29	1
Davis, John H., et ux. [8]	47447	24	1006
Delsanter, Anthony	49167	28	845
Denzer, Alan R., executor of estate of Bernard E. Denzer [6] Denzer, Bernard E., estate of [6]	62141	29	237
de Vegar, Edward A. Neuman	58742	28	1055
Erburu, Michael P., et ux	51137	23	820
Farah, John, et ux	52515	28	845
Frieder, Alex [10]	63800	28	1256
Funk, Emilie Furnish (former wife of Richard D. Furnish)	51401		
Furnish, Richard Douglas	51416 51417	29	279
Garden City Bank and Trust Co., executor of estate of Myles C. Watson [6]	38341	20	386
Geometric Stamping Co.[11]	50645	26	301
Gersten, Albert	51226		
Gersten, Albert, et ux	51227		
Gersten, Albert, transferee of Lawrence Land Co	51234		
Gersten, Albert, transferee of Rex Land Co	51231		
Gersten, Albert, transferee of J. Richard Co	51237		
Gersten, Albert, transferee of Whittier Development Co	51240	28	756
Gersten, Milton, et ux	51229		
Gersten, Milton, et ux., transferees of Lawrence Land Co	51236		
Gersten, Milton, et ux., transferees of Whittier Development Co	51242		

See footnotes at end of table.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
Goodrich, William H., et ux	51181	25	1235
Halsted, Harbeck [10]	57648	28	1069
Harvey, John W., III, a minor, by J. W. Harvey, guardian	61511	28	910
Haynes, William C., et ux.[2]	49797	23	1046
Hydraulic Press Manufacturing Co	26255 45261	27	278
Jones, Hugh McK	57509	29	200
Jones, Thomas B	44126	29	601
Jones, Thomas B., et ux	44127		
Kaufman's, Inc	57540	28	1179
Kavinoky, Edward H., et al., executors of estate of Lawrence M. Weil, and Lucille G. Weil, surviving wife	60161	29	366
Kilborn, Charles M., et ux	56499	29	102
Lawrence Land Co., a dissolved corporation	51233	28	756
Lee, Oliver, estate of [6]	57257	28	1259
Lockwood, Frederick M., et al., executors of estate of Oliver Lee [6]			
Martin, Lester B., et ux.[12]	52953	26	100
McElroy, William R.[10]	54565	29	149
Merritt, Marjorie M.[10]	54563		
Miller, Mary [9]	40631	22	293
National Bank of Commerce of Seattle [13]	56324	27	762
Newlin Machinery Corp	63750	28	837
O'Dwyer, William, et ux	54608 59475	28	698
Pendleton, Lula Marion McElroy (formerly Lula Marion McElroy Parker) [10]	54564	29	149
Peterson, B. Blaine, et ux	61437	28	910
Peterson, Earl G., et ux	61436		
Peterson, O. R., et ux	61485		
Phillips, Pamphila H., estate of [6 14]	87519	36	1102
Phillips, Thomas W., Jr., executor of estate of Pamphila H. Phillips.[6 14]			
Pinkerton, Volney L., et ux	61435	28	910
Post, Rosalie W	54184	26	1055
Rand, Albert, a/k/a Albert E. Rand, Morris Fink, Kalman Rand, Henry Rozen and Richard Freed, estate of [6]	58396	28	1002
Rand, Bessie, administratrix of estate of Albert Rand [6]			
Rex Land Co., a dissolved corporation	51230	28	756
Romer, Henry J	51607	28	1228
Romer, Herman J., et ux	51606		
Romer, Joyce M	51608		
Seaboard Commercial Corp., and subsidiary companies	32857	28	1034

See footnotes at end of table.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
Shoe Corporation of America	60544	29	297
Silverstein, Carl [5]	36442	21	123
Silverstein, Cecily [5]	36443	21	123
Silverstein, Morris [5]	36444	21	123
	36445	21	123
	36446	21	123
	36447	21	123
	36448	21	123
	36449	21	123
Smiling Jack Chesbro, Inc.[5]	36452	21	123
Sorin, Arthur, et ux	56400	29	959
Spencer, Craig L., estate of	61488	28	910
Spencer, Laura W., et al., executors of estate of Craig L. Spencer			
Standing, James J., et ux.[15]	57030	28	789
Tarver, Theodore Geddings, estate of [6]	57255	26	490
Thomas, Joseph, executor of estate of Allen L. Weisberger [6]	57673	29	217
Tivoli-Union Co	57616	28	1196
Tobin, Edward F., individually, and administrator of estate of Mary Catherine Tobin	52463	28	845
Tobin, Mary Catherine, estate of			
Tulane Hardwood Lumber Co., Inc.[11]	49860	24	1146
Vichey, Lo Raine Good	57617	28	1196
Washington Post Co.[16]	[a] 8085	10	1077
Watson, Myles C., estate of [6]	38341	20	386
Weidekamp, Alois Joseph [11]	58889	29	16
Weil, Lawrence M., estate of	60161	29	366
Weisberger, Allen L., estate of [6]	57673	29	217
Western Products Co	57615	28	1196
Western Wine & Liquor Co.[7]	23346	18	1090
Whittier Development Co., a dissolved corporation	51239	28	756
Williams, Jay A., et ux	61283	28	1000

[a] United States Board of Tax Appeals.

[1] Nonacquiescence published in C. B. 1954-2, 6, is withdrawn and acquiescence as to result only, is substituted therefor. The Commissioner, while disagreeing with the treatment by the court of the issue involved, will not file an appeal in this case.

[2] Nonacquiescence published in C. B. 1956-2, 10, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 58-302, page 62.

[3] Acquiescence regarding the issue as to whether the deficiencies for 1940 through 1944 were due to fraud thereby permitting assessment of deficiencies and penalties otherwise barred by the statute of limitations.

[4] Nonacquiescence published in C. B. XIII-1, 19 (1934), is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 58-256, page 215.

[5] Acquiescence deals with the issues with respect to petitioner's understatement of income and the allowability of certain unsubstantiated expenditures; the allowance of corporate loss involved in the demolition of a building to comply with the requirements of the Fire Dep't.; and as to whether the amount of bank deposits in the personal account of Cecily Silverstein constituted income to her.

[6] Estate tax decision.

[7] See Rev. Rul. 58-40, page 275.

[8] Nonacquiescence published in C. B. 1956-2, 10, is withdrawn and acquiescence is substituted therefor.

[9] Nonacquiescence published in C. B. 1955-1, 7 and 8, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 58-94, page 194.

[10] Gift tax decision.

[11] Acquiescence as to result only. The Commissioner, while disagreeing with the treatment by the court of the issue involved, will not file an appeal in this case.

[12] See Rev. Rul. 58-95, page 197.

[13] See Rev. Rul. 58-42, page 555.

[14] Nonacquiescence published in C. B. 1938-1, 52, is withdrawn and acquiescence is substituted therefor.

[15] Acquiescence with regard to the issue as to whether petitioners' business income and expenses should have been accounted for on the accrual basis.

[16] Nonacquiescence published in C. B. X-1, 95 (1931), is withdrawn and acquiescence is substituted therefor.

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Anchor, Cleaning Service, Inc	44647	22	1029
Avco Manufacturing Corp.[17]	45633	25	975
Belridge, Oil Co	54288	27	1044
Campeau, Ray W., et ux	48329	24	370
Consolidated Premium Iron Ores, Ltd.[18]	47893	28	127
Cunningham, Eugene F., et ux	55091	28	670
Cunningham, Grace H	55090		
Daley, William R., et ux.[18]	54352	28	127
Eaton, Cyrus S.[18]	54396		
Fenton, Leslie [19]	35203	21	15
Heintz, Ralph M	50167	25	132
Jack, William S	50168		
Litvak, Anatole	31244	23	441
LoBue, Philip J	41595	28	1317
MacMurray, Fred [19]	35201	21	15
MacMurray, Lillian Wehmhoener, estate of [19]	35202		
Ogsbury, Florence N., executrix of estate of James S. Ogsbury, and as surviving wife	52837	28	93
Ogsbury, James S., estate of			
Roos, Bo C., executor of estate of Lillian Wehmhoener MacMurray [19]	35202	21	15
Smiling, Jack Chesbro, Inc.[20]	36452	21	123
Smith, Luther Ely [21]	109631	3	696
Standing, James J., et ux.[22]	57030	28	789

[17] Nonacquiescence relates to the issue whether the liquidation of the Crosley Corp. constituted a tax-free transaction under section 112(b)(6) of the 1939 Code. Acquiescence in the other issues involving the amount of loss incurred upon the liquidation of a corporate subsidiary; the status of certain stock distributions to shareholders; and the deductions claimed for accrued compensation payments to employees, and for certain tooling expenses, published in C. B. 1957-1, 3, remains unchanged.

[18] Nonacquiescence regarding the issues as to whether (1) the two individuals at all times acted as agents of the corporation, rather than in their individual capacities, in connection with the bargain purchase of stock; (2) under the Canadian Tax Convention, the corporation had a permanent establishment, and engaged in trade or business, within the United States and so incurred taxes on income, capital gains, etc., derived from sources therein. Acquiescence as to the delay in the timely filing of income and excess profits tax returns by the corporation as being due to reasonable cause and not to willful neglect, was published in C. B. 1957-2, 4.

[19] Acquiescence published in C. B. 1954-1, 4 and 5, insofar as it relates to the issue of whether the amount received from the producers-distributors of the movie "Pardon My Past" constituted capital gain to the petitioners, is withdrawn and nonacquiescence is substituted therefor.

[20] Nonacquiescence in the issue as to whether the adjustment, which increased corporate income, entitled the corporation to accrue and deduct the additional New York State franchise taxes based upon such increase.

[21] Acquiescence published in C. B. 1944-26, in the issue as to the deductibility of petitioner's contribution to the Missouri Institute for the Administration of Justice, is withdrawn and nonacquiescence is substituted therefor. Acquiescence in the issues as to the reporting of compensation received for the performance of legal services, and the deductibility of petitioner's contribution to the St. Louis League for Women Voters, remains unchanged. See Rev. Rul. 58-255, page 91.

[22] Nonacquiescence in the issues as to whether legal and accounting fees incurred in the settlement of income tax deficiencies for prior years and the unpaid interest on such deficiencies constitute trade or business expenses and are deductible in determining taxpayer's adjusted gross income. Acquiescence with respect to taxpayer's accrual method of accounting for business income is published on page 6.

PART I

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1954

Rulings and decisions published in Part I of the Internal Revenue Bulletin are based on the application of provisions of the Internal Revenue Code of 1954, and, unless otherwise stated in the rulings or decisions, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1939 or related public laws.

SUBTITLE A.—INCOME TAXES

CHAPTER 1.—NORMAL TAXES AND SURTAXES

SUBCHAPTER A.—DETERMINATION OF TAX LIABILITY

PART IV.—CREDITS AGAINST TAX

SECTION 37.—RETIREMENT INCOME

26 CFR 1.37-3: Retirement income. Rev. Rul. 58-257
(Also Section 1402; 1.1402(a)-1.)

Rental income does not lose its identity as rental income for the purposes of section 37 of the Internal Revenue Code of 1954 for the reason that it comes within the exception provided in section 1402 (a)(1) of the Self-Employment Contributions Act of 1954. Where there is a landlord-tenant or a sublessor-sublessee arrangement and the landlord or sublessor materially participates in the production of or management of agricultural and horticultural crops, the 30-percent rule contained in Code section 911(b), ordinarily applicable in such situations, should be considered in computing retirement income for purposes of section 37(c) of the Code.

Rev. Rul. 56-357, C. B. 1956-2, 14, and Rev. Rul. 56-496, C. B. 1956-2, 17, modified.

Advice has been requested with respect to the application of section 37 of the Internal Revenue Code of 1954 in the case of landowners who materially participate in the production or management of agricultural or horticultural crops on a crop-share basis, within the purview of that phrase for purposes of section 1402(a)(1) of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954).

Section 1402(a) of the Self-Employment Contributions Act, which defines the term "net earnings from self-employment," specifically provides:

(1) there shall be excluded rentals from real estate and from personal property leased with the real estate (including such rentals paid in crop

shares) together with the deductions attributable thereto, unless such rentals are received in the course of a trade or business as a real estate dealer; except that the preceding provisions of this paragraph shall not apply to any income derived by the owner or tenant of land if (A) such income is derived under an arrangement, between the owner or tenant and another individual, which provides that such other individual shall produce agricultural or horticultural commodities (including livestock, bees, poultry, and fur-bearing animals and wild life) on such land, and that there shall be material participation by the owner or tenant in the production or the management of the production of such agricultural or horticultural commodities, and (B) there is material participation by the owner or tenant with respect to any such agricultural or horticultural commodity.

Section 37 of the Code provides in part as follows:

(c) RETIREMENT INCOME.—For purposes of subsection (a), the term 'retirement income' means—

(1) in the case of an individual who has attained the age of 65 before the close of the taxable year, income from—

(A) pension and annuities,

(B) interest,

(C) rents, and

(D) dividends, * * *.

The exclusion provided in section 1402(a)(1) of the Self-Employment Contributions Act relates to the exclusion of rentals from the term "net earnings from self-employment" and the exception thereto merely provides that income of the type described in the exception shall be included in the term "net earnings from self-employment" provided there is material participation by the landowner or by a tenant subleasing to another individual. Such exception does not result in the income's losing its identity as rentals paid in crop shares.

Accordingly, where there is a landlord and tenant relationship between a farm owner and a tenant and the landlord (or sublessor, if applicable) has materially participated in the production or management of agricultural or horticultural commodities, the income derived, or at least a part thereof, by the farm owner (or sublessor) will ordinarily constitute retirement income within the meaning of section 37 of the Code to any farm owner (or sublessor) who has attained the age of 65 if the income has been reduced to money or its equivalent.

Section 911 of the Code provides, in part, as follows:

* * * 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 rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business shall be considered as earned income.

The 30-percent rule expressed in section 911 has no application to section 1402(a)(1) of the Self-Employment Contributions Act. However, the determination of earned income by the 30-percent rule in accordance with section 911(b) of the Code is applicable to section 37 of the Code. The only connection between section 37 of the Code and section 1402(a)(1) of the above Act is the designation of a certain type of income; namely, rents, including rents paid in crop shares, which are includible in the term "retirement income" where a landlord and tenant relationship exists and which are ordinarily excluded from the term "net earnings from self-employment" but for the exception provided in the amendment to section 1402(a)(1) of the above Act where there is material participation by the landowner or by a tenant subleasing to another individual.

Revenue Ruling 56–416, C. B. 1956–2, 14, and Revenue Ruling 56–417, C. B. 1956–2, 17, which relate to the question of personal services as an income-producing factor in the case or ordinary rentals are equally applicable where rents paid in crop shares under a rental arrangement are involved; that is, if there is such "material participation" by the landlord or by the sublessor which satisfies the 30-percent rule requirements of section 911(b) of the Code, then the gross rents must be reduced by a reasonable allowance as compensation for personal services, not to exceed 30 percent of the net rental income, for the purpose of coming within the meaning of retirement income under the provisions of section 37(c) of the Code.

Under the limitations provided under section 37(d)(2) of the Code, the earned income as determined under 30-percent rule, as provided by section 911(b) of the Code, must be taken into consideration in reducing the $1200 of retirement income, subject to the conditions relating to the age of the individual.

Accordingly, it is held that rental income which comes within the exception provided in section 1402(a)(1) of the Self-Employment Contributions Act, does not lose its identity as rental income for the purposes of section 37 of the Code. Where there is a landlord-tenant arrangement and the landlord materially participates in the production or management of agricultural and horticultural crops, the 30-percent rule contained in Code section 911(b), ordinarily applicable in such situations, should be considered in computing retirement income for purposes of section 37(c) of the Code.

Revenue Ruling 56–496, C. B. 1956–2, 17, and Revenue Ruling 56–357, C. B. 1956–2, 14, in equating rental income from crop shares with retirement income, gives no consideration to the application of the 30-percent rule in section 911(b) of the Code. To that extent, they are inconsistent with the foregoing and therefore modified accordingly.

SUBCHAPTER B.—COMPUTATION OF TAXABLE INCOME

PART I.—DEFINITION OF GROSS INCOME, ADJUSTED GROSS INCOME, AND TAXABLE INCOME

SECTION 61.—GROSS INCOME DEFINED

The amount received by the writer of a "put" or "call" option which is not exercised constitutes ordinary income. See Rev. Rul. 58–234, page 279.

---

26 CFR 1.61–1: Gross income. Rev. Rul. 58–17

The owner and operator of a swimming school, in order to construct a new swimming pool with all the attendant facilities, organized a club and collected membership fees from those who desired to join. The amount of the membership fee will be refunded if the minimum number of members required is not reached within six months. In addition to the membership fee, each member agreed to pay yearly dues of $75. Under the contract, should any member become and remain delinquent in the payment of dues for 30 days or more, the operator

will deduct the amount of such dues from the membership fee. Should any deliquency continue for 60 days or more the membership will be canceled. Except for the amount of a membership fee retained on account of a delinquency in dues, the full amount of such fee is required to be refunded to each member within five years after the pool is put into use. Terms and new conditions of membership will then be agreed upon.

Held, the amount of membership fees contributed by members of the swimming club under the terms of the contract is in the nature of a loan to the extent that the owner has a continuing obligation to refund such fees. However, any amount by which such obligation is reduced to cure a delinquency in membership dues constitutes gross income to him derived from his business.

(Also Section 1402; 1.1402(a)-1.) Rev. Rul. 58-64

Income derived from the sale of cattle raised on allotted and restricted Indian lands while such lands are held by the United States, as trustee, in accordance with section 5 of the General Allotment Act of 1887, is not considered income derived directly from the land and is therefore includible in gross income. If such income constitutes income from a trade or business, it is also includible in computing net earnings from self-employment for the purpose of the tax imposed by the Self-Employment Contributions Act of 1954.

Revenue Ruling 56-342, C. B. 1956-2, 20, amplified.

Advice has been requested regarding the application of Revenue Ruling 56-342, C. B. 1956-2, 20, to income derived from the sale of cattle raised on allotted and restricted Indian lands.

The taxpayer, an Indian, is the patent holder of certain allotted and restricted Indian lands held by the United States, as trustee, in accordance with section 5 of the General Allotment Act of 1887, 24 Stat. 388, as amended, 25 U. S. C. 348. The taxpayer's income results primarily from the sale of cattle raised on his allotted lands.

Revenue Ruling 56-342, *supra*, based on the decision of the Supreme Court of the United States in *Squire* v. *Horton Capoeman et ux*, 351 U. S. 1, Ct. D. 1796, C. B. 1956-1, 605, holds that income held in trust for or received by the patent holder which is derived directly from allotted and restricted Indian lands while such lands are held by the United States, as trustee, in accordance with section 5 of the General Allotment Act, *supra*, is exempt from Federal income tax. Some types of income exempt under this Revenue Ruling are rentals (including crop rentals), royalties, proceeds from the sales of natural resources, income from the sale of crops, and income from the use of the land for grazing purposes.

The afore-mentioned exempt sources of income are nontaxable only to the extent that they are derived from lands held in trust for the taxpayer. Such income derived from land which the taxpayer rents from other patent holders is includible in his gross income as it is not "income held in trust for or received by the patent holder" within the meaning of Revenue Ruling 56-342, *supra*. See Revenue Ruling 57-523, C. B. 1957-2, 51.

The term "income from the use of the land for grazing purposes" in Revenue Ruling 56-342, *supra*, pertains to income received for

allowing the use of the land for grazing purposes, such as "grazing fees," as referred to in Revenue Ruling 57–523, *supra*, and does not refer to income received from the sale of cattle, poultry, or other animals which were raised on the allotted land.

Income derived from a "trade or business" as defined in section 1402(c) of the Self-Employment Contributions Act of 1954, which is includible in gross income and which is not within the exclusions specified in section 1402(a), for Federal income tax purposes, is includible in computing net earnings from self-employment. The gain or loss from the sale of livestock held primarily for sale to customers in the ordinary course of the taxpayer's trade or business is includible in computing net earnings from self-employment regardless of how long held, or whether raised or purchased. See also sections 1.1402(a) and (c) of the Income Tax Regulations.

Accordingly, income derived from the sale of cattle raised on allotted and restricted Indian lands while such lands are held by the United States, as trustee, in accordance with section 5 of the General Allotment Act of 1887, *supra*, is not considered income derived directly from the land and is therefore includible in gross income. If such income constitutes income from a trade or business, it is also includible in computing net earnings from self-employment for the purpose of the tax imposed by the Self-Employment Contributions Act of 1954.

Rev. Rul. 58–65

A savings and loan association, in opening a savings account for a minor, followed an established procedure by which it placed the account in the name of the parents as trustees, subject to the order of either trustee. The trustees are not subject to court order or other agreement. Under the arrangement, no taxable trust is intended to be created. *Held*, if, under the law of the state in which the minor resides, the savings account legally belongs to the child and the parents are not legally permitted to use any of the funds to satisfy their obligation to support the child, any dividends received on such savings account are taxable to the minor as the beneficial owner thereof. See Rev. Rul. 55–469, C. B. 1955–2, 519; Rev. Rul. 56–484, C. B. 1956–2, 23.

(Also Part II, Section 22(a); Regulations 118, Section 39.22(a)–1.) Rev. Rul. 58–126

A transfer in 1957 by a savings and loan association to its undivided profits account of an amount from its reserve for losses that was set up from its undivided profits during years prior to 1952, when such associations were not subject to Federal income tax, did not result in the production of gross income, for Federal income tax purposes. However, any transfer to its undivided profits account from its reserve for losses which diminishes the reserve below the aggregate amount of additions thereto after 1951 deducted for Federal income tax purposes, minus charge-offs for bad debts losses sustained after 1951 and plus recoveries on debts or portions thereof charged to the reserve after 1951, will result in the production of gross income in the amount of such diminution.

Advice has been requested as to the Federal income tax consequences of a transfer by a savings and loan association to undivided profits of part of its reserve for bad debts which arose in years during which the association was not subject to Federal income tax.

The taxpayer is a Federal savings and loan association. For its calendar years prior to 1952, the association was not subject to Federal income tax. For its calendar year 1952 and subsequent taxable years, in accordance with section 313 of the Revenue Act of 1951, 26 U. S. C. 101, the association computed its income pursuant to Chapter 1 of the Internal Revenue Code of 1939 and 1954.

As required by the rules and regulations for the Federal savings and loan system, the association maintains a "Reserve for Contingencies," which is used by the association solely for absorbing losses and for no other purpose. For taxable years beginning with the calendar year 1952, the taxpayer adopted, through additional credits to its "Reserve for Contingencies," the bad debt reserve method prescribed in section 23(k) of the 1939 Code and section 593 of the 1954 Code. Proper additions to the reserve claimed as income tax deductions, beginning with 1952, amounted to $100x$ dollars. In 1957, it was determined that the amount in its pre-1952 loss reserve was excessive by $50x$ dollars. Accordingly, the association transferred this amount from the pre-1952 reserve to its undivided profits account.

The specific question presented is whether the transfer in 1957 of $50x$ dollars from the association's pre-1952 loss reserve to its undivided profits account, results in the production of taxable income.

For Federal income tax purposes, the taxpayer's "Reserve for Contingencies," to the extent that it was accumulated during years prior to 1952, when such associations were not subject to Federal income tax, and exceeds the aggregate amount of additions thereto after 1951 deducted for Federal income tax purposes, adjusted for charge-offs of bad debt losses sustained after 1951 and for recoveries on debts or portions thereof charged to the reserve after 1951, represents an appropriation of surplus or undivided profits. See section 1.593–1(c) of the Income Tax Regulations promulgated under the Internal Revenue Code of 1954, and section 29.23(k)–5(b)(3) of Regulations 111, as amended by Treasury Decision 5954, C. B. 1953–1, 98, 102, 103, and section 39.23(k)–5(b)(3) of Regulations 118, promulgated under the Internal Revenue Code of 1939.

Accordingly, a transfer, in 1957, by a savings and loan association to its undivided profits of an amount from its reserve for losses that was set up from undivided profits during years prior to 1952, when such associations were not subject to Federal income tax, did not result in the production of gross income, for Federal income tax purposes. However, any transfer to its undivided profits account from its reserve for losses which diminishes the reserve below the aggregate amount of additions thereto after 1951 deducted for Federal income tax purposes, minus charge-offs for bad debt losses sustained after 1951 and plus recoveries on debts or portions thereof charged to the reserve after 1951, will result in the production of gross income, for Federal income tax purposes, in the amount of such diminution.

(Also Sections 3121, 3306, 3401; 31.3121(a)–1, 31.3306(b)–1, 31.3401(a)–1.) Rev. Rul. 58–139

(Also Part II, Section 22(a); Regulations 118, Section 39.22(a)–1.)

Revenue Ruling 57–1, C. B. 1957–1, 721, holds that strike benefits paid by a labor union to workers who are unemployed as the result of a strike are includible in gross income of the recipients in the year received. Such benefits paid to nonmembers as well as members are includible even though distributed on the basis of need and irrespective of the nature and form of the benefits distributed. The same principles are applicable to "lockout" benefits which, like strike benefits, are distributed in furtherance of union objectives. Accordingly, it is held that lockout benefits are includible in the gross income of the recipients in the year received, even though distributed on the basis of need and irrespective of the nature and form of the payments. If the benefits are paid in goods rather than cash, the fair market value of the goods at the time received is to be included in gross income. However, such payments, regardless of the medium in which paid, do not constitute wages for the purposes of Federal employment taxes.

Rev. Rul. 58–140

The amount received by a taxpayer from the Department of the Air Force as reimbursement for wages lost incident to his suspension at the direction of that Department from employment with a privately owned aircraft company as a security risk, but now cleared, constitutes gross income to such employee for Federal income tax purposes, since the settlement is essentially a substitute for wages earned. See *Elmer John La Pointe* v. *Commissioner*, Tax Court Memorandum Opinion, entered June 10, 1943.

(Also Sections 170, 501, 642.) Rev. Rul. 58–190

A cemetery company or corporation, operated for profit, shall not be required to include in gross income, for Federal income tax purposes, that portion of the contract sale price of burial lots, or mausoleum crypts, which, by requirement of state law or its own by-laws and/or contracts, it is obligated to irrevocably set aside in trust solely for perpetual care and maintenance of the cemetery, burial lots, or mausoleum crypts to the extent that such portion is so set aside.

An organization, including a trust, created by formal action, the funds of which are irrevocably dedicated to the perpetual care of a nonprofit cemetery, as a whole, none of the earnings of which inures to the benefit of any private shareholder or individual, may qualify for exemption from Federal income tax as an organization described in section 501(c)(13) of the Internal Revenue Code of 1954.

Voluntary contributions to or for the use of a nonprofit cemetery company or corporation, the funds of which are irrevocably dedicated to the perpetual care of the cemetery, as a whole, are deductible by the donors as charitable contributions in the manner and to the extent provided by section 170(c)(5) of the Internal Revenue Code of 1954. However, a donor may not deduct a contribution for the perpetual care of a particular lot or mausoleum crypt.

Payments made to a cemetery company or corporation, which constitute a part of the purchase price of a burial lot or mausoleum crypt and are irrevocably dedicated to a perpetual care fund, are not deductible as charitable contributions.

Where funds are received by a cemetery company or corporation through a will or from a living person for the perpetual care of an individual lot or crypt, a trust is created which is subject to the tax imposed by section 641 of the Internal Revenue Code of 1954.

The income of any trust, which is used or permanently set aside for the care, maintenance or beautification of a particular family burial lot or mausoleum crypt, is not allowable as a deduction under section 642(c) of the Internal Revenue Code of 1954 in computing the net income of such a trust.

G. C. M. 8446, C. B. IX–2, 370 (1930), modified; I. T. 1881, C. B. 11–2, 200 (1923), revoked.

Advice has been requested relative to the Federal income tax consequences of transactions connected with the operation of a cemetery and the maintenance and care of burial lots or mausoleum crypts, as more fully described in the four situations set forth below.

SITUATION 1.

A cemetery association, company, corporation, or society organized and operated for profit under the laws of the state in which it is located, sells certain rights in burial lots, or mausoleum crypts, and maintains and cares for the cemetery grounds and buildings. Under the state law, and/or in accordance with the by-laws and contracts of the organization, it sets aside a stated percentage of the gross proceeds from the sale of the burial lots and crypts in an irrevocable trust, as a trust fund, the income from which is to be applied to the perpetual care and maintenance of the cemetery, burial lots, and mausoleum crypts.

It is held that the portion of the receipts from the sale of burial lots and mausoleum crypts set aside by a profit cemetery company, pursuant to state law and/or pursuant to its by-laws and contracts, as a fund to be used for the perpetual care of the burial lots, and mausoleum crypts constitutes a trust fund from the very instant such portion passes into the hands of the company and that such fund so set apart does not give rise to taxable income to the company. See *Inglewood Park Cemetery Association* v. *Commissioner*, 6 B. T. A. 386, acquiescence substituted for nonacquiescence, C. B. 1955–2, 6. See also *Community Mausoleum Company* v. *Commissioner*, 33 B. T. A. 19, acquiescence substituted for nonacquiescence, C. B. 1955–2, 4, and *Twin Hills Memorial Park and Mausoleum Corporation* v. *Commissioner*, T. C. Memo. 1954–206. G. C. M. 8446, C. B. IX–2,370 (1930), which limits the exclusion from gross receipts of the association only to that portion of the contract price of the burial lots of crypts which is actually paid by the association to the trustee of the fund, is modified to conform to the conclusion reached herein.

SITUATION 2.

An organization was formed to receive, maintain and administer funds which it received from a nonprofit cemetery association pursuant to state law and contracts. Such funds consist of a part of the purchase price of lots and crypts, income from the investment of such funds, and payments made to it for the perpetual care of the cemetery as a whole. The organization does not own any land dedicated to the burial of the dead or perform any services usual to the operation of a cemetery other than receiving and administering funds for the perpetual care of the nonprofit cemetery. No part of its net earnings inures to the benefit of any private shareholder or individual.

Section 501(c) of the Code describes certain organizations exempt from Federal income tax under section 501(a) of the Code and reads, in part, as follows:

(13) 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.

Although the instant organization does not own and develop land dedicated to the burial of the dead or perform certain other services usual to a nonprofit cemetery company, it performs a service essential to the maintenance of a cemetery and is considered to be organized and operated for burial purposes within the contemplation of section 501(c)(13) of the Code. Accordingly, it is held that the instant organization whose funds are irrevocably dedicated to the perpetual care of a nonprofit cemetery, as a whole, none of the net earnings of which inures to the benefit of any private shareholder or individual, may qualify for exemption from Federal income tax as an organization described in section 501(c)(13) of the Code. I. T. 1881, C. B. II-2, 200 (1923), wherein it is held that an unincorporated perpetual care fund was a "trust" and, as such, is not entitled to exemption, is hereby revoked. However, an organization is not exempt from tax merely because it is organized and operated not for profit. In order to establish its exemption, it is necessary that each organization claiming exemption file an appropriate application form with the District Director of Internal Revenue for the internal revenue district in which is located the principal place of business or principal office of the organization. An organization claiming exemption under section 501(c)(13) shall file its application of Form 1026, Exemption Application. See section 39.101–1 of Regulations 118 made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, C. B. 1954–2, 47.

SITUATION 3.

Under the contract of sale of a burial lot or crypt in a nonprofit cemetery, the cemetery company or corporation agreed to set aside in trust a portion of the purchase price of the lot or crypt for the purpose of general maintenance of the cemetery. In addition to the contract price of such lots or crypts, the purchasers also make contributions to the organization for the perpetual care of particular lots or crypts as well as for the general maintenance and care of the cemetery as a whole. The question is presented whether, under such circumstances, that portion of the purchase price of burial lots or crypts, together with any additional contributions irrevocably dedicated to the perpetual care of the cemetery, burial lots, and crypts, may be deducted by the purchasers or donors as charitable contributions under section 170 of the Code.

Section 170(a) of the Code provides that there shall be allowed as a deduction any charitable contribution paid within the taxable year. Subsection (c)(5) of section 170 provides that the term "charitable contribution" means a contribution or gift to or for the use of a cemetery company owned and operated exclusively for the benefit of its members, or 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, if such company or corporation is not operated for profit and no part of the net earnings of such company or corporation inures to the benefit of any private shareholder or individual.

It is the position of the Internal Revenue Service that that portion of the purchase price of a burial lot or crypt which is required by the contract of purchase or by state or local law to be irrevocably dedicated to the perpetual care of the cemetery as a whole is in consideration of a binding obligation to provide services and facilities for the benefit of the purchaser of the burial lot or crypt. Consequently, the payment does not constitute a charitable contribution. With respect to payments to a cemetery company or corporation "earmarked" for the care of a particular lot, whether they are made as part of the purchase price of the lot or as a separate payment at the time of purchase or later, where such payments are required to be made, there is a consideration passing to the purchaser or donor which takes the amount out of the classification of a charitable contribution.

Accordingly, it is held that contributions *voluntarily* made to or for the use of a nonprofit cemetery company or corporation, the funds of which are irrevocably dedicated to the care of the cemetery as a whole, are deductible by the donors as charitable contributions in the manner and to the extent provided by section 170(c)(5) of the Internal Revenue Code of 1954. However, a donor may not deduct a contribution made for the perpetual care of a particular lot or crypt. Furthermore, payments made to a cemetery company as part of the purchase price of a burial lot or crypt, even though irrevocably dedicated to the perpetual care of the cemetery as a whole, are also not deductible.

SITUATION 4.

A testamentary disposition of property established a trust in the amount of $25x$ dollars, the income therefrom to be used perpetually for the care, maintenance and beautifying of a mausoleum and family burial lot located in a community cemetery which is not operated for profit. The question presented for consideration is whether the gross income of the trust may be deducted under section 642(c) of the Code.

Section 641(b) of the Code provides in part that the taxable income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual. Section 642(c) of the Code provides in part that an estate or trust (other than a trust meeting the specifications of subpart B) shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 170(a)) 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 section 170(c), 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.

Where funds are received by a cemetery company or corporation through a will or from a living person for the perpetual care of an individual lot or mausoleum crypt, a trust is created which is subject to the tax imposed by section 641 of the Internal Revenue Code of 1954.

Since it would appear that the income of a trust established and designed for the purpose of furnishing perpetual care for a particular mausoleum crypt or burial lot inures to the benefit of the grantor, it is the position of the Service that any disbursements made by the trust for such purposes are not being used exclusively for charitable

purposes. Furthermore, there seems little reason to conclude that payments by a trust for the care and maintenance of one particular mausoleum crypt or burial lot are motivated by other than an incidental interest in the care or maintenance of a public nonprofit cemetery as a whole. Accordingly, it is held that the income of any trust which is used or permanently set aside for the care, maintenance, and beautification of a particular burial lot or mausoleum crypt is not allowable as a deduction under section 642(c) of the Code in computing the net income of such a trust.

G. C. M. 8446, C. B. IX-2, 370 (1930), modified; I. T. 1881, C. B. 11-2, 200 (1923), revoked.

(Also Section 162.) Rev. Rul. 58-209

Amounts received by a corporation composed of dealers in similar or related products or services in a designated area, which corporation is organized and operated for the primary purpose of promoting the sale of such products or services by financing general advertising campaigns, constitute gross income under section 61 of the Internal Revenue Code of 1954, where the corporation can also use the amounts received for purposes other than advertising and administrative expenses incident thereto. Such corporation is taxable on any unexpended funds (representing the excess of amounts collected over expenditures) remaining at the end of its taxable year. The amounts paid to the corporation by the dealer-members constitute deductible business expenses.

Advice has been requested whether a corporation, which is primarily organized and operated for the purpose of advertising and promoting the sale of a particular make of automobile, is taxable on any unexpended funds (representing the excess of contributions collected over expenditures) remaining at the end of the taxable year under the circumstances described below.

The corporation is a nonprofit membership corporation organized under the "General Not for Profit Corporation Act" of the state within which it operates. Membership in the corporation in question is restricted to dealers who hold franchises for the sale of a certain make of automobile in a designated area. The corporation was organized for the purpose of uniting such dealers in that area and promoting the sale of automobiles, parts and services by financing general advertising campaigns from funds paid in by dealer-members. The amounts of these payments are based on the number of automobiles purchased from the manufacturer by each member.

The articles of incorporation provide that the purposes for which the corporation is organized are (1) to improve business conditions in the general area with respect to the sale in that area of passenger cars, commercial cars and/or trucks and automotive equipment handled by members of the corporation, whether new or used; (2) to promote public interest in the products offered for sale by the members of the corporation through the use of advertising, exhibitions and other means of all types; (3) to compile and distribute information regarding effective methods of carrying on the businesses of the members of the corporation; (4) to hold conferences of members for the purpose of exchanging ideas with respect to the operation and management of the members' businesses; (5) to foster good relations between the members and the members of the public; and (6) to engage in such other nonprofit activities as are incidental or related to the foregoing purposes.

The articles of incorporation also provide that the corporation shall not engage in any business of a kind ordinarily carried on for profit; the corporation shall not enter into any transaction, carry on any activity, or engage in any business for pecuniary profit; and any income received by the corporation shall be applied exclusively to the not-for-profit purposes and objects of the corporation and no part thereof shall ever inure to the benefit of any private member or individual. In connection with and to further its objects and purposes, the corporation shall have and may exercise all of the powers and authority now or hereafter granted to and vested in not-for-profit corporations organized and existing under the "General Not for Profit Corporation Act" of the state. The corporation may have one or more offices within and without the state and may promote its objects and purposes, and exercise its powers, subject to all applicable laws, within and without the state, to the extent from time to time determined by its board of directors. Upon the termination or dissolution of the corporation, any surplus of property and assets remaining after all of the debts and obligations of the corporation have been paid and satisfied shall not, either directly or indirectly, inure to the benefit of any private member of the corporation or individual, but all such property and assets shall be expended in their entirety for the not-for-profit purposes set forth in the articles of incorporation.

The dealer agrement provides that in the event of termination of the written contract of franchise of a dealer-member to sell products or services of the manufacturer, membership in the fund shall automatically cease and terminate. No member shall be entitled to a refund of any part of his contributions under any circumstances, including the circumstances of termination of such contract.

Examination of the stated purposes of the corporation discloses that with the possible exception of stated purpose (2), which relates to advertising in a broad sense, the other stated purposes relate to the general business welfare of the organization which embrace activities of a nonadvertising nature rather than advertising as such. For example, stated purpose (1) permits the organization to improve business conditions by means other than advertising and stated purpose (5) encompasses the broad field of public relations which could include nonadvertising activities such as contributions to public charities. Of significance is the fact that the corporation is authorized to utilize the payments made by its members in the furtherance of its business welfare activities, which precludes a finding that the payments constitute a trust fund for advertising, as such, or that the corporation receives the payments burdened with an obligation to expend them solely for advertising. Since the payments received by the corporation may be expended for purposes other than advertising and general administrative expenses incidental thereto, it follows that the corporation, which has contractually undertaken to perform advertising and other services for the dealer-members, must include such payments in its income.

The instant case is distinguishable from the decision of *The Seven-Up Company* v. *Commissioner*, 14 T. C. 965 (1950 acquiescence C. B. 1950–2, 4. There The Tax Court of the United States found that

amounts received by the petitioner, from bottlers who contributed to a national advertising fund, were burdened with the obligation to expend such funds for national advertising; that such amounts constituted a trust fund which the company administered as agent, and that such amounts were not income to the company. The court stated on page 977, as follows:

> While the petitioner had the right to receive the bottlers' contributions under its agreement with them, all of the facts and circumstances surrounding the transaction clearly indicate that it was the intention of all of the parties concerned that these contributions were to be used to acquire national advertising for the 7-Up bottled beverage and for that purpose only, and that the petitioner was to be a conduit for passing on the funds contributed to the advertising agency which was to arrange for and supply the national advertising.

The court found that a trust existed with respect to the contributions in that case and that the petitioner acted as the conduit, agent, or custodian thereof. Therefore, the petitioner was not taxed on the excess contributions because it did not receive the bottlers' contributions as its own property, but received the contributions burdened with the offsetting obligation to use them for national advertising only.

In the instant case, the corporation is permitted to obtain not only national advertising for the dealer-members, but is also permitted to engage in other activities which promote the general business welfare of the dealer -members. The Corporation is authorized to expend the payments received from the dealer-members in furtherance of these general corporate activities. Such factors preclude a finding that a trust for advertising exists or that the corporation receives the payments burdened with the obligation to expend them solely for advertising. The same result follows with respect to dealers in other than automotive products or services under similar circumstances. The limitations surrounding the contribution in the *Seven-Up Company* case do not exist in the instant case.

The *Seven-Up Company* case will be followed only in those cases where the factual pattern is similar, that is, where the facts show that the organizatoin is a mere conduit for the expenditure of a fund established for a specific purpose. For example, where the dealers in products or services, whether automotive or otherwise, acting in concert, vest in their selected representative the authority to contract solely for advertising in their behalf, contributions to a fund managed by the representative, as agent, custodian, or conduit are not taxable income to the representative. This result would follow whether the members of the group are informally organized, are members of a more formal unincorporated association, or are members of a nonprofit corporation.

Accordingly, amounts received by a corporation composed of dealers in similar or related products or services in a designated area, which is organized and operated for the primary purpose of promoting the sale of such products or services by financing general advertising campaigns, constitute gross income under section 61 of the Internal Revenue Code of 1954, where the corporation can also use the amounts received for purposes other than advertising and administrative expenses incident thereto. Such corporation is taxable on any unexpended funds (representing the excess of amounts collected over expenditures) remaining at the end of its taxable year. The amounts paid to the corporation by the dealer-members constitute deductible business expenses under section 162 of the Code.

475254°—58——3

Back-interest coupons, received by the holder of certain Japanese bonds in the refunding transaction described in Revenue Ruling 54, represent a right to receive interest income, and amounts received upon the sale or collection of such coupons are taxable as ordinary income. Accordingly, if a taxpayer who has received back-interest coupons in the refunding transaction in question makes a gift of such coupons to a member of his family, the gift would be treated as an attempted assignment of income, and any amounts subsequently received by the donee upon the sale or redemption of the coupons will be taxable to the donor as ordinary income in the year in which the income is received.

Advice has been requested as to the tax consequences of a gift of back-interest bond coupons by a taxpayer to his sister under the circumstances described below.

In July, 1941, the taxpayer purchased certain Japanese prewar dollar bonds of the type described in Revenue Ruling 54, C. B. 1953–1, 204. Default occurred on the bonds after December 7, 1941. In 1952, the Government of Japan resumed service on the bonds under a refunding arrangement in which the bonds were restamped so as to make the principal on the bonds payable in 1954, ten years after their original maturity date. At the same time, the Government of Japan issued new blocks of back-interest coupons payable semiannually over a ten-year period ending in 1962. The taxpayer held the bonds in question during the entire default period from 1941 to 1952 and continued to hold them until they were redeemed at par in 1954. In 1956, the taxpayer gave the back-interest coupons, which had not yet become payable, to his sister.

In Revenue Ruling 54, *supra*, the Internal Revenue Service held that the refunding transaction whereby the Japanese Government resumed service on the defaulted bonds in question did not constitute an exchange of property which resulted in recognizable gain or loss under section 112 of the Internal Revenue Code of 1939. This position was based on the following factors: no new bonds were issued; the interest rate and the terms of the bonds remained the same; and the refunding transaction amounted primarily to an extension of the maturity dates of the bonds and coupons.

Accordingly, it is held in the instant case that, following the refunding transaction in 1952, the back-interest coupons received by the taxpayer did not constitute "a new obligation" in his hands, but retained their character as interest. Since the taxpayer received the interest coupons after having held the bonds from 1941 to 1952 and since he recovered his entire capital investment when he redeemed the bonds at par in 1954, the back-interest coupons represented a right to receive interest income. If he had sold these coupons or had held them until they became payable, the income resulting therefrom would have been ordinary income. See *Charles T. Fisher* v. *Commissioner*, 209 Fed. (2d) 513, certiorari denied, 347 U. S. 1014.

This case is distinguishable from Revenue Ruling 54–251, C. B. 1954–2, 172, wherein similar back-interest coupons were sold and resold with a resulting recognition of capital gain. Revenue Ruling 54–251 *supra*, dealt with the status of the coupons in the hands of a third party, who had purchased only the coupons. That is not the case here.

Here the taxpayer received the back-interest coupons not as a purchaser for value but rather as one who has held the original obligation itself for a period of over ten years (during the entire default period from 1941 to 1952). To this taxpayer, the back-interest coupons represent delayed payments of interest.

Accordingly, when the taxpayer gave the back-interest coupons in question to his sister, the gift is to be treated as an attempted assignment of income, and any amounts subsequently received by his sister upon the sale or redemption of the coupons will be taxable to him as ordinary income in the year in which the income was received. See *Helvering* v. *Paul R. G. Horst*, 311 U. S. 112, Ct. D. 1472, C. B. 1940–2, 206, and *Helvering* v. *Gerald A. Eubank*, 311 U. S. 122, Ct. D. 1473, C. B. 1940–2, 209.

Rev. Rul. 58–276

A television broadcasting station conducted a "telethon" over a period of several hours for the purpose of raising funds for a charitable organization exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954. None of the funds collected during or as a result of the "telethon" inured in any way to the benefit of the broadcasting station, and in soliciting such funds the public was informed that their entire contributions would go to the charitable organization. All of the money collected, unreduced by any expenses incurred by the broadcasting station in conducting the "telethon," were turned over to the charitable organization. *Held*, the gross receipts from the "telethon," all of which were paid over to the charitable organization, do not constitute income to the television broadcasting station.

(Also Sections 451, 3121, 3402; 1.451–1, 31.3121(a)–1, 31.3402(a)–1.) Rev. Rul. 58–301

The lump sum payment received by an employee as consideration for the cancellation of his employment contract constitutes gross income to the recipient in the taxable year of receipt. However, such amount does not constitute "wages" for Federal employment and income tax withholding purposes.

Advice has been requested whether an amount received by an employee as consideration for the cancellation of an employment contract constitutes ordinary income or capital gain, and, in either event, the taxable year of its inclusion in gross income.

In the instant case, the taxpayer was employed under a written contract providing for five years of employment. During the second year of employment, the taxpayer and his employer agreed to cancel the remaining period of the contract. In consideration of the taxpayer's relinquishment of his contract rights, the employer paid him $40x$ dollars during the taxable year.

In order for a transaction to result in a capital gain or loss, it must meet the requirements of sections 1221 and 1222 of the Internal Revenue Code of 1954, which set forth the meaning of "capital asset" in terms of property and classifies capital gains and losses arising from the sale or exchange of them. First of all it must fall within the meaning of property qualifying as a capital asset under section

1221 and then there has to be a sale or exchange of the property under section 1222. Under the facts of the instant case, the taxpayer fails to meet the requirements under both sections.

In *Thurlow E. McFall et al.* v. *Commissioner*, 34 B. T. A. 108, the United States Board of Tax Appeals, in determining that the sale and assignment of an employment contract to a third person did not result in a capital gain to the petitioners, stated, in part:

> * * * there was a right of petitioners to continue to perform service and then to be paid-to persist in their contractual relation for its agreed term. While this right is property in the constitutional sense in that it could not be arbitrarily legislated away, it is not capital. * * *. Obviously it is not the sort of property which is susceptible of ownership for a length of time as is a share of stock, a bond, or a thing.

A similar conclusion was reached in *George K. Gann* v. *Commissioner*, 41 B. T. A. 388, where the Board held that the amount received by an employee from his employer in consideration for the cancellation of a contract of employment which had several years to run was ordinary income and not a capital gain. The decision was predicated on the fact that the qualifications and skill of the employee formed the material ingredient of the contract and such a contract could not be sold. See also *Charles J. Williams* v. *Commissioner*, 5 T. C. 639; *General Artists Corporation* v. *Commissioner*, 205 Fed. (2d) 360, certiorari denied 346 U. S. 866; and *W. Morgan Shuster* v. *Helvering*, 121 Fed. (2d) 643.

Under certain circumstances, income received in one year may be taxed as if received ratably over the years in which it was earned. See sections 1301–1305, inclusive, of the Code, relating to the taxation of income attributable to several taxable years. The provisions of these sections, however, are by their terms inapplicable to the instant case.

Accordingly, it is held that a lump sum payment received by an employee as consideration for the cancellation of his employment contract constitutes gross income to the recipient in the taxable year of receipt. However, such amount is not subject to the Federal employment and income tax withholding provisions of section 3121 of the Federal Insurance Contributions Act and section 3402 of the Code, (Chapters 21 and 24, respectively, Subtitle C, Internal Revenue Code of 1954). See Rev. Rul. 55–520, C. B. 1955–2, 393.

(Also Section 1402; 1.1402(a)–1.) Rev. Rul. 58–320

> In the absence of an applicable exemption provision in a treaty or agreement with the Indian tribe concerned or in some Act of Congress dealing with its affairs, income directly derived by a member of an Indian tribe from unallotted Indian tribal lands cultivated by him under an arrangement with the tribe is includible in the gross income of the recipient. If such income is derived from the taxpayer's "trade or business" and if it is not within the exclusions specified in section 1402(a) of the Self-Employment Contributions Act of 1954, it is includible in computing his net earnings from self-employment under that section.

Advice has been requested regarding the taxability of income directly derived from unallotted Indian tribal lands.

The taxpayer, an Indian, is the patent holder of certain allotted and restricted Indian lands held by the United States, as trustee, in accordance with section 5 of the General Allotment Act of 1887, 24 Stat. 388, as amended, 25 U. S. C. 348. His income is chiefly derived from farming. In addition to farming the lands allotted to him, the taxpayer cultivates unallotted Indian tribal lands which are assigned to him by the tribe for a nominal fee.

Revenue Ruling 56–342, C. B. 1956–2, 20, based on the decision of the Supreme Court of the United States in *Squire* v. *Horton Capoeman et ux*, 351 U. S. 1, Ct. D. 1796, C. B. 1956–1, 605, holds that income held in trust for or received by the patent holder which is derived directly from allotted and restricted Indians lands while such lands are held by the United States, as trustee, in accordance with section 5 of the General Allotment Act, *supra*, is exempt from Federal income tax. Some of the types of exempt income according to that Revenue Ruling are rentals (including crop rentals), royalties, proceeds from the sales of natural resources, income from the sale of crops, and income from the use of the land for grazing purposes.

The afore-mentioned types of income are nontaxable only to the extent that they are directly derived from allotted lands held in trust for the taxpayer under that Act. In that regard it is noteworthy that the Supreme Court in the *Capoeman* decision found in section 6 of the General Allotment Act a congressional intent that lands held in trust under section 5 be exempt from tax. The Court had observed earlier in its opinion:

> We agree with the Government that Indians are citizens and that in ordinary affairs of life, not governed by treaties or remedial legislation, they are subject to the payment of income taxes as are other citizens. We also agree that to be valid, exemptions to tax laws should be clearly expressed.

Where there is no applicable exemption provision in a treaty or in legislation dealing with the tribe from whose lands he derives income, a member of an Indian tribe, though entitled to exemption in respect of income derived from lands held in trust under section 5 of the General Allotment Act, cannot treat other income derived from unallotted tribal lands as also exempt.

Accordingly, in the absence of an applicable exemption provision in a treaty or agreement with the Indian tribe concerned or in some Act of Congress dealing with its affairs, income directly derived by a member of an Indian Tribe from unallotted Indian tribal lands cultivated by him under an arrangement with the tribe is includible in the gross income of the recipient. If such income is derived from the taxpayer's "trade or business" as defined in section 1402(c) of the Self Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954) and if it is not within the exclusions specified in section 1402(a) of that Act, it is includible in computing his net earnings from self employment under the latter section.

Gain or loss upon the sale of securities which were purchased pursuant to a contract performed during the ordinary course of a taxpayer's business or are purchased solely for the purpose of obtaining inventory. See Rev. Rul. 58–40, page 275.

Benefits received from a trust fund under a supplemental unemployment plan voluntarily adopted by the employer. See Rev. Rul. 58–128, page 89.

---

26 CFR 1.61–2: Compensation for services, including fees, commissions, and similar items. Rev. Rul. 58–220

It is the rule of employment, under which physicians are appointed on a full-time salary basis to the staff of a certain hospital, that such physicians shall receive no fees or compensation for their individual benefit from or on behalf of any patients admitted to the hospital. In some instances, the patients insist on making checks for the services rendered payable directly to the physician instead of to the hospital. The hospital, and not the physicians, actually bills all patients treated. In line with the above condition of their employment, the physicians endorse the checks and turn them over to the hospital. The fees so received are used entirely in the operation of the hospital. *Held*, where, under the above circumstances, checks are received by a physician and are immediately endorsed to the hospital, the physician is not required to include the amounts thereof in his gross income. He is an agent for the hospital, merely acting as a conduit for the fees collected. *See L. A. Menaux et ux.* v. *Commissioner*, 38 B. T. A. 200, for a similar holding with respect to poll tax and political contributions collected and remitted by the petitioner, acquiescence, C. B. 1939–2, 24, on the issue herein pertinent, and nonacquiescence, C. B. 1939–2, 58, as to another issue. See also Revenue Ruling 55–234, C. B. 1955–1, 217, which held, on the facts therein presented, that income realized from business transacted by a corporation through the nominal agency of one of its officers, acting as purported sole proprietor, is taxable to the corporation. However, a physician who receives fees under the above conditions should attach to his Federal income tax return a schedule setting forth the sources of the fees, the amounts received and the disposition made of them.

Rev. Rul. 58–235

Where the executive director of a tax exempt organization engages to appear as a contestant on a quiz show, the proceeds of which are to go to the organization, the amount of money won by him constitutes gross income to him and not to the exempt organization.

Advice has been requested whether money won by a television quiz show contestant and paid over to an exempt organization is to be considered income to the contestant.

During 1957, the taxpayer was the executive director of an organization exempt from Federal income tax under section 501(a) of the Internal Revenue Code of 1954, which qualified as an organization described in section 170(c) of the Code. A part of his duties as executive director comprised raising funds for the organization. Due to certain publicity which the taxpayer had received on the basis of his personal qualifications, the producer of a television show invited him

to appear as a contestant. He agreed to appear provided the board of directors of the organization approved, which it did, his diverting time for the show. He requested the producer to pay any prize he might win directly to the organization. The taxpayer won 60x dollars on the program, which pursuant to his request, was paid directly to the organization. It is contended that the prize is not taxable to the contestant on the grounds that he was acting as an agent for the organization in fulfilling his duty to raise funds and that there was no contract between him and the producer of the show.

Section 61 of the Code provides, in part:

(a) GENERAL DEFINITION.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived * * *.

Although section 1.61–2 of the Income Tax Regulations, at subsection (c), specifically excludes from gross income the value of gratuitous services rendered directly to certain exempt organizations, it expressly provides that:

Where, however, pursuant to an agreement or understanding, services are rendered to a person for the benefit of an organization described in section 170(c) and an amount for such services is paid to such organization by the person to whom the services are rendered, the amount so paid constitutes income to the person performing the services.

Section 74 of the Code brought prizes and awards within the scope of gross income, and section 1.74–1(a) of the regulations points out that such prizes and awards include amounts received from radio and television giveaway shows and awards in contests of all types.

In *Leroy J. Robertson* v. *United States*, 143 U. S. 711, C. B. 1952–2, 66, at 67, the Supreme Court of the United States stated the applicable general contract rule of law, as follows:

In the legal sense payment of a prize to a winner of a contest is the discharge of a contractual obligation. The acceptance by the contestants of the offer tendered by the sponsor of the contest creates an enforceable contract. . . .

The instant contract was entered into between the producer and the taxpayer individually. The taxpayer was contacted originally and specifically because of his personal qualifications. All arrangements for the appearance were made between the taxpayer and the producer. The taxpayer had the right to enforce the contract, receive the income, or direct its use or disposition.

It is a fundamental concept in tax law that there is a realization of income to the person who has the right to receive or the power to dispose of it, and payment directly to an exempt organization, at the direction of the person whose individual personal services earned it, constitutes an assignment of income which is disregarded for Federal income tax purposes. See *Helvering* v. *Paul R. G. Horst*, 311 U. S. 112, Ct. D. 1492, C. B. 1940–2, 206; *Lucas* v. *Guy C. Earl*, 281 U. S. 111; Rev. Rul. 58–127, page 42.

The action of the board of directors in the instant case involved only permission to divert time from the taxpayer's normal duties. The facts presented do not indicate that the exempt organization was entitled to the taxpayer's services as a quiz contestant or that appearances on quiz shows comprised an incident of his duties as a fund raiser.

Under the circumstances presented, the application of Revenue Ruling 71, C. B. 1953–1, 18, militates against the contention that the taxpayer was acting as an agent for the exempt organization.

Accordingly, it is held that the amount realized as a result of winning a television quiz contest prize constitutes gross income to the contestant and not to the exempt organization.

Insurance premiums paid by an employer on a policy, covering sickness and disability, for the benefit of an employee. See Rev. Rul. 58–90, page 88.

Amounts received by the recipient of an award which with it carried an appointment to an officially established position as a civil service employee of the United States Government. See Rev. Rul. 58–322, page 59.

---

26 CFR 1.61–3: Gross income derived from business.

Treatment of gain or loss upon the failure of customers to return containers within a specified period. See Rev. Rul. 58–77, page 118.

SECTION 62.—ADJUSTED GROSS INCOME DEFINED

26 CFR 1.62–1: Adjusted gross income. Rev. Rul. 58–175

Industrial insurance debit agents employed by insurance companies to collect, service and sell weekly and monthly insurance policies are not considered to be "outside salesmen" for the purposes of section 62(2)(D) of the Internal Revenue Code of 1954 in computing their adjusted gross income.

Advice has been requested whether industrial insurance debit agents are considered "outside salesmen" for the purposes of section 62(2)(D) of the Internal Revenue Code of 1954.

The principal activity of industrial insurance debit agents is to collect premiums on, service and sell weekly and monthly insurance policies and also ordinary and accident insurance. They report to their local territorial office several times a week and then go out to the field. They are considered employees for the purposes of social security, unemployment insurance and state workmen's compensation programs. See Rev. Rul. 58–176, page 349. Under section 62(2)(D) of the Code, an "outside salesman" who is an employee is entitled to deduct all of his business expenses in determining his adjusted gross income and also claim the standard deduction. However, the Senate Report of the Committee on Finance, No. 1622, 83d Congress, Second Session, pages 169 and 170, makes it clear that section 62(2)(D), *supra*, applies only to full-time outside salesmen and that it does not apply to salesmen whose principal activities consist of service and delivery, such as bread or milk-driver salesmen. Based upon the foregoing, it is the conclusion of the Internal Revenue

Service that the activities of industrial insurance debit agents correspond to those of the bread or milk-driver salesmen and, therefore, are not considered "outside salesmen" within the meaning of section 62(2)(D) of the Code for the purpose of computing adjusted gross income.

PART II.—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

SECTION 71.—ALIMONY AND SEPARATE MAINTENANCE PAYMENTS

26 CFR 1.71–1: Alimony and separate maintenance; income to wife or former wife. (Also Section 215; 1.215–1.) Rev. Rul. 58–52

The tax consequence of a decree granting periodic payments of alimony for support and maintenance of a minor child, where there is no specific allocation thereof between the wife and child, cannot be altered by a subsequent decree which merely reduces the periodic payment.

That portion of the award earmarked by the decree for payment by the wife of installments of principal and interest due upon a note secured by a deed of trust, which is a first lien upon a residence owned jointly as tenants by the entirety and upon which both parties are principal obligors, is not considered as a payment in the nature of alimony deductible from gross income by the husband and includible in gross income of the wife.

That a portion of the award is earmarked by the decree for payment by the wife of insurance, real estate taxes and utilities, which are current expenses, does not alter the character of that portion of the award as constituting a periodic payment of alimony in the nature of support includible in the gross income of the wife and deductible from gross income by the husband.

Advice has been requested as to the treatment of an alimony award for support and maintenance of a wife and a minor child where a subsequent decree reduced the alimony payments. A portion of the award is allocable to payments of installments of principal and interest due upon an indebtedness secured by a first lien against real estate owned jointly as tenants by the entirety, together with the taxes, insurance, and utility expenses incurred on such property.

Pursuant to a decree of limited divorce, it was ordered that the husband pay the wife a stated sum per month as alimony and maintenance for herself and the minor child of the parties, without allocation. It was further ordered that out of the amount paid to the wife she should pay the installments of principal and interest due upon a note secured by a deed of trust, which is a first lien upon a residence owned jointly by the husband and wife as tenants by the entirety with the right of survivorship, and the insurance, real estate taxes and all utility charges. By a subsequent court order, the monthly payment was reduced upon the ground that the minor child had attained majority and the husband was no longer under a legal obligation to maintain him.

Section 71 of the Internal Revenue Code of 1954 specifically applies to and makes includible in the wife's gross income the full amount of

a periodic payment unless there is a specific allocation of a part thereof for the support of minor children of the husband.

It is the position of the Internal Revenue Service that a *nunc pro tunc* decree of a state court does not retroactively alter the tax consequences of a decree of periodic payment of alimony for support and maintenance of wife and minor child. See I. T. 4108, C. B. 1952–2, 113. Where there was no specific allocation between the wife and child, a subsequent reduction by the court of future payments will not constitute an allocation.

The portion of the alimony award allocable to the payment of installments of principal and interest due upon the indebtedness secured by a first lien against the jointly-owned real estate is in discharge of an obligation, not in the nature of alimony or support pursuant to the decree, but for the purchase of a capital asset apart from the decree. Each party is a principal obligor upon the note, liable both jointly and severally to the noteholder. While the decree has fixed the responsibility for the actual payment to the noteholder, in the mechanical sense, it does not alter the ultimate liability incurred prior to the divorce.

In the instant case legal title is vested in fee simple in both husband and wife, but the interest of each is subject to being divested by the survivorship provisions. Thus, the instant case is comparable to the life insurance premium payment cases that arise in connection with the periodic payment of alimony where the husband by decree is directed to pay a specified amount per month to the wife for and during her lifetime or until she remarries and from which she is to pay the premiums upon life insurance policies of which she is beneficiary to insure continued payment of alimony after the husband's death. In such cases, the income tax treatment of the premium payments which are made is dependent upon the interest retained by the insured in the insurance policy which is issued. I. T. 4001, C. B. 1950–1, 27, holds that premiums paid by a husband on a life insurance policy absolutely assigned to his former wife and in respect of which she is the irrevocable beneficiary are includible in the gross income of the wife and deductible by the husband. Premiums paid by the husband on a life insurance policy not assigned to the wife and with respect to which she is only a contingent beneficiary are neither includible in the gross income of the wife nor deductible by the husband. See also *Meyer Blumenthal* v. *Commissioner*, 183 Fed. (2d) 15, and *Edna H. V. Seligmann* v. *Commissioner*, 207 Fed. (2d) 489. Under the facts in this case, the husband still retained a survivorship interest in the property upon which the installment payments of principal and interest were made.

If the court here had ordered the husband to make payments on the indebtedness to the holder of the trust note, there would be a direct parallel to the situation in I. T. 4001, *supra;* however, the court's direction that the husband pay the wife alimony and that the wife make the payments on the indebtedness out of the amount she receives from the husband does not differ in substance from a direction that payments on the indebtedness be made directly by the husband. Consequently, there is no difference in tax treatment because the wife was interposed in the chain of payment in the role of a conduit.

Accordingly, it is held that the tax consequence of a decree granting periodic payments for support and maintenance of the wife and minor child, where there is no specific allocation thereof between the wife and child, are not altered by a subsequent decree which merely reduces the amount of the future periodic payments.

The portion of the award which is applied upon the monthly installments of principal and interest due upon a note secured by a deed of trust, which is a first lien upon the residence owned jointly as tenants by the entirety, is neither includible in the wife's gross income nor deductible by the husband, and the latter is regarded as paying any interest on the indebtedness.

Insurance, real estate taxes and utilities constitute current expenses or charges, and that portion of the award received by the wife is includible in the wife's gross income and deductible by the husband.

(Also Section 215, 1.215–1.) Rev. Rul. 58–100

Two installment payments to be made in 1958 and 1959 by a husband to his former wife to cover Federal income tax deficiencies attributable to alimony payments, liability for which was assumed by him under a written agreement incident to the divorce, constitute periodic payments. Such payments are includible in the gross income of the wife and are deductible by the husband for the taxable years in which the payments are made.

The above conclusion is equally applicable to the amounts to be paid by the husband to the wife representing the additional taxes attributable to the amount she will receive to cover her tax deficiencies.

Advice has been requested whether two installment payments received by a divorced wife from her former husband to pay Federal income tax deficiencies on alimony payments which she did not report for income tax purposes and for amounts payable by her for taxes by reason of receipt of such installments are includible in the gross income of the wife and deductible by the husband.

Under the terms of a separation agreement, a husband agreed to pay his wife, for her own support and maintenance during his lifetime and until her death or remarriage, a stipulated sum per year in equal monthly payments. The husband further agreed to pay all taxes and assessments levied or assessed against the payment on account of any law, regulation or act of the United States, it being the intent of the parties that the wife would receive without diminution the full amount of the payment for her maintenance. The decree of divorce, which was granted the parties, recites that the separation agreement is approved and ordered to survive the decree of divorce.

The stipulated annual amount has been paid by the husband in monthly payments but, since the wife did not file Federal income tax returns for the years in which such payments were received by her, the tax attributable to such income was not paid. When a determination was made as to the wife's tax liability on such income, the husband agreed to pay her the amount thereof in two equal installments, one in 1958 and the other in 1959, but not the interest due thereon. He also agreed to pay her the amount of income tax which she is required to pay by reason of the receipt of the two installment payments.

It is therefore held that, since the husband was required under the settlement agreement to pay, in addition to the stipulated amount, all taxes and assessments levied against such amount, the payments made by him to meet the amount of Federal income taxes due on the periodic payments made subsequent to the divorce decree will be made under the written agreement incident to the divorce decree and will constitute periodic payments under the provisions of section 71 of the Internal Revenue Code of 1954. Accordingly, such payments are includible in the wife's gross income. They are also deductible under section 215 of the Code by the husband in computing his taxable income for the years in which the payments are made.

It is further held that the payment by the husband to meet the additional income taxes attributable to the amounts includible in the wife's gross income by reason of the receipt by her of the two installments in 1958 and 1959 will constitute periodic payments includible in the wife's gross income and deductible by the husband.

(Also Section 215; 1.215-1.) Rev. Rul. 58-152

Where a modification of a judgment nisi is predicated on an agreement in writing providing, among other things, for payments in lieu of alimony support, the agreement gives effect to the continuing status of the legal obligation of support of the divorced wife. Accordingly, such agreement constitutes a written instrument incident to the divorce within the meaning of section 71(a)(1) of the Internal Revenue Code of 1954, and payments made pursuant to the agreement, subject to the limitations of section 71(c) of the Code, are includible in the wife's gross income and deductible by the husband.

Advice has been requested whether payments made to a divorced wife pursuant to the settlement agreement described below are includible in the wife's gross income and deductible by the husband.

In the instant case, the provisions of a judgment nisi which provided for support and maintenance for the wife were incorporated in the final decree of divorce by order of the Superior Court of New Jersey. In accordance with the terms of a later agreement, entered into following a court-ordered examination of the husband's income and assets, the husband agreed to pay to the wife as a final property settlement, and in lieu of the payments he was ordered to make under the decree of divorce, a stipulated sum in equal amounts over a period of 530 weeks. Under New Jersey law, any judgment for alimony ceases upon remarriage or death of the wife or the death of the husband; however, the husband's obligation to make installment payments under the instant agreement will survive those contingencies. The court, as requested by the taxpayers, amended the judgment nisi to delete the provision for the support and maintenance of the wife.

Section 71 of the Internal Revenue Code of 1954 provides, in part, as follows:

(a) GENERAL RULE.—

(1) DECREE OF DIVORCE OR SEPARATE MAINTENANCE.—If a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the wife's gross income includes periodic payments whether or not made at regular intervals) received after such decree in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation which, because of the marital or family

relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.

* * * * * * *

(c) PRINCIPAL SUM PAID IN INSTALLMENT.—

(1) GENERAL RULE.—For purposes of subsection (a), installment payments discharging a part of an obligation the principal sum of which is, either in terms of money or property, specified in the decree, instrument, or agreement shall not be treated as periodic payments.

(2) WHERE PERIOD FOR PAYMENTS IS MORE THAN 10 YEARS.—If, by the terms of the decree, instrument, or agreement, the principal sum referred to in paragraph (1) is to be paid or may be paid over a period ending more than 10 years from the date of such decree, instrument, or agreement, then (notwithstanding paragraph (1)) the installment payments shall be treated as periodic payments for purposes of subsection (a), but (in the case of any one taxable year of the wife) only to the extent of 10 percent of the principal sum. For purposes of the preceding sentence, the part of any principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be treated as an installment payment for the taxable year in which it is received.

Section 215 of the Code provides that in the case of a husband described in section 71 there shall be allowed as a deduction amounts includible under section 71 in the gross income of the wife, payment of which is made in the husband's taxable year.

In *Dorothy B. Smith* v. *Commissioner*, 192 Fed. (2d) 841, the court held that payments made by a husband, under an agreement which was not made a part of the decree of divorce, were made in discharge of a legal obligation which, because of the marital relationship, was incurred by the husband under a written instrument incident to the final decree of divorce. The court referred to the Report of the Ways and Means Committee, House Report No. 2333, 77th Cong. 1st Sess., C. B. 1942–2, 372, relative to the inclusion of section 22 (k) in the Internal Revenue Code of 1939 (section 71 of the 1954 Code) wherein, at page 428 of Cumulative Bulletin 1942–2, it is stated that the section applies only where the legal obligation being discharged arises out of the family or marital relationship in recognition of the general obligation to support, which is made specific by the instrument or decree and has as its purpose the uniform treatment of amounts paid in the nature of or in lieu of alimony, regardless of any variance in the laws of different States concerning the existence and continuance of an obligation to pay alimony.

Although the payments to be made, under the later agreement here under consideration, are not specifically mentioned in the order of the court modifying the judgment nisi, cognizance is given to such agreement in the court order as "an agreement in writing providing inter alia for the payment * * * in lieu of all alimony support and maintenance for the plaintiff." Thus, the deletion from the judgment nisi of the requirement that the husband make weekly payments for the support and maintenance of the wife is predicated on the agreement providing for payments in lieu thereof.

Accordingly, it is held that where a modification of a judgment nisi is predicated on an agreement in writing providing, among other things, for payments in lieu of alimony support, the agreement gives effect to the continuing status of the legal obligation of support of the divorced wife and, therefore, constitutes a written instrument incident to the divorce within the meaning of section 71 (a) (1) of the Code, and payments made pursuant to the agreement, subject to the

limitations of section 71(c) of the Code, are includible in the wife's gross income and deductible by the husband as provided in section 215 of the Code.

(Also Section 215; 1.215–1.) Rev. Rul. 58–192

The characterization by a state court of payments received by a divorced wife as payments for her property rights is not controlling in determining whether, for Federal income tax purposes, such payments are periodic payments received under a divorce decree in discharge of a legal obligation imposed upon or incurred by the husband because of the marital or family relationship.

Advice has been requested whether the characterization by a state court of payments received by a divorced wife as being payments for her property rights precludes the Internal Revenue Service from taxing them as periodic payments received under a decree of divorce in discharge of a legal obligation imposed on the husband because of the marital or family relationship.

In 1954, under the terms of a divorce decree obtained in Florida, and in accordance with a separation agreement made a part thereof, the husband was ordered to pay $300 per month, designated in the agreement as "alimony and in full and complete satisfaction of the husband's obligation to maintain and support the wife," to his former wife during her lifetime.

The monthly payments were to continue even though the wife remarried. A circuit court in Florida, upon the husband's petition to have the decree modified following the former wife's remarriage, released him from making any further payments, which it designated as "alimony," to his wife. The Supreme Court of Florida, upon appeal by the wife, ordered the payments, specifically adjudged to be payments for "property rights" or to represent a "property settlement," to be continued.

Section 71(a) of the Internal Revenue Code of 1954 provides, in part, as follows:

(1) * * * If a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such decree in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.

The Tax Court of the United States, in *Intercounty Operating Corporation* v. *Commissioner*, 4 T. C. 55, acquiescence, C. B. 1944, 15, in considering whether certain income from the redemption of tax liens in the State of New York constituted "interest," used the following language.

* * * The well established rule applying to the interpretation of a Federal statute such as is here being considered is stated in *Burnet* v. *Harmel*, 287 U. S. 103, 110 as follows:

It is the will of Congress which controls, and the expression of its will in legislation, in the absence of language evidencing a different purpose, is to be interpreted so as to give a uniform application to a nationwide scheme of taxation. * * * State law may control only when the Federal taxing act,

by express language or necessary implication, makes its own operation dependent on the State law.

See also *Lyeth* v. *Hoey*, 305 U. S. 188; and *United States* v. *Pelzer*, 312 U. S. 399.

The Tax Court thus concluded that, in applying a provision of the Internal Revenue Code, the Act of Congress has its own criteria, irrespective of any particular characteriaztion by the law of a state. More particularly, the District Court of the United States, in *Helen Brown, Executrix, et al* v. *United States*, 121 Fed. Supp. 106, in allowing the husband to deduct certain payments made pursuant to the terms of a divorce decree, concluded that the right to a deduction for payments under sections 22(k) and 23(u) of the Internal Revenue Code of 1939, now sections 71 and 215 of the 1954 Code, does not depend upon their characterization under state law. See *Charles Campbell* v. *Commissioner*, 15 T. C. 355, acquiescence, C. B. 1951–1, 1. See also Senate Report No. 1631, 77th Cong., C. B. 1942–2, 504 at 568, and H. R. Report No. 2333, 77th Cong., C. B. 1942–2, 372 at 427.

The characterization by the Supreme Court of Florida of payments made by a divorced husband to his former wife does not control the interpretation of the following language used in section 71 of the Code:

> * * * periodic payments * * * in discharge of * * * a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.

The Internal Revenue Service may make its own examination in each case to determine whether property rights exist in the wife irrespective of any state court characterization. Where the evidence failed to support the wife's claim that certain payments received by her were in settlement of her property rights, the Tax Court of the United States upheld the Service's contention that such payments were periodic payments made to her in discharge of a legal obligation to support. *Julia Nathan* v. *Commissioner*, 19 T. C. 865.

In the instant case, since there are no property rights enumerated or specified in the separation agreement or in the decree or modified decree of which it is made a part, since there is no recital in any of these documents to the effect that the wife is giving up any property rights, and since the facts do not reveal the existence of any property rights in the wife, the monthly payments made to her qualify as periodic payments in discharge of a legal obligation which, because of the marital or family relationship, is imposed upon her husband under the decree of divorce or under a written instrument incident to such decree. These payments are therefore subject to tax in her hands.

Accordingly, it is held that a state court decision holding that payments made by a husband under a divorce decree constitute a settlement of a wife's property rights, rather than alimony, is not binding on the Internal Revenue Service.

(Also Section 214; 1.214–1.) Rev. Rul. 58–321

> A decree for support of an abandoned wife under section 50–16 of the General Statues of North Carolina, or under the laws of other states having similar statutory requirements in the case of nonsupport, does not constitute a legal separation within the meaning of section 71(a)(1) and section 214(c)(3) of the Internal

Revenue Code of 1954; it does, however, constitute a decree for support under section 71(a)(3) of the Code, and periodic payments thereunder are taxable to the wife.

Advice has been requested whether a decree issued under section 50–16 of the General Statutes of North Carolina, or under the laws of other states having similar statutory requirements in the case of nonsupport, results in a legal separation of a husband and wife within the meaning of section 71(a)(1) and section 214(c)(3) of the Internal Revenue Code of 1954.

In the instant case, the husband abandoned his wife and child and a court order was issued requiring him to make monthly payments toward their support.

Section 50–16 of the General Statutes of North Carolina, Vol. 2A, 1957 Cumulative Supplement, provides, in part, as follows:

50–16 Alimony without divorce.—If any husband shall separate himself from his wife and fail to provide her and the children of the marriage with the necessary subsistence according to his means and condition in life, or if he shall be a drunkard or spendthrift, or be guilty of any misconduct or acts that would be or constitute cause for divorce, either absolute or from bed and board, the wife may institute an action in the superior court of the county in which the cause of action arose to have a reasonable subsistence allotted and paid or secured from the estate or earnings of her husband, * * *

Section 71(a)(1) of the Code provides that if a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the wife's gross income includes periodic payments received after such decree in discharge of a legal obligation which is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.

Section 71(a)(3) of the Code provides that if a wife is separated from her husband, the wife's gross income includes periodic payments (whether or not made at regular intervals) received by her from her husband under a decree entered into after March 1, 1954, requiring the husband to make the payments for her support or maintenance. This section does not apply if the husband and wife make a single return jointly.

Under section 214(a) of the Code, a deduction is allowable for expenses paid for the care of certain dependents if such care is for the purpose of enabling the taxpayer to be gainfully employed. Section 214(b)(2) of the Code, applicable to working wives, provides that in the case of a woman who is married the deduction under section 214(a) of the Code shall not be allowed unless she files a joint return with her husband for the taxable year and shall be reduced by the amount (if any) by which the adjusted gross income of the taxpayer and her spouse exceeds $4,500. Section 214(b)(2) shall not apply if the taxpayer's husband is incapable of self-support because mentally or physically defective.

Section 214(c)(3) of the Code provides that a woman shall not be considered as married if she is legally separated from her spouse under a decree of divorce or of separate maintenance at the close of the taxable year.

Section 50–16 of the General Statues of North Carolina, *supra*, provides solely for support. It provides a remedy for an abandoned wife to obtain support from the estate or earnings of her husband. See *Lake D. Shore* v. *P. M. Shore*, 220 N. C. 802, 18 S. E. (2d) 353.

Two separate remedies are provided by this section, one for alimony without divorce and one for reasonable subsistence and counsel fees, *pendente lite*. See *Leola C. Oldham* v. *Lacy T. Oldham*, 225 N. C. 476, 35 S. E. (2d) 332.

Decrees issued in cases tried under section 50–16 of the North Carolina statutes are not decrees of separate maintenance but are decrees enforcing the husband's marital duty to support his wife. They are issued because of the separation. A decree in such a case is essentially a decree for support which, under section 71(a)(3) of the Code, requires the inclusion in the gross income of the wife of periodic payments received by her after August 16, 1954, under such a decree entered after March 1, 1954.

Accordingly, it is held that a decree for support of an abandoned wife issued under section 50–16 of the General Statutes of North Carolina, or under similar laws of other states, does not result in the legal separation of a husband and wife within the meaning of section 71(a)(1) and section 214(c)(3) of the Code. In such case, the wife is subject to the provisions of section 71(a)(3) of the Code, requiring her to include the periodic payments in her gross income, and to the provisions of section 214(b)(2) of the Code, limiting the deduction for expenses paid for care of certain dependents.

SECTION 72.—ANNUITIES; CERTAIN PROCEEDS OF ENDOWMENT AND LIFE INSURANCE CONTRACTS

26 CFR 1.72–2: Application of section. Rev. Rul. 58–236

An alien residing in the United States may include as his investment in the contract for an annuity, under an employees' trust established in a foreign country by a foreign corporation, the amount of the employer's contribution to the trust on his behalf for services rendered in a foreign country or in a possession of the United States. Where such annuity is a variable payment joint and survivor's annuity, the expected return multiple for one life and that for two lives are combined for the purpose of determining the amount to be excluded from gross income by the primary and survivor annuitants. If the services were rendered during a period of the married alien's domicile in a foreign country or a possession of the United States which is a community property country, the resident wife shall include in her gross income her community property share in such payments and where the wife is a United States citizen she shall include such amounts in her gross income whether or not she is resident in the United States.

Advice has been requested whether the recipients, a resident alien husband and his wife, a United States citizen, of a distribution, in the form of a joint and survivor's annuity, from an employees' trust established in a foreign country by a foreign corporation, for service rendered by the resident alien in countries other than the United States, including the Philippine Islands, may include any part of the employer's contributions to the trust as their investment in computing the consideration paid for the annuity and whether the spouse may have a community property interest in any of the annuity payments made to her husband while living.

In 1921, the taxpayer, a foreign subject, was employed by a foreign corporation for service in the Philippine Islands. His service there

was continuous until 1951, when he returned to his native country and continued his employment until his retirement at the end of 1955. In the year 1933, during his employment in the Philippine Islands, which is and was then a community property country, he married a citizen of the United States (not also a citizen of the Philippine Islands), with whom he continues to live. In 1956 the taxpayer and his spouse took up residence in the United States.

The foreign corporation established a contributory pension plan and foreign-situs trust which covered the taxpayer's entire period of employment. On January 1, 1956, pursuant to the pension plan, the taxpayer began receiving, in foreign currency payable in equal monthly amounts, a joint and survivor annuity. By the terms of the plan, if his spouse survives him, she will receive for the remainder of her life a survivor's annuity, also in foreign currency, at one-half the rate being paid to her husband. The annuity thus is considered to be a variable joint and survivor annuity within the meaning of sections 1.72–2(b)(3)(i)(b) and 1.72–5(b)(2) of the Income Tax Regulations.

Distributions of the character here involved from an employees' pension trust are taxable to the distributee in the year in which so distributed or made available, under section 72 of the Internal Revenue Code of 1954 relating to annuities except that section 72(e)(3) shall not apply. See section 402(a)(1) and (b) of the Code. Section 72 of the Code provides, in general, that gross income includes any amount received as an annuity under an annuity, endowment, or life insurance contract. However, section 72(b) of the Code states that gross income does not include that part of any amount received as an annuity, under such a contract, which bears the same ratio to such amount as the investment in the contract bears to the expected return under the contract. Section 72(f) of the Code provides that, for the purpose of computing (a) the aggregate amount of premiums or other consideration paid for the contract, (b) the consideration for the contract contributed by the employees, and (c) the aggregate premiums or other consideration paid, amounts contributed by the employer shall be included, but only to the extent that (1) such amounts were includible in the gross income of the employee, or (2) if such amounts had been paid directly to the employee at the time they were contributed they would not have been includible in the gross income of the employee under the law applicable at the time of such contribution.

In section 72(c) of the Code, the reference to the investment in the contract is in the singular, including cases where the expected return depends upon the life expectancy of one or more individuals. This compels the inference that the investment in a contract, whether or not the contract is for one life, is to be determined as a whole with respect to the entire amount of all periodic payments to be made thereunder.

In the present case, since the taxpayer was a nonresident alien during all of his employment by the foreign corporation and during his participation in the contributory pension plan, none of the compensation paid directly to him by his employer with respect to his services rendered outside the United States was includible in his gross income for Federal income tax purposes. By the same token, amounts

contributed with respect to the same services on his behalf by his employer under the pension plan would not have been includible in gross income had they been paid directly to him at the time they were contributed to the fund under the plan.

Inasmuch as community property laws prevailed in the Philippine Islands throughout the period of the alien's marriage and his employment therein and since a portion of the annuity payable to such alien for the remainder of his lifetime is attributable to services rendered by him in such islands after the date of and during his marriage, his spouse has, for Federal income tax purposes, a community property interest in all annuity payments made to such individual.

In determining the amount to be excluded from gross income as an annuity under section 72 of the Code, the investment in a contract, such as here involved, should be spread over the combined life expectancy of the taxpayer and his wife. For a joint and survivor annuity, within the meaning of section 1.72–5(b)(2) of the Income Tax Regulations, Table II of section 1.72–9 of the regulations would be used to find the expected return multiple, but, since the taxpayer's payments under the contract are to be twice those of his wife, the correct method of computation with an annuity that is variable, within the meaning of section 1.72–2(b)(3)(i)(b) of the regulations, in accordance with the rule stated in section 1.72–2(b)(3), is to take the taxpayer's expected return multiple from Table I of section 1.72–9 of the regulations, add to it the joint and survivor's multiple determined from Table II, and then divide the sum so obtained into the investment in the contract. The resultant quotient, divided by 12, will be the amount excludable from each monthly payment made to the taxpayer's wife after his death, and twice such amount will be the amount excludable from each monthly payment made to the taxpayer.

For an example, assume that the contract, in this case, provides for payments of $100 per month for the life of the taxpayer and, after his death, payments to his wife of $50 per month for the remainder of her life. As of the annuity starting date the taxpayer's age at his nearest birthday is 70 and that of his wife at her nearest birthday is 67.

Taxpayer's Multiple from Table I (male, age 70)	12.1
Joint and Survivor's Multiple from Table II (male age 70; female age 67)	19.7
Combined Expected Return Multiple	31.8

Thus, if the investment in the contract, in this example is $14,310, then 31.8 divided into $14,310 gives $450. This quotient, divided by 12, produces $37.50 which will be the amount excludable from each monthly payment made to the taxpayer's wife after his death, and twice such amount, or $75, will be the amount excludable from each monthly payment made to the taxpayer. This method of computation is analogous to that employed in example (1) of section 1.725(b)(7) of the regulations.

The amount paid to the taxpayer, which is not so excludable, is includible in his gross income to the extent of his community property interest therein. The amount paid to the taxpayer which is not excludable from gross income, to the extent of his wife's community property interest therein, will be includible in her gross income, for Federal income tax purposes, whether or not she continues to reside in the United States. Likewise, a payment made to the wife after the taxpayer's death, to the extent not excludable, will be includible in her gross income for the year in which received, whether or not she is resident in the United States.

The investment in the contract, having been made by the employer and the employee taxpayer in foreign currency, must be expressed in and should be converted to its equivalent in United States currency for purposes of determining the exclusion ratio under section 72 (b) of the Code. In making such conversion, the taxpayer is entitled, with respect to each individual employee and employer contribution to the fund on his behalf, to use the rate of exchange in effect at the time such contribution was made to the fund in converting that particular contribution to its equivalent in United States currency. If, for any reason, such method of conversion is impossible or impracticable, *e.g.*, because the rates of exchange in effect throughout the entire period of the taxpayer's participation in the fund are unknown and unascertainable, the conversion may be made at the rate of exchange in effect on the taxpayer's annuity starting date.

The amount of each monthly payment received by the taxpayer or his wife which is includible in gross income will, in accordance with section 1.72–2(b)(3)(i) of the regulations, be considered to be an amount not received as an annuity within the meaning of section 72(e) of the Code and will be wholly includible in gross income. On the other hand, if the aggregate of the monthly payments made during a taxable year to either the taxpayer or his wife after the annuity starting date, at the rate of exchange then in effect, is less in United States currency than the total of the amounts excludable from gross income under section 72 of the Code during that year, the taxpayer may, as stated in section 1.72–4(d)(3)(ii), elect in a succeeding taxable year in which he receives another payment, to redetermine the amounts to be received as an annuity during the current and succeeding taxable years in accordance with the method outlined in that section of the regulations.

Treatment of survivor benefit payments, paid in installments over a period of years, pursuant to a noncontributory, unfunded, and uninsured plan of an employer. See Rev. Rul. 58–153, page 43.

SECTION 74.—PRIZES AND AWARDS

26 CFR 1.74–1: Prizes and awards. Rev. Rul. 58–89

The Maria Moors Cabot prize award, including the $1,000 given to the recipient to appear personally, or through a personal representative, to receive and accept the prize, is an award made in recognition of literary achievements and is excludable from gross income under section 74(b) of the Internal Revenue Code of 1954.

Advice has been requested whether amounts received as a Maria Moore Cabot prize award, including $1,000 given the recipient to appear personally or through a personal representative, in recognition of outstanding public service in journalism, are excludable from gross income under section 74(b) of the Internal Revenue Code of 1954.

The Maria Moore Cabot prizes, established in 1938, are awards made annually by Columbia University to those persons, newspapers, press associations, news services or syndicates serving the profession of journalism in the Western Hemisphere, which, during a calendar year, have performed an international public service in journalism. Public service in journalism includes any material published in the news, or editorials, or a news policy which promotes mutual public understanding. Whenever possible the awards are based on exhibits of the material published which reveal that through reporting, exposition, analysis, interpretation or friendly criticism, the person, newspaper, press association, news service, or syndicate has performed an international public service in journalism.

Each prize consists of a bronze plaque and a gold medal and ribbon. In addition to the prize, the recipient receives $1,000 in order that he, or his representative, may appear to receive and accept the award.

Under the provisions of section 74(a) of the Internal Revenue Code of 1954, gross income includes amounts received as prizes or awards. However, section 74(b) of the Code excludes from gross income those prizes and awards which are primarily in recognition of religious, charitable, scientific, educational, artistic, literary or civic achievements, but only if (1) the recipient was selected without any action on his part to enter the contest or proceeding; and (2) the recipient is not required to render substantial future services as a condition to receiving the prize or award.

Accordingly, it is held that a Maria Moors Cabot prize award, including the $1,000 given to the recipient to appear personally, or through a personal representative, to receive and accept the prize is an award made in recognition of literary achievements and is excludable from gross income under section 74(b) of the Code. Compare Revenue Ruling 55–314, C. B. 1955–1, 235, which holds that certain awards, administered by the American Chemical Society (including traveling expenses to the meeting at which the awards are presented), are excludable from the gross income of the recipients.

(Also Section 3401; 31.3401(a)–1.) Rev. Rul. 58–277

An x-dollar payment presented by a labor union to each of its members who complete twenty-five years of service with the M company constitutes an award which is includible in the member's gross income. However, the payment does not represent wages within the meaning of section 3401 of the Internal Revenue Code of 1954 and is not subject to withholding of Federal income tax.

Advice has been requested relative to the tax treatment of a payment which a member of a labor union received from the union. The labor union presented each of its members who completed twenty-five years of service with the M company an award of x dollars.

Section 74 of the Internal Revenue Code of 1954 provides, in part, as follows:

(a) GENERAL RULE.—Except as provided in subsection (b) and in section 117 (relating to scholarships and fellowship grants), gross income includes amounts received as prizes and awards.

(b) EXCEPTION.—Gross income does not include amounts received as prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, * * *.

Since the award in the instant case was not made in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, it does not come within the exceptions provided by section 74(b) of the Code, but falls within the general rule provided by section 74 and is includible in gross income. See section 1.74–1 of the Income Tax Regulations.

Accordingly, it is held that an x-dollar payment presented by a labor union to each of its members who complete twenty-five years of service with the *M* Company constitutes an award which is includible in the member's gross income. However, the payment does not represent wages within the meaning of section 3401 of the Code and is not subject to withholding of Federal income tax.

The fair market value of a home received by the taxpayer as a prize for taking part in a contest is includible in the gross income of the taxpayer for the year in which title to the property is received. See Rev. Rul. 58–101, page 233.

---

26 CFR 1.74–1(a): Inclusion in gross income. Rev. Rul. 58–127

Where a taxpayer submits an entry in a contest, and wins a prize payable to his child, the amount of such prize is includible in the taxpayer's gross income for Federal income tax purposes under section 74 of the Internal Revenue Code of 1954.

Advice has been requested whether the amount of a prize awarded under the circumstances described below is includible in the taxpayer's gross income.

During the taxable year, the taxpayer prepared and submitted a winning entry in an essay contest. Pursuant to the terms of such contest, the taxpayer received a check payable to his child. The sponsor of the contest designated the prize as a "Scholarship Fund" but made no restrictions with respect to its use.

Section 74 of the Internal Revenue Code of 1954 provides, in part:

"(a) GENERAL RULE.—Except as provided in subsection (b) and in section 117 (relating to scholarships and fellowship grants), gross income includes amounts received as prizes and awards."

Section 1.74–1 of the Income Tax Regulations, in interpreting the provisions of the 1954 Code, provides, in part, that prizes and awards includible in the gross income of the recipient include amounts received from participation in contests of all types.

The basic rule in determining to whom an item of income is taxable is that income is taxable to the one who earns it. In determining that income from personal services is taxable to the person

who earns such income even though he assigns it to another, the Supreme Court of the United States, in *Helvering* v. *Paul R. G. Horst*, 311 U. S. 112, Ct. D. 1472, C. B. 1940–2, 206, stated that "The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment and hence the realization of the income by him who exercises it." In this regard, it has been held that income cannot be split merely by assigning the income itself. See *Lucas* v. *Guy C. Earl*, 281 U. S. 111.

It is not material whether the taxpayer actually acquired title to the prize. The terms of the contest constitute an anticipatory arrangement to vest income in someone other than the person whose services produced it. Since the right to receive the prize was created by the taxpayer by his submission of a winning entry, the anticipatory arrangement to vest the award in his child does not relieve him of his responsibility of accounting for such award in his gross income for Federal income tax purposes.

Accordingly, it is held that where a taxpayer submits a winning entry in a contest, the terms of which provide that the prize is payable to his child, the amount of such prize is includible in the taxpayer's gross income for Federal income tax purposes under section 74 of the Code.

PART III.—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

SECTION 101.—CERTAIN DEATH BENEFITS

26 CFR 1.101–2: Employees' death benefits. Rev. Rul. 58–153
(Also Section 72; 1.72–2.)

The amount, not in excess of $5,000, excludable from gross income under section 101(b) of the Internal Revenue Code of 1954, as a survivor benefit payment, receivable in installments over a period of years, pursuant to a noncontributory plan of an employer, shall be treated as consideration paid by the employee for purpose of section 72 of the Code. Where the amount receivable in the first three years is equal to or greater than the amount excludable, the entire amount of each installment shall be excluded from gross income until the beneficiary shall have received the total amount so excludable, not in excess of $5,000, after which all amounts received shall be included in gross income.

Rev. Rul. 57–483, C. B. 1957–2, 92, revoked.

The Internal Revenue Service has reconsidered its position with regard to the $5,000 exclusion from gross income, provided by section 101(b)(2)(A) of the Internal Revenue Code of 1954, for amounts received by a beneficiary on account of the death of an employee, which are received in installments over a period of years pursuant to a noncontributory plan of an employer.

Revenue Ruling 57–483, C. B. 1957–2, 92, states that the $5,000 exclusion from gross income provided by section 101(b)(2)(A) of the Code, for amounts received by a beneficiary on account of the death of an employee, may not be prorated over the entire period for which monthly installments of a death benefit in excess of $5,000 will be paid; but, if such payments represent amounts in which the employee had

only a forfeitable interest while living, the entire amount of each installment shall be excluded from gross income until there has been received and excluded an amount not in excess of $5,000, after which all amounts received shall be included in gross income.

Revenue Ruling 57–483, *supra*, was issued in regard to a noncontributory survivor benefit plan of an employer wherein the beneficiary, of a deceased employee participant in the plan, is to receive a total survivor benefit payment of $30,000 payable in equal installments for 60 months. No portion of the death benefit represents an amount with respect to which the employee, immediately prior to his death, possessed a nonforfeitable right to receive had he remained alive.

Section 101(b)(1) of the Code provides that gross income does not include amounts received (whether in a single sum or otherwise) by the beneficiaries or the estate of an employee, if such amounts are paid by or on behalf of an employer and are paid by reason of the death of the employee. Section 101(b)(2)(A) of the Code provides that the aggregate amounts excludable from gross income with respect to the death of an employee shall not exceed $5,000. Under the provisions of section 101(b)(2)(B) of the Code, the exclusion provided in section 101(b)(1) will not apply to any amounts with respect to which a deceased employee possessed, immediately before his death, a nonforfeitable right to receive while living. Since the employee's right to receive the death benefit, in the instant case, was not a "nonforfeitable right," the restriction of section 101(b)(2)(B) against the exclusion does not apply to the payment here involved.

Section 101(b)(2)(D) of the Code provides that, in the case of any payments to which section 72 (relating to annuities) applies, the amount excludable under section 101(b) shall be determined by reference to the value of such amount as of the day on which the employee died, and shall, for the purposes of section 72, be treated as additional consideration paid by the employee. In the instant case, the value of the payments as of the date of the employee's death, while somewhat less than $30,000, is clearly more than $5,000. Therefore, the amount excludable is $5,000, and this amount is treated as the consideration paid by the employee for the purpose of section 72; and since the employee made no other contribution, the total consideration deemed paid by the employee is $5,000. See section 1.72–2 of the Income Tax Regulations.

Section 72(d) of the Code provides, in part, that where part of the consideration is contributed by the employer and the aggregate amount receivable during the three-year period, beginning with the date an amount is first received as an annuity, is equal to or greater than the consideration contributed by the employee, then all amounts received as an annuity shall be excluded from gross income until there has been so excluded an amount equal to the consideration contributed by the employee. In the instant case, since the monthly installments of $500 each, receivable in three years, will exceed $5,000, section 72(d) applies. Therefore, all amounts received should be excluded from gross income until $5,000 has been received and so excluded, after which all amounts received shall be included in gross income. If the amount receivable in the first three years, as stated above, is less than the consideration deemed to have been contributed by the employee, the amount excludable would be computed under section 72(b) of the Code, which

provides that gross income shall not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract bears to the expected return under the contract.

Accordingly, it is held that where, on account of the death of an employee, survivor benefit payments are received in installments over a period of years, pursuant to a noncontributory plan of an employer, the amount not in excess of $5,000 excludable from gross income under section 101(b) of the Code shall be treated as consideration paid by the employee for purposes of section 72 of the Code; also, if the amount receivable in three years is equal to or greater than the amount excludable, the entire amount of each installment shall be excluded from gross income until the beneficiary has received the total amount so excludable, not in excess of $5,000, after which all amounts received shall be included in gross income. Compare Revenue Ruling 55–64, C. B. 1955–1, 228, relating to the comparable exclusion under the 1939 Code.

Revenue Ruling 57–483, *supra*, is hereby revoked.

SECTION 103.—INTEREST ON CERTAIN GOVERNMENTAL OBLIGATIONS

26 CFR 1.103–1: Interest on obligations of a State, Territory, etc.

Interest on bonds issued under District of Columbia Stadium Act of 1957. See P. L. 85–300, page 626.

SECTION 104.—COMPENSATION FOR INJURIES OR SICKNESS

26 CFR 1.104.1: Compensation for injuries or sickness.

Proceeds from insurance policies for sickness and disability where the premiums are paid by the employer. See Rev. Rul. 58–90, page 88.

SECTION 105.—AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS

26 CFR 1.105–4: Wage continuation plans. Rev. Rul. 58–43

A member of the Armed Forces on the retired list for reasons other than physical disability is not absent from work on account of personal injuries or sickness within the meaning of section 105(d) of the Internal Revenue Code of 1954. No part of the retired pay of such a member may be excluded from gross income under the provisions of that section even though he is sick or injured and hospitalized as a result thereof.

The provisions of section 402 of the Career Compensation Act of 1949, 63 Stat. 802, and chapter 61 of Title 10 of the United States Code constitute wage continuation plans for the purpose of section 1.105–4(a)(3)(i) of the Income Tax Regulations. The disability retirement pay received by a member on the retired list pursuant

to those provisions, which is in excess of the amount excluded under section 104(a)(4) of the Code may be excluded from gross income to the extent provided in section 105(d) if received before the member reaches retirement age. Section 105(d) is not applicable to any disability retirement pay received after the member reaches retirement age.

In view of sections 1.105–4(a)(3) and 1.105–4(a)(5) of the Income Tax Regulations, Revenue Ruling 57–76, C. B. 1957–1, 66, and the decision of the Supreme Court of the United States in *United States* v. *Richard W. Tyler*, 105 U. S. 244, the Internal Revenue Service has been requested to state its position with respect to the application of section 105(d) of the Internal Revenue Code of 1954 to the retired pay received by (1) military personnel who are under the mandatory retirement age of 62 and who are on the retired list for other than physical disability incurred in active service and (2) military personnel who are on the retired list for physical disability incurred in active service but whose retired pay is not wholly excluded under section 104(a)(4) of the Code by reason of the limitation in section 402(h) of the Career Compensation Act of 1949, 63 Stat. 802, 37 U. S. C. 272.

Subject to certain limitations, section 105(d) of the Code excludes from gross income amounts received by an employee pursuant to the provisions of a wage continuation plan if such amounts constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injuries or sickness.

Section 1.105–4(a) of the Income Tax Regulations provides, in part, as follows:

(3)(i). Section 105(d) applies only to amounts attributable to periods during which the employee would be at work were it not for a personal injury or sickness. Thus, an employee is not absent from work if he is not expected to work because, for example, he has reached retirement age. If a plan provides that an employee, who is absent from work on account of a personal injury or sickness, will receive a disability pension as long as he is disabled, section 105(d) is applicable to any payments which such an employee receives under this plan before he reaches retirement age, but section 105(d) does not apply to the payments which such an employee receives after he reaches retirement age.

* * * * * * *

(5). For the purpose of section 105(d), whether an employee is absent from work depends upon all the circumstances. * * * A member of the Armed Forces, who on a particular day has no assigned duties but to stand ready for duty, is absent from work if he is unable to answer any duty call that may be made upon him. * * *.

Revenue Ruling 57–76, *supra*, at page 11, states, in part as follows:

It is held that, for the purpose of excluding an employee's disability pension from gross income pursuant to section 1.105–4(a)(3)(i) of the Income Tax Regulations, 'retirement age' will be deemed to be

(1) The lowest age specified in the appropriate written * * * plan at which the employee, had he not been disabled and had he continued in such employment, would have had the right to retire without the consent of the employer and receive retirement benefits based on service to date of retirement computed at the full rate set forth in the plan, *i. e.*, without actuarial or similar reduction because of retirement before some later specified age, * * *.

Section 402 of the Career Compensation Act of 1949, supra, provides for (1) the retirement of a member of the uniformed services found to be unfit to perform the duties of his office, rank, grade, or rating, by

reason of physical disability, and (2) the payment of disability retirement pay to such member. The retired pay of such members is computed on the basis of years of active service or percentage of physical disability at the member's election. I. T. 4017, C. B. 1950–2, 12, which was amplified by Revenue Ruling 55–88, C. B. 1955–1, 241, provides that the disability retirement pay, received by members of the "uniformed services," who retire under section 402(f) of the Career Compensation Act, with an an active service disability of less than 30 percent and who elect under section 402(d) of such Act to have their disability retirement pay computed on the basis of years of active service, is excludable from gross income under section 22(b)(5) of the Internal Revenue Code of 1939 to the extent that such pay does not exceed the amount to which they would have been entitled had it been computed on the basis of percentage of disability; that any excess constitutes taxable income to the recipients.

Section 402 of the Career Compensation Act of 1949, *supra*, was repealed by the Act of August 10, 1956, Public Law 1028, 84th Cong., 70A Stat. 1, enacted as "Title 10 of the United States Code," except with respect to the rights that matured before the effective date of the Act, 70A Stat. 641, 680. However, similar retirement provisions are contained in chapter 61 of Title 10, of the United States Code, 70A Stat. 91.

Chapter 61 of Title 10, *supra*, provides that, under specific circumstances, the Secretary concerned may retire a member upon a determination that the member is unfit to perform the duties of his office, grade, rank or rating because of physical disability. Sections 1201 and 1204 of Title 10, *supra*. It also provides that if a member would otherwise qualify for such retirement except for the fact that his disability is not determined to be of a permanent nature, the Secretary shall place the member's name on the temporary disability retired list if he determines that the disability may be of a permanent nature. Sections 1202 and 1205 of Title 10, *supra*. Each member whose name is on the temporary disability retired list is required to have a physical examination at least once every 18 months to determine whether there has been a change in the disability. If it is determined that the member is physically fit to perform the duties of his office, grade, rank, and rating, he shall, with his consent, be recalled to active duty and reappointed or reenlisted. If he does not consent to such action, his status on the temporary disability retired list and his disability retired pay shall be terminated. If his name is not sooner removed from the temporary disability retired list, a final determination shall be made with respect to the member's physical condition upon the expiration of five years and he shall be retired or separated, depending on the circumstances. Sections 1210 and 1211 of Title 10, *supra*.

The retired pay of members retired under chapter 61 of Title 10, *supra*, is computed on the basis of years of active service or percentage of physical disability, at the member's election. The portion of the retired pay computed on the basis of years of service which exceeds the retired pay the member would receive if it were computed on the basis of percentage of disability is not considered a pension, annuity, or similar allowance for personal injury or sickness resulting from active service in the Armed Forces within the meaning of section 104(a)(4) of the Internal Revenue Code of 1954. Section 1403 of Title 10, *supra*.

Retirement of members of the Armed Forces, including the Army, the Nurses' Corps, the Navy and the Air Force, for reasons other than physical disability is provided for in chapters 63, 65, 365, 367, 571, 573, 865 and 867 of Title 10, *supra*. (For purposes of this ruling, provisions relating to Navy personnel are cited. However, the conclusions stated herein are applicable with respect to members of other branches of the Armed Forces under similar circumstances.)

Chapters 571 and 573 of Title 10, *supra*, contain the conditions under which officers and members of the Navy may be retired prior to the mandatory retirement age and the basis of the compensation that will be received under various circumstances. Chapter 575 of Title 10, *supra*, contains the following provisions relating to recall to active duty:

In time of war or national emergency declared by the President, the Secretary of the Navy may order any retired officer of the Regular Navy to active duty at sea or on shore. At any other time the Secretary may order such retired officer to active duty at sea or on shore only with his consent. Section 6481, Title 10, *supra*.

In time of war or national emergency the Secretary of the Navy may order to active duty any retired enlisted member of the Regular Navy. Section 6382, Title 10, *supra*.

To qualify for the exclusion under section 105(d) of the Code, the amounts received by an employee must be for "a period of absence from work" and the absence must be "on account of personal injuries or sickness."

As a result of the special employer-employee relationship between the United States Government and the Service member, he retains a certain measure of that relationship even when retired. In the *Tyler* case, *supra*, the Supreme Court held that retired officers are in the military service of the United States in the sense that they are entitled to what is known as "longevity pay." While such proposition is conceded, it has no bearing upon the question whether the retired Service member is "at work" within the meaning of section 105(d) of the Code while on the retired list.

The retired Service member may be recalled to duty but until such time no service can be required of him. The mere fact that he is subject to the remote contingency of being thus employed cannot be regarded as "work" within the purview of section 105(d) of the Code. By very definition, the retired member is no longer working. A member of the Armed Forces on the retired list is absent from work but, unless the absence is on account of personal injuries or sickness, section 105(d) does not apply.

Accordingly, it is held that a member of the Armed Forces on the retired list for reasons other than physical disability is not absent from work on account of personal injuries or sickness within the meaning of section 105(d) of the Code. No part of the retired pay of such a member may be excluded from gross income under the provisions of that section, even though he is sick or injured and hospitalized as a result thereof.

The provisions of section 402 of the Career Compensation Act of 1949, *supra*, and Chapter 61 of Title 10 of the United States Code constitute wage continuation plans for the purpose of section 1.105–4(a)(3)(i) of the Income Tax Regulations. The disability

retirement pay received by a member on the retired list pursuant to those provisions which is in excess of the amount excluded under section 104(a)(4) of the Code may be excluded from gross income to the extent provided in section 105(d) of the Code if received before the member reaches retirement age. Section 105(d) is not applicable to any disability retirement pay received after the member reaches retirement age.

Rev. Rul. 58–91

Provisions of a state statute, or of bylaws and regulations of a board of education, authorizing payments in lieu of wages to a teacher on sabbatical leave for the restoration of health constitute a wage continuation plan. The amounts received under such a plan for a period during which the teacher is, in fact, incapacitated on account of personal injuries or sickness may be excluded from gross income, subject to other limitations of section 105(d) of the Internal Revenue Code of 1954, providing such periods are not included within his normal summer, Christmas, Easter or other vacation period.

Advice is requested whether amounts which a public school teacher receives while on sabbatical leave for the purpose of rest and recuperation may be excluded from gross income under section 105(d) of the Internal Revenue Code of 1954.

In the instant case, the bylaws and regulations of a board of education provide that sabbatical leave for the restoration of health may be granted to teachers who meet certain conditions. While on such leave, the teacher is paid wages at a reduced rate. Sabbatical leave for the restoration of health is granted (when other requirements are met) upon the application of the teacher, submission of a medical report by his physician, approval of the school medical director, and the approval of the associate superintendent in charge of personnel. A person on sabbatical leave for the restoration of health may not resume his duties, prior to the expiration of the sabbatical leave, without the approval of the superintendent of schools, nor may he engage in any gainful occupation or in study for another trade or profession.

Under the provisions of section 105(d) of the Code, wages or payments in lieu of wages received by an employee pursuant to the provisions of a wage continuation plan for a period during which the employee is absent from work on account of personal injuries or sickness are excludable from gross income subject to the following limitations: (1) the exclusion does not apply to the extent that the amounts received exceed a weekly rate of $100; and (2) if the absence is due to sickness (as distinguished from injury), the exclusion does not apply to amounts attributable to the first seven calendar days of the period of absence unless the employee is hospitalized on account of sickness for at least one day during the period of absence.

Section 1.105–4(a)(2)(i) of the Income Tax Regulations provides that section 105(d) of the Code is applicable only if the wages or payments in lieu of wages are paid pursuant to a wage continuation plan; that the term "wage continuation plan" means an accident or health plan under which wages, or payments in lieu of wages, are paid to an employee for a period during which he is absent from work on account of personal injury or sickness; and that such term includes a plan under which wages are paid to an employee who is absent from

work on account of personal injury or sickness, even though the plan also provides that wages may be paid to an employee who is absent from work for reasons other than a personal injury or sickness.

Section 1.105–4(a)(3) of the Income Tax Regulations provides that section 105(d) of the Code applies only to amounts attributable to periods during which the employee would be at work were it not for a personal injury or sickness and that a teacher, who becomes sick during the summer or other vacation period when he is not expected to teach, is not entitled to any exclusion under section 105(d) of the Code for the summer or vacation period. See also Rev. Rul. 57–360, C. B. 1957–2, 97.

In accordance with section 1.105–4(a)(4) of the Income Tax Regulations, a period of absence from work shall commence the moment the employee first becomes absent from work and shall end the moment the employee first returns to work. However, the exclusion provided under section 105(d) of the Code is applicable only to payments attributable to a period of absence from work which is due to a personal injury or sickness and to payments attributable to a period when the employee would have been at work but for such personal injury or sickness.

Accordingly, it is held that provisions of a state statute, or of bylaws and regulations of a board of education, authorizing payments in lieu of wages to a teacher on sabbatical leave for the restoration of health constitute a wage continuation plan. The amounts received under such plan for periods during which the teacher is, in fact, incapacitated on account of personal injuries or sickness may be excluded from gross income, subject to other limitations of section 105(d) of the Code, providing such periods are not included within his normal summer, Christmas, Easter, or other vacation period.

Rev. Rul. 58–163

Where it is established that an employee received wages for stated periods of absence from work under an accident or health plan of his employer and can substantiate that such absences, including absences for part of a day at various intervals, were, in fact, directly due to a personal injury sustained by him, he may exclude such wages from gross income to the extent that they do not exceed a weekly rate of $100. This rule does not apply to intermittent periods of absence from work (without hospitalization) on account of sickness, in view of the seven-day limitation.

Advice has been requested whether a taxpayer, who, after returning to work following a personal injury, was required to be absent for two or three hours each day at various intervals for medical treatments directly necessitated by the injury, may exclude from his gross income the part-time pay which he receives.

Under the provisions of section 105(d) of the Internal Revenue Code of 1954, gross income does not include amounts received by an employee under an accident or health plan financed by his employer (either by contributions of the employer which were not includible in the gross income of the employee or by direct payment to the employee) if they constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injuries or sickness. Two limitations are provided in section 105(d)

of the Code, namely, (1) the exclusion does not apply to the extent that the wages received exceed a weekly rate of $100, and (2) if the absence is due to sickness, as distinguished from injury, the exclusion does not apply to amounts attributable to the first seven calendar days in the period of absence unless the employee is hospitalized on account of sickness for at least one day during such period. The seven-calendar-day waiting period does not apply if the absence from work is due to a personal injury.

Whether an absence from work is on account of personal injury is a question of fact to be established by the employee.

Accordingly, it is held that where, it is established that an employee received wages for stated periods of absence from work under an accident or health plan of his employer and can substantiate that such absences, including absences for part of a day at various intervals, were, in fact, directly due to a personal injury sustained by him, he may exclude such wages from gross income to the extent that they do not exceed a weekly rate of $100. This rule does not apply to intermittent periods of absence from work (without hospitalization) on account of sickness, in view of the seven-day limitation, as to which see section 1.105–4(c) of the Income Tax Regulations.

Rev. Rul. 58–178

Section 105(d) of the Internal Revenue Code of 1954 is not applicable to lump-sum payments received by a Federal Government employee for accumulated and current accrued annual or vacation leave when such individual resigns or retires and receives a disability annuity before reaching the normal age of retirement. The lump-sum payment so received by such employee must be included in gross income.

The provisions of Revenue Ruling 55–85, C. B. 1955–1, 15, and section 1.105–4(a)(3)(ii) of the Income Tax Regulations, relative to absence from work because of personal injuries or sickness, are distinguished.

Advice has been requested relative to (1) whether section 105(d) of the Internal Revenue Code of 1954 applies to lump-sum payments received by a Federal employee for accumulated and current accrued annual or vacation leave upon resignation or retirement for disability before the normal age of retirement, and (2) whether Revenue Ruling 55–85, C. B. 1955–1, 15, relative to absence from work because of personal injuries or sickness, is contrary to section 1.105–4(a)(3)(ii) of the Income Tax Regulations.

In the instant case, a civil service employee was hospitalized on account of sickness. He was unable to return to work and was retired on account of disability before the normal age of retirement. His disability retirement benefits are received under the Civil Service Retirement Act of May 29, 1930, 46 Stat. 469, 5 U. S. C. 691.

With respect to the lump-sum payment for accumulated and accrued annual leave, section 1 of the Act of December 21, 1944, Public Law 525, 78th Cong., 58 Stat. 845, as amended by section 4 (a) of the Act of July 2, 1953, Public Law 102, 83rd Cong., 67 Stat. 137, 5 U. S. C. 61 (b), provides, in pertinent part, as follows:

Whenever any civilian officer or employee of the Federal Government * * * is separated from the service * * * he shall be paid compensation in a lump sum for all accumulated and current accrued annual or vacation leave to which he is

entitled under existing law. Such lump-sum payment shall equal the compensation that such officer or employee would have received had he remained in the service until the expiration of the period of such annual or vacation leave * * *. If such officer or employee is reemployed * * * in the Federal Service * * * prior to the expiration of the period covered by such leave payment, he shall refund to the employing agency an amount equal to the compensation covering the period between the date of reemployment and the expiration of such leave period. * * *. The lump-sum payment herein authorized shall not be regarded, except for purposes of taxation, as salary or compensation and shall not be subject to retirement deductions.

Subject to certain limitations, section 105(d) of the Code excludes from gross income amounts received by an employee pursuant to the provisions of a wage continuation plan if such amounts constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injuries or sickness.

Section 105(d) of the Code is applicable only if the wages or payments in lieu of wages are paid pursuant to a wage continuation plan. The term "wage continuation plan" means an accident or health plan under which wages, or payments in lieu of wages, are paid to an employee for a period during which he is absent from work on account of a personal injury or sickness. In general, an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness.

The statute under which the lum-sum payment for accumulated and current accrued annual leave is made is an arrangement for compensating an employee who is separated from the service for the annual leave which he has previously earned but has not taken. It is not an arrangement for the payment of amounts to an employee in the event of personal injuries or sickness and, therefore, it is not a wage continuation plan for purposes of section 105(d) of the Code.

Accordingly, it is held that section 105(d) of the Code is not applicable to lump-sum payments received by a Federal Government employee for accumulated and current accrued annual or vacation leave when such individual resigns or retires and receives a disability annuity before reaching the normal age of retirement. The lump sum payment so received by such employee must be included in gross income.

Revenue Ruling 55–85, *supra*, provides, in part, as follows:

* * * If the absence is, in fact, due to personal injury or illness, the manner in which the absence is reflected in the records of the employing agency will not be determinative of the right of the employee to the benefit of the exclusion under such section.

Section 1.105–4(a)(3)(ii) of the Income Tax Regulations provides, in part, as follows:

(ii) Similarly, an employee who incurs a personal injury or sickness during his paid vacation is not allowed to exclude under section 105 (d) any of the vacation pay which he receives, since he is not absent from work on account of the personal injury or sickness. * * * However, if an employee who would otherwise be at work during a particular period is absent from work and his absence is in fact due to a personal injury or sickness, a payment which he receives for such period under a wage continuation plan is subject to section 105(d).

Section 1.105–4(a)(3)(ii) of the regulations deals with the situation wherein an employee is on a vacation and becomes ill. In such case, the employee is not in fact absent from work on account of

sickness since, in any event, he would not have been at work during that period.

Section 1.105–4(a)(3)(ii) of the regulations and the quoted sentence from Revenue Ruling 55–85, *supra*, deal with two entirely different situations. In the former, the employee is not in fact absent from work on account of personal injury or sickness; in the latter, the employee is in fact absent on account of personal injury or sickness. Section 1.105–4(a)(3)(ii) is concerned with the cause of absence; the quoted sentence from Revenue Ruling 55–85, *supra*, is concerned with the method or source of the payment where an employee is in fact absent from work on account of personal injury or sickness. There is no inconsistency since they deal with separate aspects of the same problem. See also Rev. Rul. 57–384, C. B. 1957–2, 100.

SECTION 106.—CONTRIBUTIONS BY EMPLOYER TO ACCIDENT AND HEALTH PLANS

26 CFR 1.106–1: Contributions by employer to accident and health plans.

Payment by employer of premiums on insurance policies covering sickness and disability of certain employees. See Rev. Rul. 58–90, page 88.

SECTION 107.—RENTAL VALUE OF PARSONAGES

26 CFR 1.107–1: Rental value of parsonages. Rev. Rul. 58–221

> Where the duties performed by an individual at a community center and temple constitute the conduct of religious worship or the ministration of sacerdotal functions according to the tenets and practices of the Jewish faith and such individual has been ordained and may perform the duties ordinarily performed by a rabbi, such individual qualifies as a "minister of the gospel" within the meaning of section 107 of the Internal Revenue Code of 1954.

Advice has been requested whether an individual who has the qualifications described below will qualify as a "minister of the gospel" within the meaning of section 107 of the Internal Revenue Code of 1954.

A certain individual is employed by a Jewish Community Center and Temple. In order to fill the post, he was required to complete post graduate religious study. He attended various theological institutions for the required time and was ordained by a theological seminary.

His duties are ordinarily, as in other synagogues, the religious duties performed by a rabbi. They include the preparation and delivery of religious sermons and the conduct of weekly and festival services for children sixteen years old and younger. Other duties consist of the religious training of youths to enable them to conduct services, the supervision of the three-year training period required for Bar Mitzvah, and the confirmation ceremonies of young people aged thir-

teen and sixteen, respectively. The remaining portion of his time is occupied with coordinating conferences with and otherwise assisting the rabbi in the performance of his work, as well as assuming some administrative responsibilities at the Center.

Section 107 of the Code provides that, in the case of a minister of the gospel, gross income does not include the rental value of a home furnished to him as part of his compensation or the rental allowance paid to him as part of his compensation to the extent used by him to rent or provide a home.

In order to qualify for the exclusion under section 107 of the Code, the home or the rental allowance must be provided as remuneration for services which are ordinarily the duties of a minister of the gospel. Such services may include the performance of sacerdotal functions, the conduct of religious worship, the administration and maintenance of religious organizations and their integral agencies, and the performance of teaching and administrative duties at the theological seminaries.

What constitutes the conduct of religious worship depends on the tenets and practices of a particular religious body constituting a church or church denomination.

As the duties here performed constitute the conduct of religious worship or the ministration of sacerdotal functions according to the tenets and practices of the Jewish faith and as the individual here considered has been ordained and does perform religious duties ordinarily performed by a rabbi, the individual is for the purpose of section 107 of the Code a minister of the gospel.

Accordingly, it is held that, where the duties performed by an individual at a community center and temple constitute the conduct of religious worship or the ministration of sacerdotal functions according to the tenets and practices of the Jewish faith and such individual has been ordained and does perform the duties ordinarily performed by a rabbi, such individual qualifies as a "minister of the gospel" within the meaning of section 107 of the Code.

SECTION 117.—SCHOLARSHIPS AND FELLOWSHIP GRANTS

26 CFR 1.117–1: Exclusion of amounts received as a scholarship or fellowship grant. Rev. Rul. 58–222

The amount received from a college by a member of its teaching staff (on sabbatical leave) while engaged in research in his particular field of interest does not constitute a scholarship or fellowship grant within the meaning of section 117 of the Internal Revenue Code of 1954. The amount so received is includible in the member's gross income as compensation.

The amount received by such member from a private (tax-exempt) foundation while engaged in such research is excludable from his gross income as a scholarship or fellowship grant to the extent provided by section 117 of the Code. Any amount received by him which is specifically designated to cover expenses for travel (including meals and lodging while traveling and an allowance for travel of his family), research, clerical help, or equipment incident to the scholarship or fellowship grant, is excludable from gross income to the extent that it is used for such purposes. Any un-

expended portion of the amount received for such expenses is includible in his gross income.

Advice has been requested whether a taxpayer on sabbatical leave from a college where he is employed may exclude from Federal income tax the amount which he received from such college for use in research in the field of psychology and an amount received from a private foundation for the same use, as well as an amount allowed by the latter organization for travel expenses.

A member of the teaching staff of a college, who was on sabbatical leave, was awarded $3,000 by such college to enable him to work out some theoretical ideas in psychology at a university within the United States, with an instructor who had a mutual interest. His activities were devoted to theoretical thinking and writing, and he had no teaching or administrative duties at the university. The college is not obligated to pay a staff member on leave; however, if the president of the college considers that a staff member has important theoretical or research problems on which to work, the college may award some financial support. The college exercised no control over the taxpayer's activities, and he was not obligated to make any reports or render any services to it.

The taxpayer also received from a private foundation, an educational and research organization exempt under section 501 (c) (3) of the Internal Revenue Code of 1954, a sum equivalent to the remainder of his normal yearly income, plus $500 to cover the travel expenses of the taxpayer and his family from their home to the university.

Section 117(a) of the Code, relating to scholarships and fellowship grants, provides that, subject to certain conditions and limitations, amounts received under such grants are excludable from gross income. The exclusion extends to the value of contributed services and accommodations (such as room, board and laundry) which are received as part of the scholarship or fellowship grant. The exclusion also applies to amounts received to cover incidental expenses for travel, research, clerical help, or equipment incident to the scholarship or fellowship to the extent that they are expended by the recipient for these purposes.

If an individual is not a candidate for a degree, section 117(b)(2) of the Code provides, in part, that amounts received under such grants are exempt from taxation if "The grantor of the scholarship or fellowship grant is an organization described in section 501(c)(3) which is exempt from tax under section 501(a) * * *." The exclusion is limited to an amount equal to $300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during such taxable year. No exclusion is allowable for a period of more than 36 months, whether or not consecutive.

In the instant case, the amount which the member of the staff received from the college where he is employed constitutes compensation for services rendered and is includible in his gross income by reason of the employer-employee relationship existing between him and the college. Accordingly, it is held that the amount received from the college by a member of its teaching staff (on sabbatical leave) while engaged in research in his particular field of interest

does not constitute a scholarship or fellowship grant within the meaning of section 117 of the Code.

The amount received by such member from the private foundation while he was engaged in such research is excludable from his gross income as a scholarship or fellowship grant to the extent provided by section 117 of the Code. Any amount received by him which is specifically designated to cover expenses for travel (including meals and lodging while traveling and an allowance for travel of his family), research, clerical help, or equipment incident to the scholarship or fellowship grant, is excludable from gross income to the extent that it is used for such purposes. Any unexpended portion of the amount received for such expenses is includible in his gross income.

---

26 CFR 1.117-2: Limitations. Rev. Rul. 58-76
(Also Section 3402.)

Grants designated "Research Fellowship," awarded by the American Heart Association, Inc., to aid specified individuals in the pursuit of a course of study preparatory to a career in cardiovascular research, are excludable from the gross income of the recipient in the manner and to the extent provided under section 117 of the Internal Revenue Code of 1954. Further, such amounts do not constitute wages subject to income tax withholding under section 3402 of the Code.

Advice has been requested as to the applicability of sections 117 and 3402 of the Internal Revenue Code of 1954 to amounts received under the circumstances described below.

The American Heart Association, Inc., an exempt organization for Federal income tax purposes, maintains a program under which it awards grants to individuals interested in furthering their training in the field of cardiovascular research. The recipients of such grants select the institutions at which their program of study leading to proficiency in the technique of research will be conducted, subject to the approval of the grantor. The subject to be investigated must also be approved by the grantor prior to the award of the fellowship. The recipient must devote his full time to his work and is not allowed to perform any duties for the institution where he is in training. Each recipient of a grant is required to file an annual report of his work with the grantor and is encouraged to publish results of his work through normal scientific channels. However, any publication will bear the statement, "This work was done during the tenure of a Research Fellowship of the American Heart Association." The grant, designated "Research Fellowship" in the instant case, is to be distinguished from other fellowships or grants awarded by the association under other titles.

Section 117(a) of the Code provides that amounts received by an individual under a scholarship or fellowship grant are excludable from gross income, with certain limitations. The limitations applicable to individuals who are not candidates for degrees are contained in subsection (b), which provides, in part, as follows:

(b) LIMITATIONS.—

(2) INDIVIDUALS WHO ARE NOT CANDIDATES FOR DEGREES.—In the case of an individual who is not a candidate for a degree * * *, subsection (a) shall

apply only if the condition in subparagraph (A is satisfied and then only within the limitations provided in subparagraph (B).

(A) CONDITIONS FOR EXCLUSION.—The grantor of the scholarship or fellowship grant is an organization described in section 501(c)(3) which is exempt from tax under section 501(a) * * *.

(B) EXTENT OF EXCLUSION.—The amount of the scholarship or fellowship grant excluded under subsection (a)(1) in any taxable year shall be limited to an amount equal to $300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during such taxable year, except no exclusion shall be allowed under subsection (a) after the recipient has been entitled to exclude under this section for a period of 36 months (whether or not consecutive) amounts received as a scholarship or fellowship grant while not a candidate for a degree * * *.

Section 1.117–1 of the Income Tax Regulations provides that to the extent that a fellowship grant exceeds the limitations of section 117(b) of the Code, it is includible in the gross income of the recipient. The application of this section of the regulations may be illustrated by the following example:

A, an individual who files his income tax return on the calendar year basis, is awarded a fellowship grant to commence January 1 of the taxable year to cover a period of three years with an annual stipend of $4800 payable at a rate of $400 each month. Under the limitations of section 117 of the Code, *A*, may exclude from his gross income for each of the three taxable years $3600 ($300 × 12) and must include in his gross income for each taxable year $1200 ($4800 minus $3600). At the end of the third year the exclusion benefit of the recipient will be exhausted as provided under section 117(b)(2) of the Code.

Section 1.117–4 of the regulations provides, in part, that amounts paid under a research grant, which represent compensation for grantor supervised services or where such research is primarily for the benefit of the grantor, are not items considered as fellowship grants. However, the fact that the recipient must furnish progress reports to the grantor or that the research may be of some benefit to the grantor shall not, of itself, be considered to destroy the essential character of such amount as a fellowship grant. See Rev. Rul. 56–419, C. B. 1956–2, 112.

The facts in the instant case indicate that the grant recipient may choose the institution in which he will study and the project to be investigated, subject to the approval of the grantor. The grantor, though it requires annual progress reports from grant recipients, awards such research fellowships for the primary purpose of enabling recipients to pursue a program of study and research in their individual capacities. Accordingly, it is held that amounts received under the grant, designated "Research Fellowship" from the American Heart Association, Inc., to aid individuals in the pursuit of a course of study preparatory to a career in cardiovascular research, are excludable from the gross income of the recipient in the manner and to the extent provided under section 117 of the Code. Further, since such amounts do not constitute wages, they are not subject to the withholding of income tax under section 3402 of the Code.

Rev. Rul. 58–179

Amounts received by an individual, not a candidate for a degree, under a fellowship grant for research purposes and travel expenses from the National Institutes of Health, an agency of the United States Government, are excludable from gross income for Federal

income tax purposes to the extent and in the manner prescribed under section 117 of the Internal Revenue Code of 1954.

Advice has been requested whether amounts received as a fellowship grant for research purposes and travel expenses under the circumstances described below are excludable from gross income for Federal income tax purposes.

The taxpayer is in receipt of a research fellowship grant awarded by the National Institutes of Health, an agency of the United States Government. The taxpayer is employed by the above-named agency. Under the grant, the taxpayer will travel to a hospital of a foreign country where he will present three or four lectures to members of his field of research, observe activities in his field carried on by the hospital, and engage in a project of research of his own choice at the hospital. The fellowship grant provides an amount to cover a specified number of months and an amount designated as travel allowance. During the period covered by the grant, the grantee will be on leave of absence from his present position and, although it is not a condition of the grant, he expects to return to this position when the period of the grant expires.

Section 117(a) of the Internal Revenue Code of 1954 provides that, subject to certain conditions and limitations, amounts received by an individual under a scholarship or fellowship grant are excludable from gross income. The limitations applicable to individuals who are not candidates for degrees are contained in subsection (b), which provides, in part, as follows:

(b) LIMITATIONS.—

* * * * * * *

(2) INDIVIDUALS WHO ARE NOT CANDIDATES FOR DEGREES.—In the case of an individual who is not a candidate for a degree * * *, subsection (a) shall apply only if the condition in subparagraph (A) is satisfied and then only within the limitations provided in subparagraph (B).

(A) CONDITIONS FOR EXCLUSION.—The grantor of the scholarship or fellowship grant is * * *, the United States, or an instrumentality thereof, * * *.

(B) EXTENT OF EXCLUSION.—The amount of the scholarship or fellowship grant excluded under subsection (a)(1) in any taxable year shall be limited to an amount equal to $300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during such taxable year * * *."

Section 1.117-1(b) of the Income Tax Regulations provides that any amount received by an individual which is specifically designated to cover expenses for travel (including meals and lodging while traveling and an allowance for travel of the individual's family), research, clerical help or equipment, is excludable from gross income, provided that such expenses are incident to a scholarship or fellowship grant which is excludable from gross income under section 117(a)(1) of the Code.

The principal issue in the instant case is whether the taxpayer will perform services during the period of the research grant which are primarily for the benefit of the grantor.

In this regard, section 1.117-4(c) of the regulations provides, in part, that amounts paid under a research grant, which represent compensation for grantor supervised employment services or where such research is primarily for the benefit of the grantor, are not items considered as fellowship grants. However, the fact that the result

of the individual's studies or research may be of some incidental benefit to the grantor shall not, of itself, be considered to destroy the essential character of such amount as a fellowship grant. The facts in the instant case indicate that the grantee recipient may choose the research area in which he will work free from the supervision of the grantor. The fact that the grantor may possibly derive some benefit from the taxpayer's research does not, of itself, affect the result. See Rev. Rul. 56–419, C. B. 1956–2, 112.

Accordingly, it is held that amounts received by an individual not a candidate for a degree, under a fellowship grant for research purposes and travel expenses from the National Institutes of Health, are excludable from gross income for Federal income tax purposes to the extent and in the manner prescribed under section 117 of the Code.

---

26 CFR 1.117–4: Items not considered as scholarships or fellowships grants.
(Also Sections 61, 3402; 1.61–2, 31.3402–(a)–(1.)

Rev. Rul. 58–322

Amounts received by the recipient of an award, which carried with it an appointment to an officially established position as a civil service employee of the United States Government, do not constitute amounts received as a fellowship grant under section 117 of the Internal Revenue Code of 1954. Such amounts are includible in gross income under section 61(a) of the Code and subject to withholding of income tax at the source on wages under section 3402 of the Code.

Advice has been requested whether the amounts received under the circumstances described below constitute amounts received as a fellowship grant subject to special tax treatment under section 117 of the Internal Revenue Code of 1954.

A candidate for a doctoral degree received an Air University Research Award from the Department of the Air Force to conduct research in the field of electronic data processing systems, one of several fields of research of interest to the Department. The research was also to be used for the candidate's doctoral dissertation. The award carried with it an appointment for a period of 12 months to an officially established position as a civil service employee of the United States Government at a salary determined by the civil service grade for which he had qualified. Before the termination of the appointment, he was required to submit a report of the results of his research which became the property of the Department of the Air Force.

Section 117(a)(1) of the Internal Revenue Code of 1954 provides that in the case of an individual, an amount received as a scholarship or a fellowship grant, including the value of contributed services and accommodations, is excludable from gross income, subject to the limitations of section 117(b) of the Code. Section 1.117–4(c) of the Income Tax Regulations provides, in part, that if any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research represents either compensation for past, present, or future employment services or payment for services which are subject to the direction or supervision of the grantor, or if the studies or research are primarily for the benefit of the grantor, such amount is not considered to be an amount received as a scholarship or a fellowship grant.

In the instant case, since the award carried with it an appointment to an officially established position as a civil service employee of the United States Government at a salary determined by the civil service grade for which he had qualified, the employer-employee relationship existed between the recipient of the award and the Department of the Air Force, and the payments he received represented compensation for services rendered. Furthermore, the research was undertaken on problems of interest to the Department as well as to the recipient of the award and he was required to submit a report of the results of his research which became the property of the Department.

Accordingly, it is held that the amounts received by the recipient of the award, which carried with it an appointment to an officially established position as a civil service employee of the United States Government are not excludable as a fellowship grant under section 117(a) (1) of the Code. The amounts are includible in his gross income under section 61(a) of the Code and subject to income tax withholding at the source on wages under section 3402 of the Code.

PART IV.—STANDARD DEDUCTION FOR INDIVIDUALS

SECTION 141.—STANDARD DEDUCTION

26 CFR 1.141–1: Standard deduction.

Treatment of taxes imposed by the City of Cincinnati Ordinance No. 42–1954 where taxpayer elects or does not elect to use the standard deduction. See Rev. Rul. 58–25, page 95.

PART V.—DEDUCTIONS FOR PERSONAL EXEMPTIONS

SECTION 151.—ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS

26 CFR 1.151–1: Deductions for personal exemptions. Rev. Rul. 58–66 (Also Section 6013.)

The marital status of individuals as determined under state law is recognized in the administration of the Federal income tax laws. Therefore, if applicable state law recognizes common-law marriages, the status of individuals living in such relationship that the state would treat them as husband and wife is, for Federal income tax purposes, that of husband and wife.

The foregoing position of the Internal Revenue Service with respect to a common-law marriage is equally applicable in the case of taxpayers who enter into a common-law marriage in a state which recognizes such relationship and who later move into a state in which a ceremony is required to initiate the marital relationship. Accordingly, a taxpayer who enters into a common-law marriage in a state which recognizes such marriages is entitled, under the provisions of section 151(b) of the Internal Revenue Code of 1954, to an exemption of $600 for his common-law wife in making a separate income tax re-

turn, provided that, for the calendar year in which the taxable year of the taxpayer begins, she has no gross income and is not the dependent of another taxpayer. Also, for the purpose of filing a joint income tax return under section 6013(a) of the Code, a common-law wife in a state which recognizes such marriages will be considered to be the taxpayer's spouse.

(Also Section 170; 1.170–1.) Rev. Rul. 58–303

Where, at the beginning of the taxable year, a taxpayer enters his father in a religious home for life, and the home determines such entrant's life expectancy to be eight years, for which period the taxpayer makes full payment in advance at the rate of $1,200 for each year, or $9,600 for his father's maintenance, such taxpayer is considered to have contributed $1,200 a year (in addition to his cash outlays each year) toward the support of his father. In those years where the sum of such amounts exceeds half of the cost of supporting his father, the taxpayer will be allowed an exemption for him as his dependent. If the father does not survive his life expectancy, no part of the advance payment retained by the home is deductible by the taxpayer as a charitable contribution.

Advice has been requested whether a taxpayer is entitled to a dependency exemption for his father and to a deduction for charitable contributions under the circumstances described below.

The taxpayer, who files his Federal income tax returns on the cash method, has placed his aged father in a religious home (an organization held to be exempt from Federal income tax) for the remainder of his life. As a condition precedent to his father's admission, the taxpayer made a lump-sum payment of $9,600 to the home for his father's maintenance. This sum was determined by the home on the basis of $1,200 a year (cost of maintaining each entrant) for the father's life expectancy of eight years from his date of entry in the home. As a further consideration of entry, the home required assignment to it of the father's only source of income, a retirement pension of $300 annually. Other expenses, such as clothing, spending money, and any surgical expenses, must be provided by the taxpayer. The home will not permit yearly payments to be made by the taxpayer, nor will any refund be made in the event the taxpayer's father does not survive his life expectancy.

Section 151(e) of the Internal Revenue Code of 1954 provides, in general, that a taxpayer may claim an exemption of $600 for each dependent (as defined in section 152 of the Internal Revenue Code of 1954) whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $600. Such exemption shall not be allowed for any dependent who has made a joint return with his spouse for the taxable year beginning in the calendar year in which the taxable year of the taxpayer begins. The term "dependent" as defined in section 152 includes the father of the taxpayer who, for the calendar year in which the taxable year of the taxpayer begins, received over half of his support from the taxpayer.

In view of the foregoing, it is held that, until the fund of $9,600 is exhausted at the rate of $1,200 a year, the taxpayer is considered to have contributed $1,200 a year (in addition to his cash outlays each year) toward the support of his father. Therefore, in those years where the sum of such amounts exceeds half of the cost of supporting

his father, the taxpayer will be allowed an exemption for him as his dependent, provided the father does not file a joint return with his spouse. If the father does not survive his life expectancy, no part of the advance payment retained by the home is deductible by the taxpayer as a charitable contribution.

SECTION 152.—DEPENDENT DEFINED

26 CFR 1.152–1: General definition of a dependent. Rev. Rul. 58–67

Federal, state or city income taxes and social security taxes paid by a dependent from his own income are not considered items of support for the purpose of determining allowable dependency exemptions for Federal income tax purposes. However, the term "support" does include church contributions as well as such other items of expense as the cost of food, shelter, clothing, medical and dental care, education, and the like. See section 1.152–1(a)(2)(i) of the Income Tax Regulations.

(Also Part II, Section 25; Regulations 118, Section 39.25–2.) Rev. Rul. 58–302

In determining who furnished over half of the support of a "dependent," support furnished in the form of lodging is measured in terms of its fair rental value.
Revenue Ruling 235, C. B. 1953–2, 23, modified.

The Internal Revenue Service has reconsidered Revenue Ruling 235, C. B. 1953–2, 23, and nonacquiescences in the decisions in *William C. Haynes et ux.* v. *Commissioner*, 23 T. C. 1046, nonacquiescence C. B. 1956–2, 10 and *Emil Blarek et ux*, v. *Commissioner*, 23 T. C. 1037, nonacquiescence C. B. 1956–2, 10, involving the issue of the fair rental value of lodging furnished by a taxpayer to a dependent, in the light of the Income Tax Regulations applicable under section 152 of the Internal Revenue Code of 1954 relating to the definition of a dependent.

Revenue Ruling 235, *supra*, was based upon sections 25 of the Internal Revenue Code of 1939, which corresponds to section 152 of the 1954 Code. The Revenue Ruling holds that in determining who furnished over half of the support of a "dependent" in a situation where several members of a household contribute to the support of the household, consideration should be given to the amount actually used in supporting the various members of the household; that expenses which are equally applicable to the support of each member of the household should be allocated equally among all such members; and that the actual expenses incurred in connection with the house owned by a taxpayer in which lodging is furnished to his parent, and not the fair rental value of such house, should be taken into account in determining whether a taxpayer furnished over half of the parent's support.

In the *Haynes* and *Blarek* cases, which were decided under section 25 of the 1939 Code, the Tax Court of the United States held that the fair rental value of lodging furnished a dependent in a house owned by the taxpayer should be included in determining whether more than

half of the support of the dependent was contributed by the taxpayer. In conformity with these decisions, the regulations promulgated under section 152 of the Code provide that the fair market value of such an item of support should be taken into consideration in measuring the amount of support furnished a dependent.

In view of the above, it is held that in determining who furnished more than half of the support of a "dependent," under section 152 of the 1954 Code or section 25 of the 1939 Code, support furnished in the form of lodging is measured in terms of its rental value. To the extent that Revenue Ruling 235 requires such lodging to be measured in terms of actual expenses incurred in connection therewith, it is hereby modified.

Acquiescences have been substituted for nonacquiescences in the *Hayes* and *Blarek* cases. See pages 5 and 3.

PART VI.—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

SECTION 161.—ALLOWANCE OF DEDUCTIONS

26 CFR 1.161: Statutory provisions; allowance of deductions. T. D. 6291[1]

Haynes and *Blarek* cases. See pages 5 and 3.

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953.

Regulations prescribed under sections 161, 162, and 168 of the Internal Revenue Code of 1954.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On July 10, 1956, notice of proposed rule making regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, under sections 161, 162, 168, and 169, relating to itemized deductions for individuals and corporations, of the Internal Revenue Code of 1954, was published in the Federal Register (21 F. R. 5091). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations (except for paragraph (c) of § 1.162–15, relating to expenditures for lobbying purposes, and §§ 1.169 to 1.169–8, inclusive, relating to amortization of grain storage facilities) are hereby adopted. Further consideration will be given to paragraph (c) of § 1.162–15 and §§ 1.169 to 1.169–8, inclusive, which continue in effect under notice of proposed rule making, before final action is taken thereon.

AUTHORITY: §§ 1.161 to 1.162–16, incl., and 1.168 to 1.168–7 incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

---

[1] The publication of this Treasury Decision in 23 F. R. 2244, dated April 5, 1958, contains (1) instructions for modifying the notice of proposed rulemaking published in 21 F. R. 5091, dated July 10, 1956, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

§ 1.161 Statutory Provisions; Allowance of Deductions.

SEC. 161. ALLOWANCE OF DEDUCTIONS.

In computing taxable income under section 63(a), there shall be allowed as deductions the items specified in this part, subject to the exceptions provided in part IX (sec. 261 and following, relating to items not deductible).

§ 1.161–1 Allowance of Deductions.—Section 161 provides for the allowance as deductions, in computing taxable income under section 63(a), of the items specified in part VI of subchapter B of chapter 1 (sections 161–175), subject to the exceptions provided in part IX (sections 261–273, relating to items not deductible). Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code of 1954 cannot again be deducted under any other provision thereof. See also section 7852(c), relating to the taking into account, both in computing a tax under subtitle A and a tax under chapter 1 or 2 of the Internal Revenue Code of 1939, of the same item of deduction.

§ 1.162 Statutory Provisions; Trade or Business: Expenses.

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) In General.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) A reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) Traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and

(3) 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. For purposes of the preceding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congressional district, Territory, or possession which he represents in Congress shall be considered his home, but amounts expended by such Members within each taxable year for living expenses shall not be deductible for income tax purposes in excess of $3,000.

(b) Charitable Contributions and Gifts Excepted.—No deductions shall be allowed under subsection (a) for any contribution or gift which would be allowable as a deduction under section 170 were it not for the percentage limtiations, or the requirements as to the time of payment, set forth in such section.

(c) Cross Reference.—For special rule relating to expenses in connection with subdividing real property for sale, see section 1237.

§ 1.162–1 Business Expenses.—(a) *In general.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, execept items which are used as the basis for a deduction or a credit under provisions of law other than section 162. 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 § 1.61–3(a). Among the items included in business expenses are management expenses, commissions (but see see section 263 and the regulations thereunder), 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 § 1.162–2), 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. No such item shall be included in business expenses, however, to the extent that it is used by the taxpayer in computing the cost of property included in its inventory or used in determining the gain or loss basis of its plant, equipment, or other property. Penalty payments with respect to Federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. In the case of any sports program to which section 114 (relating to sports programs conducted for the American National Red Cross) applies, expenses described in section 114(a)(2) shall be allowable as deductions under section 162(a) only to the extent that such expenses exceed the amount excluded from gross income under section 114(a).

(b) *Cross references.*—(1) For charitable contributions by individuals and corporations not deductible under section 162, see § 1.162–15.

(2) For items not deductible, see sections 261–273, inclusive, and regulations thereunder.

(3) For research and experimental expenditures, see section 174 and regulations thereunder.

(4) For soil and water conservation expenditures, see section 175 and regulations thereunder.

(5) For expenditures attributable to grant or loan by United States for encouragement of exploration for, or development or mining of, critical and strategic minerals or metals, see section 621 and regulations thereunder.

§ 1.162–2 Traveling Expenses.—(a) Traveling expenses include travel fares, meals and lodging, and expenses incident to travel such as expenses for sample rooms, telephone and telegram, public stenographers, etc. Only such traveling expenses as are reasonable and necessary in the conduct of the taxpayer's business and directly attributable to it may be deducted. If the trip is undertaken for other than business purposes, the travel fares and expenses incident to travel are personal expenses and the meals and lodging are living expenses. If the trip is solely on business, the reasonable and necessary traveling expenses, including travel fares, meals and lodging, and expenses incident to travel, are business expenses. For the allowance of traveling expenses as deductions in determining adjusted gross income, see section 62(2)(B) and the regulations thereunder.

(b)(1) If a taxpayer travels to a destination and while at such destination engages in both business and personal activities, traveling expenses to and from such destination are deductible only if the trip is related primarily to the taxpayer's trade or business. If the trip is primarily personal in nature, the traveling expenses to and from the destination are not deductible even though the taxpayer engages in business activities while at such destination. However, expenses while at the destination which are properly allocable to the taxpayer's trade

or business are deductible even though the traveling expenses to and from the destination are not deductible.

(2) Whether a trip is related primarily to the taxpayer's trade or business or is primarily personal in nature depends on the facts and circumstances in each case. The amount of time during the period of the trip which is spent on personal activity compared to the amount of time spent on activities directly relating to the taxpayer's trade or business is an important factor in determining whether the trip is primarily personal. If, for example, a taxpayer spends one week while at a destination on activities which are directly related to his trade or business and subsequently spends an additional five weeks for vacation or other personal activities, the trip will be considered primarily personal in nature in the absence of a clear showing to the contrary.

(c) Where a taxpayer's wife accompanies him on a business trip, expenses attributable to her travel are not deductible unless it can be adequately shown that the wife's presence on the trip has a bona fide business purpose. The wife's performance of some incidental service does not cause her expenses to qualify as deductible business expenses. The same rules apply to any other members of the taxpayer's family who accompany him on such a trip.

(d) Expenses paid or incurred by a taxpayer in attending a convention or other meeting may constitute an ordinary and necessary business expense under section 162 depending upon the facts and circumstances of each case. No distinction will be made between self-employed persons and employee. The fact that an employee uses vacation or leave time or that his attendance at the convention is voluntary will not necessarily prohibit the allowance of the deduction. The allowance of deductions for such expenses will depend upon whether there is a sufficient relationship between the taxpayer's trade or business and his attendance at the convention or other meeting so that he is benefiting or advancing the interest of his trade or business by such attendance. If the convention is for political, social or other purposes unrelated to the taxpayer's trade or business, the expenses are not deductible.

(e) Commuters' fares are not considered as business expenses and are not deductible.

§ 1.162–3 Cost of Materials.—Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only in the amount that they are actually consumed and used in the operation during the taxable year for which the return is made, provided that the costs of such materials and supplies have not been deducted in determining the net income or loss or taxable 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 to deduct from gross income the total cost of such supplies and materials as were purchased during the taxable year for which the return is made, provided the taxable income is clearly reflected by this method.

§ 1.162–4 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 an expense, provided the cost of acquisition or production or the gain or loss basis of the taxpayer's plant, equipment, or other property, as the case may be, 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, shall either be capitalized and depreciated in accordance with section 167 or charged against the depreciation reserve if such an account is kept.

§ 1.162–5 EXPENSES FOR EDUCATION.—(a) Expenditures made by a taxpayer for his education are deductible if they are for education (including research activities) undertaken primarily for the purpose of:

(1) Maintaining or improving skills required by the taxpayer in his employment or other trade or business, or

(2) Meeting the express requirements of a taxpayer's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the taxpayer of his salary, status or employment.

Whether or not education is of the type referred to in subparagraph (1) of this paragraph shall be determined upon the basis of all the facts of each case. If it is customary for other established members of the taxpayer's trade or business to undertake such education, the taxpayer will ordinarily be considered to have undertaken this education for the purposes described in subparagraph (1) of this paragraph. Expenditures for education of the type described in subparagraph (2) of this paragraph are deductible under subparagraph (2) only to the extent that they are for the minimum education required by the taxpayer's employer, or by applicable law or regulations, as a condition to the retention of the taxpayer's salary, status, or employment. Expenditures for education other than those so required may be deductible under subparagraph (1) of this paragraph if the education meets the qualifications of subparagraph (1). A taxpayer is considered to have made expenditures for education to meet the express requirements of his employer only if the requirement is imposed primarily for a bona fide business purpose of the taxpayer's employer and not primarily for the taxpayer's benefit. Except as provided in the last sentence of paragraph (b) of this section, in the case of teachers, a written statement from an authorized official or school officer to the effect that the education was required as a condition to the retention of the taxpayer's salary, status, or employment will be accepted for the purpose of meeting the requirements of this paragraph.

(b) Expenditures made by a taxpayer for his education are not deductible if they are for education undertaken primarily for the purpose of obtaining a new position or substantial advancement in position, or primarily for the purpose of fulfilling the general educational aspirations or other personal purposes of the taxpayer. The fact that the education undertaken meets express requirements for the new position or substantial advancement in position will be an important factor indicating that the eduaction is undertaken primarily for the purpose of obtaining such position or advancement, unless such education is required as a condition to the retention by the taxpayer of his present employment. In any event, if education is required of the taxpayer in order to meet the minimum requirements for qualification

or establishment in his intended trade or business or specialty therein, the expense of such education is personal in nature and therefore is not deductible.

(c) In general, a taxpayer's expenditures for travel (including travel while on sabbatical leave) as a form of education shall be considered as primarily personal in nature and therefore not deductible.

(d) If a taxpayer travels away from home primarily to obtain education the expenses of which are deductible under this section, his expenditures for travel, meals, and lodging while away from home are deductible. However, if as an incident of such trip the taxpayer engages in some personal activity such as sightseeing, social visiting or entertaining, or other recreation, the portion of the expenses attributable to such personal activity constitutes nondeductible personal or living expenses and is not allowable as a deduction. If the taxpayer's travel away from home is primarily personal, the taxpayer's expenditures for travel, meals, and lodging (other than meals and lodging during the time spent in participating in deductible educational pursuits) are not deductible. Whether a particular trip is primarily personal or primarily to obtain education the expenses of which are deductible under this section depends upon all the facts and circumstances of each case. An important factor to be taken into consideration in making the determination is the relative amount of time devoted to personal activity as compared with the time devoted to educational pursuits. Expenses in the nature of commuters' fares are not deductible.

(e) The provisions of this section may be illustrated by the following examples:

Example (1).—A is employed by an accounting firm. In order to become a certified public accountant he takes courses in accounting. Since the education was undertaken prior to the time A became qualified in his chosen profession as a certified public accountant, A's expenditures for such courses and expenses for any transportation, meals, and lodging while away from home are not deductible.

Example (2).—B, a general practitioner of medicine, takes a course of study in order to become a specialist in pediatrics. C, a general practitioner of medicine, take a 2-week course reviewing developments in several specialized fields, including pediatrics, for the purpose of carrying on his general practice. B's expenses are not deductible because the course of study qualified him for a specialty within his trade or business. C's expenses for his education and any transportation, meals, and lodging while away from home are deductible because they were undertaken primarily to improve skills required by him in his trade or business.

Example (3).—D is required by his employer (or by State law) either to read a list of books or to take certain courses giving six hours academic credit every two years in order to retain his position as a teacher. D fulfills the requirement by taking the courses and thereby receives an automatic increase in salary in his present position and salary schedule. Also, as the result of taking the prescribed courses, at the end of ten years, D receives a master's degree and becomes automatically eligible for an additional salary increase. Since D's purpose in taking the courses was primarily to fulfill the educational requirement of his employer, his expenses for such educa-

tion and transportation, meals, and lodging while away from home are deductible.

Example (4).—The facts are the same as in example (3) except that, due solely to a shortage of qualified teachers, D's employer does not enforce the prescribed educational requirements in that other teachers who do not fulfill those requirements are retained in their positions. D's expenses are nevertheless deductible.

Example (5).—E, a high school teacher of physics, in order to improve skills required by him and thus improve his effectiveness as such a teacher, takes summer school courses in nuclear physics and educational methods. E's expenses for such courses are deductible.

Example (6).—F takes summer school courses in order to improve skills required by him in his employment as a teacher. As a result of taking such courses F receives an in-grade increase in salary in his present position pursuant to a salary schedule established by the school system for which he works. F's expenditures for such courses are deductible.

Example (7).—G, a graduate student at a university, plans to become a university professor. In order to qualify as a regular faculty member, G must obtain a graduate degree. While taking the required graduate courses, G is engaged in teaching at the university. G's expenses therefor are not deductible since he has not completed the education required to become qualified as a regular faculty member at the time he takes such courses.

Example (8).—H, a self-employed tax consultant, decides to take a 1-week course in taxation, which is offered in City X, 500 miles away from his home. His primary purpose in going to X is to take the course, but he also takes a side trip to City Y (50 miles from X) for one day, takes a sightseeing trip while in X, and entertains some personal friends. H's transportation expenses to City X and return to his home are deductible but his transportation expenses to City Y are not deductible. H's expenses for meals and lodging while away from home will be allocated between his educational pursuits and his personal activities. Those expenses which are entirely personal, such as sightseeing and entertaining friends, are not deductible to any extent.

Example (9).—The facts are the same as in example (8) except that H's primary purpose in going to City X is to take a vacation. This purpose is indicated by several factors, one of which is the fact that he spends only one week attending the tax course and devotes five weeks entirely to personal activities. None of H's transportation expenses are deductible and his expenses for meals and lodging while away from home are not deductible to the extent attributable to personal activities. His expenses for meals and lodging allocable to the week attending the tax course are, however, deductible.

§ 1.162–6 Professional Expenses.—A professional man may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid or accrued 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 or accrued for office rooms, the cost of the fuel, light, water, telephone, etc., used in such offices, and the hire of office assistants. Amounts currently paid or accrued for books, furniture, and professional instru-

ments and equipment, the useful life of which is short, may be deducted.

§ 1.162–7 Compensation for Personal Services.—(a) There may be included among the ordinary and necessary expenses paid or incurred in carrying on any trade or business 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.

(b) The test set forth in paragraph (a) of this section 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. 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 shareholders, 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. 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 under 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 under 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.

(4) For disallowance of deduction in the case of certain transfers of stock pursuant to employees stock options, see section 421 and the regulations thereunder.

§ 1.162–8 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 stockholdings, and are found to be a distribution of earnings or profits, the excessive payments will be treated as a dividend. If such payments constitute payment for property, they should be treated by the payor as a capital expenditure and by the recipient as part of the purchase price. In the absence of evidence to justify other treatment, excessive payments for salaries or other compensation for personal services will be included in gross income of the recipient.

§ 1.162–9 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 which are in excess of reasonable compensation for services, are not deductible from gross income.

§ 1.162–10 CERTAIN EMPLOYEE BENEFITS.—(a) *In general.*—Amounts paid or accrued by a taxpayer 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. Amounts paid or accrued within the taxable year for dismissal wages, unemployment benefits, guaranteed annual wages, vacations, or a sickness, accident, hospitalization, medical expense, recreational, welfare, or similar benefit plan, are deductible under section 162(a) if they are ordinary and necessary expenses of the trade or business. However, except as provided in paragraph (b) of this section, such amounts shall not be deductible under section 162(a) if, under any circumstances, they may be used to provide benefits under a stock bonus, pension, annuity, profit-sharing, or other deferred compensation plan of the type referred to in section 404(a). In such an event, the extent to which these amounts are deductible from gross income shall be governed by the provisions of section 404 and the regulations issued thereunder.

(b) *Certain negotiated plans.*—(1) Subject to the limitations set forth in subparagraphs (2) and (3) below, contributions paid by an employer under a plan under which such contributions are held in a welfare trust for the purpose of paying (either from principal or income or both) for the benefit of employees, their families, and dependents, at least medical or hospital care, and pensions on retirement or death of employees, are deductible when paid as business expenses under section 162(a).

(2) For the purpose of subparagraph (1), the word "plan" means any plan established prior to January 1, 1954, as a result of an agreement between employee representatives and the Government of the

United States, during a period of Government operation, under seizure powers, of a major part of the productive facilities of the industry in which the employer claiming the deduction is engaged. The phrase "plan established prior to January 1, 1954, as a result of an agreement" is intended primarily to cover a trust established under the terms of such an agreement. It also includes a trust established under a plan of an employer, or group of employers, who, by reason of producing the same commodity, are in competition with the employers whose facilities were seized and who would therefore be expected to establish such a trust as a reasonable measure to maintain a sound position in the labor market producing the commodity. For example, if a trust was established under such an agreement in the bituminous coal industry, a similar trust established in the anthracite coal industry within a reasonable time, but before January 1, 1954, would qualify under subparagraph (1) above.

(3) If any trust described in subparagraph (2) above becomes qualified for exemption from tax under the provisions of section 501(a), the deductibility of contributions by an employer to such trust on or after any date of such qualification shall no longer be governed by the provisions of section 162, even though the trust may later lose its exemption from tax under section 501(a).

(c) *Other plans providing deferred compensation.*—For rules relating to the deduction of amounts paid to or under a stock bonus, pension, annuity, or profit-sharing plan or amounts paid or accrued under any other plan deferring the receipt of compensation, see section 404 and the regulations thereunder.

§ 1.162–11 RENTALS.—(a) If 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. For disallowance of deduction for income taxes paid by a lessee corporation pursuant to a lease arrangement with the lessor corporation, see section 110 and the regulations thereunder.

(b)(1) The cost to a lessee of erecting buildings or making permanent improvements on property of which he is the lessee is a capital investment, and is not deductible as a business expense. If the estimated useful life in the hands of the taxpayer of the building erected or of the improvements made, determined without regard to the terms of the lease, is longer than the remaining period of the lease, 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 in the term of the lease, and such deduction shall be in lieu of a deduction for depreciation. If, on the other hand, the useful life of such buildings or improvements in the hands of the taxpayer is equal to or shorter than the remaining period of the lease, this deduction shall be computed under the provisions of section 167 (relating to depreciation). Where there is a possibility that the lease may be renewed, the matter of spreading such costs over the term of the original lease, together with the renewal period or periods, depends upon the facts in the particular case, including the presence or absence of an

option of renewal and the relationship between the parties. As a general rule, unless the lease has been renewed or the facts show with reasonable certainty that the lease will be renewed, the cost or other basis of the lease, or the cost of improvements shall be spread only over the number of years the lease has to run without taking into account any right of renewal.

(2) Subparagraph (1) may be illustrated by the following examples:

Example (1).—A subsidiary corporation leases land from its parent at a fair rental for a 25-year period. The subsidiary erects on the land valuable factory buildings having a normal useful life of 50 years. These facts show with reasonable certainty that the lease will be renewed, even though the lease contains no option of renewal. Therefore, the cost of the building shall be depreciated over the estimated useful life of the buildings in accordance with section 167 and the regulations thereunder.

Example (2).—A retail merchandising corporation leases land at a fair rental from an unrelated lessor for the longest period that the lessor is willing to lease the land (30 years). The lessee erects on the land a department store having a normal useful life of 40 years. These facts do not show with reasonable certainty that the lease will be renewed. Therefore, the cost of the building shall be spread over the remaining term of the lease. An annual deduction may be made of an amount equal to the cost of the building divided by the number of years remaining in the term of the lease, and such deduction shall be in lieu of a deduction for depreciation.

§ 1.162–12 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 deducted. The purchase of feed and other costs connected with raising livestock may be treated as expense deductions insofar as such costs represent 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, with the consent of the Commissioner (see section 446 and the regulations thereunder), be determined upon the crop method, and such deductions must be taken in the taxable year in which the gross income from the crop has been realized. If a farmer does not compute income upon the crop method, the cost of seeds and young plants which are purchased for further development and cultivation prior to sale in later years may be deducted as an expense for the year of purchase, provided the farmer follows a consistent practice of deducting such costs as an expense from year to year. The preceding sentence does not apply to the cost of seeds and young plants connected with the planting of timber. See section 611 and the regulations thereunder. 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. For the treatment of soil

and water conservation expenditures as expenses which are not chargeable to capital account, see section 175 and the regulations thereunder. 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 § 1.61–4. 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 farm 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 §§ 1.61–4, 1.167 (a)–6 (b), and sections 165 and 270 and the regulations thereunder.)

§ 1.162–13 Depositors' Guaranty Fund.—Banking corporations which pursuant to the laws of the State 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.

§ 1.162–14 Expenditures for Advertising or Promotion of Good Will.—A corporation which has, for the purpose of computing its excess profits tax credit under subchapter E of chapter 2 or subchapter D of chapter 1, of the Internal Revenue Code of 1939, elected under section 733 or section 451 (applicable to the excess profits tax imposed by subchapter E of chapter 2, and subchapter D of chapter 1, respectively) to charge to capital account for taxable years in its base period expenditures for advertising or the promotion of good will which may be regarded as capital investments, may not deduct similar expenditures for the taxable year. See section 263(b). Such a taxpayer has the burden of proving that expenditures for advertising or the promotion of good will which it seeks to deduct in the taxable year may not be regarded as capital investments under the provisions of

the regulations prescribed under section 733 or section 451 of the 1939 Code. See § 35.733–2 of Regulations 112 (26 CFR (1939) Part 35) and § 40.451–2 of Regulations 130 (26 CFR (1939) Part 40).

§ 1.162–15 EXCEPTED CONTRIBUTIONS.—(a) No deduction is allowable under section 162(a) for a contribution or gift by an individual or a corporation if any part thereof is deductible under section 170. For example, if a taxpayer makes a contribution of $5,000 and only $4,000 of this amount is deductible under section 170(a) (whether because of the percentage limitation under either section 170(b)(1) or (2), the requirement as to time of payment, or both), no deduction is allowable under section 162(a) for the remaining $1,000.

(b) The limitations provided in section 162(b) and this section apply only to payments which are in fact contributions or gifts to organizations described in section 170. For example, payments by a street railway company to a local hospital (which is a charitable organization within the meaning of section 170) in consideration of a binding obligation on the part of the hospital to provide hospital services and facilities for the company's employees are not contributions or gifts within the meaning of section 170 and may be deductible under section 162(a) if the requirements of section 162(a) are otherwise satisfied. Donations to organizations other than those described in section 170 which bear a direct relationship to the taxpayer's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway company may donate a sum of money to an organization (of a class not referred to in section 170) intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars.

(c) [Reserved.]

§ 1.162–16 CROSS REFERENCE.—For special rules relating to expenes in connection with subdividing real property for sale, see section 1237 and the regulations thereunder.

§ 1.168 STATUTORY PROVISIONS; AMORTIZATION OF EMERGENCY FACILITIES.

SEC. 168. AMORTIZATION OF EMERGENCY FACILITIES.

(a) GENERAL RULE.—Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of any emergency facility (as defined in subsection (d)), based on a period of 60 months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the facility at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction above provided with respect to any month shall, except to the extent provided in subsection (f), be in lieu of the depreciation deduction with respect to such facility for such month provided by section 167. The 60-month period shall begin as to any emergency facility, at the election of the taxpayer, with the month following the month in which the facility was completed or acquired, or with the succeeding taxable year.

(b) ELECTION OF AMORTIZATION.—The election of the taxpayer to take the amortization deduction and to begin the 60-month period with the

month following the month in which the facility was completed or acquired, or with the taxable year succeeding the taxable year in which such facility was completed or acquired, shall be made by filing with the Secretary or his delegate, in such manner, in such form, and within such time, as the Secretary or his delegate may by regulations prescribe, a statement of such election.

(c) TERMINATION OF AMORTIZATION DEDUCTION.—A taxpayer which has elected under subsection (b) to take the amortization deduction provided in subsection (a) may, at any time after making such election, discontinue the amortization deduction with respect to the remainder of the amortization period, such discontinuance to begin as of the beginning of any month specified by the taxpayer in a notice in writing filed with the Secretary or his delegate before the beginning of such month. The depreciation deduction provided under section 167 shall be allowed, beginning with the first month as to which the amortization deduction does not apply, and the taxpayer shall not be entitled to any further amortization deduction with respect to such emergency facility.

(d) DEFINITIONS.—

(1) EMERGENCY FACILITY.—For purposes of this section, the term "emergency facility" means any facility, land, building, machinery, or equipment, or any part thereof, the construction, reconstruction, erection, installation, or acquisition of which was completed after December 31, 1949, and with respect to which a certificate under subsection (e) has been made. In no event shall an amortization deduction be allowed in respect of any emergency facility for any taxable year unless a certificate in respect thereof under this paragraph shall have been made before the filing of the taxpayer's return for such taxable year.

(2) EMERGENCY PERIOD.—For purposes of this section, the term "emergency period" means the period beginning January 1, 1950, and ending on the date on which the President proclaims that the utilization of a substantial portion of the emergency facilities with respect to which certifications under subsection (e) have been made is no longer required in the interest of national defense.

(e) DETERMINATION OF ADJUSTED BASIS OF EMERGENCY FACILITY.—In determining, for purposes of subsection (a) or (g), the adjusted basis of an emergency facility—

(1) There shall be included only so much of the amount of the adjusted basis of such facility (computed without regard to this section) as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1949, as the certifying authority, designated by the President by Executive Order, has certified as necessary in the interest of national defense during the emergency period, and only such portion of such amount as such authority has certified as attributable to defense purposes. Such certification shall be under such regulations as may be prescribed from time to time by such certifying authority with the approval of the President. An application for a certificate must be filed at such time and in such manner as may be prescribed by such certifying authority under such regulations, but in no event shall such certificate have any effect unless an application therefor is filed before March 24, 1951, or before the expiration of 6 months after the beginning of such construction, reconstruction, erection, or installation or the date of such acquisition, whichever is later.

(2) After the completion or acquistion of any emergency facility with respect to which a certificate under paragraph (1) has been made, any expenditure (attributable to such facility and to the period after such completion or acquistion) which does not represent construction, reconstruction, erection, installation, or acquisition included in such certificate, but with respect to which a separate certificate is made under paragraph (1), shall not be applied in adjustment of the basis of such facility, but a separate basis shall be computed therefor pursuant to paragraph (1) as if it were a new and separate emergency facility.

(f) DEPRECIATION DEDUCTION.—If the adjusted basis of the emergency facility (computed without regard to this section) is in excess of the

adjusted basis computed under subsection (e), the depreciation deduction provided by section 167 shall, despite the provisions of subsection (a) of this section, be allowed with respect to such emergency facility as if its adjusted basis for the purpose of such deduction were an amount equal to the amount of such excess.

(g) PAYMENT BY UNITED STATES OF UNAMORTIZED COST OF FACILITY.—If an amount is properly includible in the gross income of the taxpayer on account of a payment with respect to an emergency facility and such payment is certified as provided in paragraph (1), then, at the election of the taxpayer in its return for the taxable year in which such amount is so includible—

(1) The amortization deduction for the month in which such amount is so includible shall (in lieu of the amount of the deduction for such month computed under subsection (a) be equal to the amount so includible but not in excess of the adjusted basis of the emergency facility as of the end of such month (computed without regard to any amortization deduction for such month). Payments referred to in this subsection shall be payments the amounts of which are certified, under such regulations as the President may prescribe, by the certifying authority designated by the President as compensation to the taxpayer for the unamortized cost of the emergency facility made because—

(A) A contract with the United States involving the use of the facility has been terminated by its terms or by cancellation, or

(B) The taxpayer had reasonable ground (either from provisions of a contract with the United States involving the use of of the facility, or from written or oral representations made under authority of the United States) for anticipating future contracts involving the use of the facility, which future contracts have not been made.

(2) In case the taxpayer is not entitled to any amortization deduction with respect to the emergency facility, the depreciation deduction allowable under section 167 on account of the month in which such amount is so includible shall be increased by such amount, but such deduction on account of such month shall not be in excess of the adjusted basis of the emergency facility as of the end of such month (computed without regard to any amount allowable, on account of such month, under section 167 or this paragraph).

(h) LIFE TENANT AND REMAINDERMAN.—In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowable to the life tenant.

(i) CROSS REFERENCE.—For special rule with respect to gain derived from the sale or exchange of property the adjusted basis of which is determined with regard to this section, see section 1238.

§ 1.168–1 AMORTIZATION OF EMERGENCY FACILITIES; GENERAL RULE.—(a) A person (including an estate or trust (see section 642(f) and § 1.642(f)–1) and a partnership (see section 703 and § 1.703–1)) is entitled, by election, to a deduction with respect to the amortization of the adjusted basis (for determining gain) of an emergency facility, such amortization to be based on a period of 60 months. As to the adjusted basis of an emergency facility, see § 1.168–5. The taxpayer may elect to begin the 60-month amortization period with (1) the month following the month in which such facility was completed or acquired, or (2) the taxable year succeeding that in which such facility was completed or acquired (see § 1.168–2). The date on which, or the month within which, an emergency facility is completed or acquired is to be determined upon the facts in the particular case. Ordinarily, the taxpayer is in possession of all the facts and, therefore, in a position to ascertain such date. A statement of the date ascertained by the taxpayer, together with a statement of the pertinent facts relied upon,

should be filed with the taxpayer's election to take amortization deductions with respect to such facility.

(b) In no event shall an amortization deduction be allowed with respect to an emergency facility for any taxable year unless such facility has been certified prior to the date of filing of the taxpayer's return for such taxable year.

(c) In general, with respect to each month of the 60-month period which falls within the taxable year, the amortization deduction is an amount equal to the adjusted basis of the facility at the end of each month divided by the number of months (including the particular month for which the deduction is computed) remaining in the 60-month period. The adjusted basis at the end of any month shall be computed without regard to the amortization deduction for such month. The total amortization deduction with respect to an emergency facility for a particular taxable year is the sum of the amortization deductions allowable for each month of the 60-month period which falls within such taxable year. The amortization deduction taken for any month is in lieu of the deduction for depreciation which would otherwise be allowable under section 167. See, however, § 1.168–6, relating to depreciation with respect to any portion of the emergency facility not subject to amortization.

(d) This section may be illustrated by the following examples:

Example (1).—On July 1, 1954, the X Corporation, which makes its income tax returns on the calendar year basis, begins the construction of an emergency facility which is completed on September 30, 1954, at a cost of $240,000. The certificate covers the entire construction. The X Corporation elects to take amortization deductions with respect to the facility and to begin the 60-month amortization period with October, the month following its completion. The adjusted basis of the facility at the end of October is $240,000. The allowable amortization deduction with respect to such facility for the taxable year 1954 is $12,000, computed as follows:

Monthly amortization deductions:

October; $240,000 divided by 60	$4,000
November; $236,000 ($240,000 minus $4,000) divided by 59	4,000
December; $232,000 ($236,000 minus $4,000) divided by 58	4,000
Total amortization deduction for 1954	12,000

Example (2).—The Y Corporation, which makes its income tax returns on the basis of a fiscal year ending November 30, purchases an emergency facility (No. 1) on July 29, 1955. On June 15, 1955, it begins the construction of an emergency facility (No. 2) which is completed on August 2, 1955. The entire acquisition and construction of such facilities are covered by the certificate. The Y Corporation elects to take amortization deductions with respect to both facilities and to begin the 60-month amortization period in each case with the month following the month of acquisition or completion. At the end of the first month of the amortization period the adjusted basis of facility No. 1 is $300,000 and the adjusted basis of facility No. 2 is $54,000. In September 1955, facility No. 1 is damaged by fire, as a result of which its adjusted basis is properly reduced by $25,370. The allowable amortization deduction with respect to such facilities for the

taxable year ending November 30, 1955, is $21,410, computed as follows:

Facility No. 1

Monthly amortization deductions:

August; $300,000 divided by 60	$5,000
September; $269,630 ($300,000 minus $5,000 and $25,370) divided by 59	4,570
October; $265,060 ($269,630 minus $4,570) divided by 58	4,570
November; $260,490 ($265,060 minus $4,570) divided by 57	4,570
Amortization deduction for 1955	18,710

Facility No. 2

Monthly amortization deductions:

September; $54,000 divided by 60	$900
October; $53,100 divided by 59	900
November; $52,200 divided by 58	900
Amortization deduction for 1955	2,700
Total amortization deduction for 1955	21,410

Example (3).—On June 15, 1954, the Z Corporation, which makes its income tax returns on the calendar year basis, completes the construction of an emergency facility at a cost of $110,000. In its income tax return for 1954, filed on March 15, 1955, the Z Corporation elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with July 1954, the month following its completion. No certificate with respect to such facility is made until April 10, 1955, and therefore no amortization deduction with respect to such facility is allowable for any month in the taxable year 1954. The Z Corporation is entitled, however, to take a deduction for depreciation of such facility for the taxable year 1954, such deduction being assumed, for the purposes of this example, to be $2,000. Accordingly, the adjusted basis of such facility at the end of January 1955 (without regard to the amortization deduction for such month) is $108,000 ($110,000 minus $2,000). For the taxable year 1955, the Z Corporation is, with respect to such facility, entitled to an amortization deduction of $24,000, computed as follows:

Monthly amortization deductions:

January; $108,000 divided by 54	$2,000
February; $106,000 ($108,000 minus $2,000) divided by 53	2,000
March; $104,000 ($106,000 minus $2,000) divided by 52	2,000
For the remaining nine months (similarly computed)	18,000
Total amortization deduction for 1955	24,000

Since the Z Corporation elected in its return for 1954 to take amortization deductions with respect to such facility and to begin the 60-month amortization period with July 1954, it must compute its amortization deductions for the 12 months in the taxable year 1955 on the basis of the remaining months of the established 60-month amortization period, as indicated in the above computation.

§ 1.168–2 Election of Amortization.—(a) *General rule.*—An election by the taxpayer to take amortization deductions with respect

to an emergency facility and to begin the 60-month amortization period either with the month following the month in which such facility was completed or acquired, or with the taxable year succeeding the taxable year in which such facility was completed or acquired, shall be made by a statement to that effect in its return for the taxable year in which falls the first month of the 60-month amortization period so elected.

(b) *Election not made in prescribed manner.*—If the statement of election is not made by the taxpayer as prescribed in paragraph (a) of this section, it may, in the discretion of the Commissioner and for good cause shown, be made in such manner and form and within such time as may be approved by the Commissioner.

(c) *Other requirements and considerations.*—No method of making such election other than those prescribed in this section and corresponding sections of prior regulations is permitted. Any statement of election should contain a description clearly identifying each emergency facility for which an amortization deduction is claimed. A taxpayer which does not elect, in the manner prescribed in this section or corresponding sections of prior regulations, to take amortization deductions with respect to an emergency facility shall not be entitled to such deductions.

§ 1.168–3 Election to Discontinue Amortization.—(a) If a taxpayer has elected to take amortization deductions with respect to an emergency facility, it may, after such election and prior to the expiration of 60-month amortiztaion period, discontinue the amortization deductions for the remainder of the 60-month period. An election to discontinue the amortization deductions shall be made by a notice in writing filed with the district director for the district in which the return of the taxpayer is required to be filed, specifying the month as of the beginning of which the taxpayer elects to discontinue such deductions. Such notice shall be filed before the beginning of the month specified therein, and shall contain a description clearly identifying the emergency facility with respect to which the taxpayer elects to discontinue the amortization deductions. If the taxpayer so elects to discontinue the amortization deductions, it shall not be entitled to any further amortization deductions with respect to such facility.

(b) A taxpayer which thus elects to discontinue amortization deductions with respect to an emergency facility is entitled, if such facility is depreciable property under section 167 and the regulations thereunder, to a deduction for depreciation with respect to such facility. The deduction for depreciation shall begin with the first month as to which the amortization deduction is not applicable, and shall be computed on the adjusted basis of the property as of the beginning of such month (see section 1011 and the regulations thereunder).

(c) This section may be illustrated by the following example:

Example.—On July 1, 1954, the X Corporation which makes its income tax returns on the calendar year basis, purchases an emergency facility, consisting of land with a building thereon, at a cost of $306,000 of which $60,000 is allocable to the land and $246,000 to the building. The certificate covers the entire acquisition. The corporation elects to take amortization deductions with respect to the facility and to begin the 60-month amortization period with the taxable year 1955. Depreciation of the building in the amount of $6,000 is deducted and al-

lowed for the taxable year 1954. On March 25, 1956, the corporation files notice with the district director of its election to discontinue the amortization deductions beginning with the month of April 1956. The adjusted basis of the facility on January 31, 1955, is $300,000, or the cost of the facility ($306,000) less the depreciation allowed for 1954 ($6,000). The amortization deductions for the taxable year 1955 and the months of January, February, and March 1956, amount to $75,000, or $5,000 per month for 15 months. Since, at the beginning of the amortization period (January 1, 1955), the adjusted basis of the land ($60,000) is one-fifth of the adjusted basis of the entire facility ($300,000) and since there are no adjustments to basis other than on account of amortization during the period, the adjusted basis of the land should be reduced by $15,000, or one-fifth of the entire amortization deduction, and the adjusted basis of the building should be reduced by $60,000, or four-fifths of the entire amortization deduction. Accordingly, the adjusted basis of the facility as of April 1, 1956, is $225,000, of which $180,000 is allocable to the building for the purpose of depreciation deductions under section 167, and $45,000 is allocable to the land.

§ 1.168–4 DEFINITIONS.—As used in the regulations under section 168, the term—

(a) "Certifying authority" means the certifying authority designated by the President by Executive order.

(b) "Emergency facility" means any facility, land, building, machinery, or equipment, or any part thereof, the acquisition of which occurred after December 31, 1949, or the construction, reconstruction, erection, or installation of which was completed after such date, and with respect to which a certificate under section 168(e) has been made. In the case of an application for a certificate under section 168(e) which is filed after March 23, 1951, only the part of any such facility which is constructed, reconstructed, erected, or installed by any person not earlier than six months prior to the filing of such application, and which is certified in accordance with section 168(e), shall be deemed to be an emergency facility, notwithstanding that the other part of such facility was constructed, reconstructed, erected, or installed earlier than six months prior to the filing of such application. The term "emergency facility," as so defined, may include, among other things, improvements of land, such as the construction of roads, bridges, and airstrips, and the dredging of channels.

(c) "Emergency period" means the period beginning on January 1, 1950, and ending on the date on which the President proclaims that the utilization of a substantial portion of the certified emergency facilities is no longer required in the interest of national defense.

§ 1.168–5 ADJUSTED BASIS OF EMERGENCY FACILITY.—(a) *In general.*—(1) The adjusted basis of an emergency facility for the purpose of computing the amortization deduction may differ from what would otherwise constitute the adjusted basis of such emergency facility, in that it shall be the adjusted basis for determining gain (see sections 1011–1022, inclusive) and in that it may be only a portion of what would otherwise constitute the adjusted basis. It will be only a portion of such other adjusted basis if only a portion of the basis (unadjusted) is attributable to certified construction, reconstruction, erection, in-

stallation, or acquisition taking place after December 31, 1949. Also it will be only a portion of what would otherwise constitute the adjusted basis of the emergency facility if only a portion of the basis (unadjusted) is certified as attributable to defense purposes. It is therefore necessary first to determine the unadjusted basis of the emergency facility from which the adjusted basis for amortization purpose is derived.

(2) The unadjusted basis for amortization purposes is the same as the unadjusted basis otherwise determined only when the entire construction, reconstruction, erection, installation, or acquisition takes place after December 31, 1949, and is certified in its entirety by the certifying authority.

(3) In cases in which only a portion of the construction, reconstruction, erection, installation, or acquisition takes place after December 31, 1949, and that portion is certified in its entirety by the certifying authority, the unadjusted basis for the purpose of amortization is so much of the entire unadjusted basis as is attributable to the certified construction, reconstruction, erection, installation, or acquisition which takes place after December 31, 1949. For example, the X Corporation begins the construction of a facility on November 15, 1949, and such facility is completed on April 1, 1952, at a cost of $5,000,000 of which $4,600,000 is attributable to construction after December 31, 1949. The entire construction after December 31, 1949, is certified by the certifying authority. The unadjusted basis of the emergency facility for amortization purposes is therefore $4,600,000. For depreciation of the remaining portion ($400,000) of the cost, see § 1.168–6.

(4) If the certifying authority certifies only a portion of the construction, reconstruction, erection, installation, or acquisition of property which takes place after December 31, 1949, the unadjusted basis for amortization purposes is limited to such portion so certified. Assuming the same facts as in the example in subparagraph (3) of this paragraph, except that only 50 percent of the construction, reconstruction, erection, installation, or acquisition after December 31, 1949, is certified, the unadjusted basis for amortization purposes is 50 percent of $4,600,000, or $2,300,000.

(5) The adjusted basis of an emergency facility for amortization purposes is the unadjusted basis for amortization purposes less the adjustments properly applicable thereto. Such adjustments are those specified in sections 1016 and 1017, except that no adjustments are to be taken into account which increase the adjusted basis. (See paragraph (b) of this section.) If the taxpayer constructs, reconstructs, erects, installs, or acquires an emergency facility pursuant to a cost reimbursement contract with an obligation for reimbursement by the United States of all or a part of the cost of such facility, the unadjusted basis of such facility for amortization purposes shall not include that part of the cost for which the taxpayer is entitled to reimbursement, and the amount received as reimbursement shall be treated as a capital receipt. However, amounts received by a taxpayer which represent in fact compensation by reason of termination of a government contract or payment for articles under such a contract, though denominated reimbursements for all or a part of the cost of an emergency facility, are not to be treated as capital receipts but are to be taken into

account in computing income, and are therefore not to be applied in reduction of the basis of such facility.

(6) The following examples will illustrate the computation of the adjusted basis of an emergency facility for amortization purposes:

Example (1).—The X Corporation completes an emergency facility on July 1, 1954, the entire unadjusted basis of which is $500,000, and the unadjusted basis of which for the purpose of amortization is $300,000. The X Corporation elects to begin amortization as of January 1, 1955. The only adjustment to basis for the period July 1, 1954, to January 31, 1955, other than depreciation or amortization for January 1955, is $5,000 for depreciation for the last six months of 1954. The adjusted basis for the purpose of amortization is therefore $300,000 less $3,000 (300,000/500,000 × $5,000), or $297,000.

Example (2).—On July 31, 1956, the Y Corporation has an emergency facility (a building) which was completed on July 1, 1952, the entire basis of which is $500,000 and the unadjusted basis of which for the purpose of amortization is $300,000. The corporation elected to begin amortization as of January 1, 1953, at which time it was entitled to $5,000 depreciation for the last six months of 1952. On July 1, 1956, the facility was damaged by fire, as the result of which its adjusted basis is properly reduced by $200,000. The adjusted basis of the emergency facility as of July 1956 for the purpose of amortization and depreciation, and the adjusted basis for other purposes, are $23,849.18, $49,250.82, and $73,100.00, respectively, computed as follows:

	For amortization	For depreciation	For other purposes
Unadjusted basis	$300, 000. 00	$200, 000. 00	$500, 000. 00
Less depreciation to Jan. 1, 1953	3, 000. 00	2, 000. 00	5, 000. 00
Adjusted basis Jan. 1953	297, 000. 00	198, 000. 00	495, 000. 00
Less amortization for 42 months	207, 900. 00		207, 900. 00
Less depreciation for 42 months		14, 000. 00	14, 000. 00
Adjusted basis at time of fire	89, 100. 00	184, 000. 00	273, 100. 00
Less fire loss (apportioned as explained below)	65, 250. 82	134, 749. 18	200, 000. 00
Adjusted basis after fire loss	23, 849. 18	49, 250. 82	73, 100. 00

The $200,000 fire loss is applied against the adjusted basis for the purpose of amortization and the adjusted basis for the purpose of depreciation in the proportion that each such adjusted basis at the time of the fire bears to their sum, i. e., 89,100/273,100 x $200,000 or $65,250.82, against the amortization basis, and 184,000/273,100 x $200,000, or $134,749.18 against the depreciation basis.

(b) *Capital additions.*—(1) If, after the completion or acquisition of an emergency facility which has been certified by the certifying authority, further expenditures are made for construction, reconstruction, erection, installation, or acquisition attributable to such facility but not covered by such certification, such expenditures shall not be added to the adjusted basis of the emergency facility for amortization purposes under such certification. If such further expenditures are

separately certified in accordance with the provisions of section 168(e)(1) and this section, they are treated as certified expenditures in connection with a new and separate emergency facility and, if proper election is made, will be taken into account in computing the adjusted basis of such new and separate emergency facility for the purpose of amortization.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example.—On March 1, 1954, the certifying authority certifies as an emergency facility a heating plant proposed to be constructed by the Z Corporation. Such facility is completed on July 1, 1954. The Z Corporation, on August 1, 1954, begins the installation in the plant of an additional boiler, which is not included in the certification for the plant but is certified as a new and separate emergency facility. For amortization purposes, the adjusted basis of the heating plant is determined without including the cost of the additional boiler. Such cost is taken into account in computing the adjusted basis of the new and separate emergency facility (the boiler), as to which the taxpayer has a separate election for amortization purposes and a separate amortization period.

§ 1.168–6 Depreciation of Portion of Emergency Facility Not Subject to Amortization.—(a) The rule that an amortization deduction with respect to an emergency facility is in lieu of any deduction for depreciation which would otherwise be allowable under section 167 is subject to the exception provided in section 168(f). Under this exception, if the property constituting such facility is depreciable property under section 167 and the regulations thereunder and if the adjusted basis of such facility as computed under section 1011 for purposes other than the amortization deductions is in excess of the adjusted basis computed for the purpose of the amortization deductions, then the excess shall be charged off over the useful life of the facility and recovered through depreciation deductions. Thus, if the construction of an emergency facility is begun on or before December 31, 1949, and completed after such date, no amortization deductions are allowable with respect to the amount attributable to such construction on or before such date (see § 1.168–5). However, if the property constituting such facility is depreciable property under section 167 and the regulations thereunder, then the depreciation deduction provided by such section and regulations is allowable with respect to the amount attributable to such construction on or before December 31, 1949.

(b) Similarly, if only a portion of the construction, reconstruction, erection, installation, or acquisition after December 31, 1949, of an emergency facility has been certified by the certifying authority, and if such facility is depreciable property under section 167 and the regulations thereunder, then the depreciation deduction provided by such section and regulations is allowable with respect to the portion which has not been so certified.

(c) For illustration of the treatment of a depreciable portion of an emergency facility, see example (2) in § 1.168–5 (a) (6).

§ 1.168–7 Payment by United States of Unamortized Cost of Facility.—(a) Section 168 (g) contemplates that certain payments

may be made by the United States to a taxpayer as compensation for the unamortized cost of an emergency facility. If any such payment is properly includible in gross income and has been certified, as provided in section 168(g), as having been paid under the circumstances described therein, a taxpayer which is recovering the adjusted basis of an emergency facility through amortization rather than depreciation may elect to take an amount equal to such payment as an amortization deduction with respect to such facility for the month in which such payment is so includible. Such amortization deduction shall be in lieu of the amortization deduction otherwise allowable with respect to such facility for such month, but it shall not in any case exceed the adjusted basis of such facility (see § 1.168–5) as of the end of such month (computed without regard to any amortization deduction for such month). The election referred to in this paragraph shall be made in the return for the taxable year in which the amount of such payment is includible in gross income.

(b) If a taxpayer is recovering the adjusted basis of an emergency facility through depreciation rather than amortization, the depreciation deduction allowable under section 167 for the month in which the amount of any such payment is includible in gross income shall, at the taxpayer's election, be increased by such amount; but the total deduction with respect to the certified portion of such facility shall not in any case exceed the adjusted basis of such facility (computed as provided in section 168(e) and § 1.168–5 for amortization purposes) as of the end of such month (computed without regard to any amount allowable for such month under section 167 or 168(g)(2). The election referred to in this paragraph shall be made in the return for the taxable year in which the amount of such payment is includible in gross income.

(c) This section may be illustrated by the following examples:

Example (1).—On January 31, 1954, the X Corporation purchases an emergency facility at a cost of $600,000. The certificate covers the entire acquisition. The X Corporation elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with February 1954, the month following the month of acquisition. On July 15, 1955, as a result of the cancellation of certain contracts with the X Corporation, the United States makes a payment of $300,000 to the corporation as compensation for the unamortized cost of such facility. The $300,000 payment is includible in the X Corporation's gross income for July 1955. The adjusted basis of such facility for amortization purposes as of the end of July 1955, computed without regard to any amortization deduction for such month, is $430,000. Accordingly, the corporation is entitled to take an amortization deduction of $300,000 for such month, in lieu of the $10,000 amortization deduction which is otherwise allowable.

Example (2).—On November 30, 1954, the Y Corporation purchases an emergency facility, consisting of land with a building thereon, at a cost of $500,000, of which $200,000 is allocable to the land and $300,000 to the building. The certificate covers the entire acquisition. The Y Corporation does not elect to take amortization deductions with respect to such facility, but is entitled to a depreciation deduction with respect to the building at the rate of 3 percent per annum, or $750 per

month. On August 12, 1956, as a result of cancellation of certain contracts, the United States makes a payment of $400,000 to the corporation as compensation for the unrecovered cost of such facility. The $400,000 is includible in the Y Corporation's gross income for August 1956. The adjusted basis of the facility as of the end of August 1956, computed without regard to depreciation for such month, is $485,000, of which amount $200,000 is allocable to the land and $285,000 to the building. Accordingly, the corporation is entitled to increase the $750 depreciation deduction for August 1956 by the full amount of the $400,000 payment.
§§ 1.169 to 1.169–8, incl. [Reserved.]

O. Gordon Delk,
Acting Commissioner of Internal Revenue.

Approved April 3, 1958.

Fred C. Scribner, Jr.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on April 3, 1958, 5 : 15 p. m., and published in the issue of the Federal Register for April 5, 1958, 23 F. R. 2244)

SECTION 162.—TRADE OR BUSINESS EXPENSES

(Also Sections 1012, 1221; 26 CFR 1.1012–1, 1.1221–1.) Rev. Rul. 58–41

Where a mortgage is sold to the Federal National Mortgage Association by a taxpayer, such as a bank, trust company or other private source dealing in mortgages and the taxpayer under the provisions of the "Federal National Mortgage Association Charter Act" purchases stock of the association, the amount paid for the stock does not constitute a deductible business expense but must be capitalized. The basis of such stock is its cost irrespective of its fair market value, and gain or loss upon subsequent disposition of such stock constitutes a capital gain or loss. However, fees paid with respect to each mortgage are additional items of mortgage cost in determining ordinary gain or loss upon its sale.

Advice has been requested as to the basis of the stock of the Federal National Mortgage Association purchased by a taxpayer under the circumstances described below and whether amounts paid for the stock, as well as certain fees paid in connection with the sale of the mortgages to the association, constitute items of cost in determining the ordinary gain or loss upon sale of the mortgages.

A mortgage corporation sold a mortgage, in the ordinary course of its business, to the Federal National Mortgage Association. The unpaid balance of the mortgage was $200x$ dollars. In order to effect the sale, the corporation, in accordance with the provisions of section 303(b) of the Federal National Mortgage Association Charter Act, approved August 2, 1954, 68 Stat. 590, 12 U. S. C. 1716, purchased stock of the association in the amount of $6x$ dollars. The corporation was also required to pay a marketing fee of $2x$ dollars in connection with the sale of the mortgage to the association.

The Act approved August 2, 1954, as far as it is pertinent, created a Government corporation known as the "Federal National Mortgage Association" which is a constituent agency of the Housing and

Home Finance Agency. One of the purposes of the Act was to establish in the Federal Government a secondary market facility for home mortgages, and the Act provides that the operation of such facility shall be financed by private capital to the maximum extent feasible.

Section 303 of the Act provides that the Secretary of the Treasury shall initially subscribe to all the capital stock of the association. In addition section 303(b) of the Act provides in part:

> The Association shall accumulate funds for its capital surplus account from private sources by requiring each mortgage seller to make payments of nonrefundable capital contributions equal to not less than 3 per centum of the unpaid principal amount of mortgages therein involved in purchases or contracts for purchase between such seller and the association, or such greater percentage as may from time to time be determined by the association. In addition, the Association may impose charges or fees for its services with the objective that all costs and expenses of its operation should be within its income derived from such operations and that such operation should be fully self-supporting.

Section 303(c) of the Act provides in part:

> The Association shall issue, from time to time, to each mortgage seller its common stock (only in denominations of $100 or multiples thereof) evidencing any capital contributions made by the seller pursuant to subsection (b) of this section.

Section 162 of the Internal Revenue Code of 1954 allows as a deduction from gross income all the ordinary and necessary expenses incurred during a taxable year in carrying on any trade or business.

Section 1012 of the Code provides, with certain exceptions not pertinent here, that the basis of property shall be the cost of such property.

The three percent payment provided in section 303(b) of the Act is a capital contribution for which shares of stock in the association are issued and is in addition to other charges or fees (which constitute an item of mortgage cost) that the association might impose for its services to sellers of mortgages. Such payment is not in lieu of the discount at which mortgages might be acquired by the association, but would be in addition to such discount.

In *Exposition Souvenir Corporation* v. *Commissioner*, 163 Fed. (2d) 283, all applicants for concessions (including the taxpayer) at the New York World's Fair were required to invest in debenture bonds that were sold to finance the Fair. The taxpayer obtained a concession until the fair closed. Shortly thereafter, the debentures were sold at a loss. The Circuit Court of Appeals for the Second Circuit in affirming the Tax Court of the United States held that the taxpayer had made an investment in the debentures and that these represented capital assets and the loss upon their sale represented a capital loss.

Revenue Ruling 58-40, page 19, this Bulletin, holds, in part, that any gain or loss upon the sale of stock, bonds or other securities which are purchased pursuant to a contract performed by the taxpayer in the regular course of his business or are purchased solely for the purpose of obtaining inventory, under the particular arrangement there described, constitutes ordinary gain or loss, as the case may be, in the year such stock, bonds, or other securities are sold.

The facts in the instant case are closer in principle to those in the *Exposition Souvenir Corporation* case. The legislative history of the Federal National Mortgage Association Charter Act of 1954 indi-

cates that Congress intended that purchases of stock of the Association are to be treated as investments in the Association. As in the *Exposition Souvenir Corporation* case, the taxpayer is required to make such an investment and, although investing in these securities may not be his primary motive in acquiring them, they are necessarily held as investments and, as such, must be treated as capital assets.

Since, in accordance with the principles of the *Exposition Souvenir case*, the stock constitutes a capital asset, the amount paid therefor does not constitute a deductible business expense but must be capitalized. Any gain or loss upon subsequent disposition constitutes a capital gain or loss measured by the difference between the amount received and $6x$ dollars (the amount paid for the stock). With respect to the gain or loss upon sale of the mortgage to the association, ordinary gain or loss is measured by the difference between the total proceeds of $200x$ dollars and the basis of the mortgage to the corporation. The marketing fee of $2x$ dollars constitutes a cost item to be included as part of the basis of the mortgage in determining the ordinary gain or loss upon its sale.

In view of the above, it is held that (1) the payment for the stock must be capitalized and, since the stock is not an inventory item or an item held for sale to customers in the ordinary course of business, may not be valued at the lower of cost or market but must be valued at cost; (2) such stock constitutes a capital asset as defined in section 1221 of the Code and any gain or loss upon its subsequent disposition constitutes a capital gain or loss as the case may be; and (3) any marketing fees paid to the Association by the corporation constitute additional items of mortgage cost to be taken into account in the computation of the ordinary gain or loss upon the sale of the mortgage to the Association.

(Also Sections 61, 104, 106; 26 CFR 1.61–2, 1.104–1, 1.106–1.)
(Also Part II, Sections 22(a), 22(b), 23(a); Regulations 118, Sections 39.22(a)–3, 39.23(a)–6.)

Rev. Rul. 58–90

Treatment for Federal income tax purposes of amounts paid as premiums on, and amounts received as benefits under, individual insurance policies covering sickness and disability protection (1) where the premiums are paid by a corporate employer for the benefit of a key employee and (2) where the premiums are paid by an individual sole proprietor of an unincorporated business for his own benefit.

Advice has been requested as to the treatment for Federal income tax purposes of amounts paid as premiums on, and amounts received as benefits under, the two insurance policies referred to in the following examples. Neither policy is part of a group insurance plan.

Example (1). A corporation purchases an individual insurance policy for a key employee. The only benefit provided by the policy is income replacement payments in the event the employee becomes sick or disabled. The employee, who is not a stockholder in the corporation, has all the rights of ownership in the policy, and no part of the benefits under the policy are payable to the corporation. The cor-

porate employer pays the premiums on the policy only so long as the employee remains in its employ.

Example (2). An individual sole proprietor of an unincorporated business purchases for his own benefit the same type of insurance coverage described in example 1 above.

Since the facts presented in example (1) indicate that the taxpayer corporation is not directly or indirectly a beneficiary under the policy, it is concluded that the amount it pays as premiums on the insurance policy there involved may be deducted by the corporation as an ordinary and necessary business expense under section 162(a) of the Internal Revenue Code of 1954, or section 23(a)(1) of the 1939 Code, if it can be shown (1) that the premiums were paid in consideration of personal services actually rendered by the employee, and (2) that the total amount paid the employee, including the premiums, was not unreasonable compensation for his services. See G. C. M. 8432, C. B. IX–2, 114 (1930), and cases cited therein; Rev. Rul. 210, C. B. 1953–2, 114; *Arthur R. Womrath, Inc.* v. *Commissioner*, 22 B. T. A. 335; and *C. F. Smith Co.* v. *Commissioner*, T. C. Memo 1954–86.

The amount of the premiums paid by the corporation should be excluded from the gross income of the employee for taxable years beginning after December 31, 1953, and ending after August 16, 1954, under the provisions of section 106 of the 1954 Code. The amount of the premiums paid by the corporation in prior taxable years should be included in the gross income of the employee for the taxable year in which paid under the provisions of section 39.22(a)–3 of Regulations 118.

In example (2), above, the insurance premiums paid by the sole proprietor on insurance in behalf of himself are not ordinary and necessary business expenses. Instead, such amounts are personal expenses which are nondeductible under section 262 of the 1954 Code and section 24(a)(1) of the 1939 Code.

Income payments received under the above policies constitute amounts received through accident or health insurance within the meaning of sections 104(a)(3) and 105(a) of the 1954 Code and section 22(b)(5) of the 1939 Code.

It is concluded, therefore, that (1) the income payments received during taxable years to which the 1939 Code is applicable under either of the above policies may be excluded from the gross income of the insured under section 22(b)(5) of the 1939 Code; (2) the income payments received during taxable years to which the 1954 Code is applicable under the policy in example (1) may be excluded from the gross income of the insured employee to the extent provided by section 105(d) of the 1954 Code; and (3) the income payments received during taxable years to which the 1954 Code is applicable under the policy in example (2) may be excluded from the gross income of the insured sole proprietor under section 104(a)(3) of the 1954 Code.

(Also Sections 61, 3121, 3401; 26 CFR 1.61–1, 31.3121(a)–1, 31.3401(a)–1. Rev. Rul. 58–128

The provisions of Revenue Ruling 56–102, C. B. 1956–1, 90, and Revenue Ruling 56–249, C. B. 1956–1, 488, relating to supplemental

unemployment benefits, are applicable with respect to supplemental unemployment benefit plans which are similar in all material details to those involved in the cited rulings, except for having been unilaterally instituted by the employer and are not union negotiated.

Contributions made to a nonprofit corporation to be used primarily for advertising purposes for the benefit of the contributors. See Rev. Rul. 58–209, page 19.

---

26 CFR 1.162: Statutory provisions; trade or business expenses.

Regulations under the Internal Revenue Code of 1954. See T. D. 6291, page 63.

---

26 CFR 1.162–1: Business expenses. Rev. Rul. 58–238

Contributions made by an employer to a joint apprenticeship and training trust fund as a result of a collective bargaining agreement between the employer and a local union constitute ordinary and necessary business expenses and are deductible from gross income within the meaning of section 162(a) of the Internal Revenue Code of 1954.

Advice has been requested whether contributions made into a trust fund by an employer for the purpose of defraying the cost of an apprenticeship program are deductible as ordinary and necessary business expense under the provisions of section 162(a) of the Internal Revenue Code of 1954.

A trust fund was established as a result of a collective bargaining agreement between an employer and a local union, involving an apprenticeship program. The bargaining agreement provides, in part, that the employer shall pay monthly the sum of three cents per straight-time hour for all productive labor during the period into an educational and training fund for the purpose of defraying the cost of daytime schooling of apprentices and the employment of a full-time training director.

The fund so created is a trust fund pursuant to the agreement negotiated between the employer and the union. Such trust is to be administered by the board of trustees consisting of six trustees with equal representation divided between the employer and the union. In the event of a deadlock relating to the administration of the trust fund, the matter is to be referred to a disinterested party, the decision being final and binding on the trustees.

The trustees of the trust fund shall (1) see that the three-cent contribution due from the employer is paid into the fund; (2) pay and make the necessary arrangements to pay the apprentices for the time they spend in school; (3) work in coordination with the training director and the joint apprenticeship and training committee; (4) adopt reasonable regulations to provide for payment of necessary administrative expenses; (5) provide for the payment of all or any part of the cost of approved program for the training of journeymen and apprentices; and (6) accumulate such reserve funds as they in their

discretion deem necessary or desirable for the proper execution of the trust fund.

Under the trust agreement the joint apprenticeship and training fund is an irrevocable trust. Title to all monies paid therein is vested collectively in and remain exclusively in the trustees of the fund. The contributing employer, any member of the union, or the union itself, has no right, title or interest in or to the trust estate. In the event of the termination of the obligation of the employer to make contributions to the trust fund, the trustees shall apply the trust estate to the continued purposes specified in the trust agreement.

Section 162(a) of the Code provides that in computing taxable income there shall be allowed as a deduction all the ordinary and necessary business expenses.

Under the facts in the instant case, an expense of the nature involved herein relates to the regular conduct of the employer's business, the consideration for which is intended to produce benefits flowing directly to the employer in the form of more efficient and skilled employees. Furthermore, the employer is subject to a legally binding and enforceable agreement to pay fixed and determinable amounts into the trust fund controlled by the trustees, the employer does not have any reversionary interest in the assets comprising the trust fund, and none of the payments made by the employer may be diverted by the trust for any purpose.

In view of the foregoing, it is held that the contributions made by the employer to the joint apprenticeship and training fund, pursuant to a collective bargaining agreement, constitute business expenses deductible from gross income under section 162(a) of the Code in the taxable year in which paid or incurred.

Rev. Rul. 58–255

Amounts expended by a taxpayer in furtherance of a campaign to influence the adoption or defeat of legislation are not deductible, for Federal income tax purposes, as ordinary and necessary trade or business expenses within the meaning of section 162 of the Internal Revenue Code of 1954.

Reconsideration has been given to the acquiescence by the Commissioner in the decision in *Luther Ely Smith* v. *Commissioner*, 3 T. C. 696, issue 2, acquiescence, C. B. 1944, 26, involving the deductibility, for Federal income tax purposes, of a contribution to the Missouri Institute for the Administration of Justice.

In the *Smith* case, supra, the taxpayer, during the taxable year involved, contributed funds to the Missouri Institute for the Administration of Justice. The ultimate purpose of such organization was to procure the adoption of an amendment to the State Constitution relating to the selection of judges which might be of some benefit to the legal profession of which the taxpayer was a member. To this end, the Institute initiated and carried on an extensive campaign, consisting of radio broadcasts and the circulation of printed literature to the public, urging the adoption of the amendment. The expense of the campaign was defrayed by contributions to the Institute, a part of which was the contribution of the taxpayer. The Tax Court of the United States held, on the facts presented, that the amount contributed by the taxpayer was deductible as an ordinary and necessary

business expense under section 23(a)(1)(A) of the Internal Revenue Code of 1939, now section 162 of the Internal Revenue Code of 1954.

It has long been the position of the Internal Revenue Service that amounts expended in furtherance of an attempt to promote or defeat legislation, either before a legislature or before the general electorate, are not deductible, for Federal income tax purposes, as ordinary and necessary business expenses within the meaning of section 162 of the Internal Revenue Code of 1954 or corresponding provisions of the 1939 Code. This position has been sustained in *Textile Mills Securities Corporation* v. *Commissioner*, 314 U. S. 326 (1941), C. B. 1941–2, 200; *Sunset Scavenger Co., Inc.* v. *Commissioner*, 84 F. 2d 453 (9th Cir. 1936); *Revere Racing Association* v. *Scanlon*, 232 F. 2d. 816 (1st Cir. 1956); *Commarano* v. *U. S.*, 246 F. 2d. 751 (9th Cir. 1957), cert. granted March 3, 1958; and *F. Strauss & Son, Inc.* v. *Commissioner*, 251 F. 2d. 724 (8th Cir. 1958).

Inasmuch as a constitution is a general or fundamental law, an attempt to influence the adoption or rejection by the general electorate of a constitutional amendment is basically an attempt to promote or defeat legislation. Accordingly, expenditures to promote or defeat a constitutional amendment are not deductible as ordinary and necessary business expenses within the meaning of section 162 of the Code.

In view of the foregoing, the prior acquiescence in *Luther Ely Smith* v. *Commissioner*, 3 T. C. 696, C. B. 1944, 26, has been withdrawn and non-acquiescence as to issue 2 and acquiescence as to the remaining issues has been substituted therefor. See page 7.

---

26 CFR 1.162–4: Repairs. Rev. Rul. 58–278
(Also Part II, Section 23(a), Regulations 118, Section 39.23(a)–4.)

A taxpayer is entitled to file claims for refund based on currently deducting, as operating expenses, expenditures for railway roadbed pole-driving capitalized in making income tax returns for any taxable years for which the statutory period of limitation has not expired. For all taxable years ending prior to August 23, 1954, whether or not the statutory period for filing refund claims has expired, a taxpayer who has capitalized expenditures for such pole-driving may continue to amortize, through annual deductions from income, the amounts so capitalized, until they are fully amortized.

Revenue Ruling 54–356, C. B. 1954–2, 82, amplified.

Advice has been requested as to the proper application of Revenue Ruling 54–356, C. B. 1954–2, 82, in a case where a taxpayer has capitalized expenditures for poles driven into a railway roadbed to correct the effects of water pockets and mud heaves, in making income tax returns for taxable years which include years for which the statutory period of limitations on refund of tax has expired.

Revenue Ruling 54–356, *supra*, is based on the United States Court of Claims decision of June 2, 1953, in the case of *Kansas City Southern Railway Company et al.* v. *United States*, 112 Fed. Supp. 164, which involved the taxable calendar year 1940. It is also based on the position of the Internal Revenue Service in allowing current deductions, as operating expenses, for expenditures for pressure-grouting, which

is of more permanent effect than pole-driving in stabilizing a railway roadbed.

Under the Court of Claims decision in the Kansas City Southern Railway Company case, *supra*, the taxpayer was allowed to currently deduct, as maintenance expense, pole-driving expenditures incurred in 1940. It and other taxpayers are entitled, under the principle of that decision adopted in Revenue Ruling 54–356, *supra*, to so deduct such expenditures for any open taxable year. In view of the foregoing and since the Internal Revenue Service had been allowing expenditures for pressure-grouting, which is of more permanent effect than pole-driving in stabilizing a railway roadbed, to be currently deducted as operating expenses, but requiring capitalization of pole-driving expenditures prior to the publication of that ruling on August 23, 1954, it is held that Revenue Ruling 54–356, *supra*, is properly applicable as follows:

(a) For all open taxable years for which the statutory period of limitation has not expired, a taxpayer is entitled to file claims for refund based on currently deducting, as operating expenses, expenditures for railway roadbed pole-driving capitalized in making income tax returns for those years.

(b) A taxpayer who has capitalized expenditures for such pole-driving may for all taxable years ending prior to the publication of Revenue Ruling 54–356, *supra*, whether or not the statutory period for filing claims for refund has expired, continue to amortize the amounts so capitalized, through annual deductions from income, until they are fully amortized.

SECTION 163.—INTEREST

26 CFR 1.163–1: Interest deduction in general. Rev. Rul. 58–129

An amount designated "interest on mortgage" paid by a home purchaser does not constitute deductible interest, within the meaning of section 163 of the Internal Revenue Code of 1954, where such amount applies to a period of occupancy of the home by the purchaser prior to the date on which he assumed an enforceable liability on the mortgage.

Advice has been requested whether a taxpayer may deduct as interest, under section 163 of the Internal Revenue Code of 1954, an amount he paid at final settlement on the purchase of a personal residence under the circumstances described below.

The taxpayer, during the taxable year, entered into negotiations for the acquisition of a new house. For several months prior to the date of final settlement, the taxpayer occupied such dwelling pursuant to an agreement, executed with the builder, which stated that as of the date of occupancy all interest, taxes and insurance premiums on the property would be prorated. Upon final settlement, the settlement papers included an item of $25x$ dollars to cover "interest on the mortgage" from the date of occupancy to the date of final settlement.

The issue in the instant case is whether the taxpayer, in computing his taxable income, may deduct the amount of $25x$ dollars as interest paid within the taxable year on an indebtedness.

Section 163(a) of the Code provides for the deduction, with certain exceptions, of all interest paid or accrued within the taxable year on indebtedness. In *Old Colony Railroad Company* v. *Commissioner*, 284 U. S. 552, Ct. D. 456, C. B. XI–I, 274 (1932), the Supreme Court

of the United States stated that interest is "the amount which one has contracted to pay for the use of borrowed money."

In order for interest to be deductible, it must be paid on an indebtedness; that is, there must be an existing, valid or enforceable obligation, on the part of the taxpayer, to pay a principal sum and to pay interest thereon to a bona fide creditor. In *Solomon N. Seale and Yvonne F. Seale* v. *Commissioner*, Tax Court Memorandum Opinion, entered January 18, 1950, the Tax Court of the United States held that the taxpayer could not deduct interest on a farm mortgage even though he had substantial control over such farm, inasmuch as his mother had legal title and was liable on the mortgage. In *William Ainslie Colston* v. *Burnet*, 59 Fed. (2d) 867, certiorari denied, 287 U. S. 640, the court disallowed deduction of interest paid by petitioner on a mortgage on a home given by him to his wife where such mortgage was in his wife's name. In remarking on the fact that the interest was not paid on the taxpayer's own obligation, the court stated, in part:

* * * it is not necessary to cite authority to the effect that voluntary payment by him or her taxes or of interest primarily due by her should not entitle him to a deduction therefor under the revenue laws.

The facts of the instant case indicate that the amount paid by the taxpayer does not represent interest on his indebtedness, inasmuch as his liability for the mortgage indebtedness did not arise until settlement was made on the property. The item of 25*x* dollars appears to be in the nature of a charge for rent imposed by the builder, to cover the period of occupancy before the taxpayer became the owner of the property.

Accordingly, it is held that an amount designated "interest on mortgage" paid by a home purchaser does not constitute deductible interest, within the meaning of section 163 of the Code, where such amount applies to a period of occupancy of the home by the purchaser prior to the date on which he assumed an enforceable liability on the mortgage.

(Also Section 6601: 301.6601.1.) Rev. Rul. 58–239

To the extent that additional taxes, penalty and interest have been assessed for one or more years against a taxpayer whose income is reported on the cash method of accounting, a partial payment thereon tendered to the District Director of Internal Revenue and accepted by him with specific directions by the taxpayer as to its application will be applied, as a general rule, in accordance with such directions. Amounts tendered in partial payments of assessed deficiencies or deficiencies mutually agreed to as to amount of liability but unassessed at the time of tender, for one or more years, without instructions from the taxpayer, will be applied by the District Director first to tax, penalty and interest in that order, due for the earliest year, then to tax, penalty and interest for the next succeeding year until the payment is absorbed. Interest satisfied by such partial payments will be deductible for Federal income tax purposes for the year in which it is paid.

Advice has been requested relative to the application, by a District Director of Internal Revenue, of a partial payment of tax, penalty and interest, assessed for one or more years, made by a taxpayer regularly employing the cash receipts and disbursements method of ac-

counting, and whether the interest, if any, satisfied by such partial payment is deductible for Federal income tax purposes in the year in which it is paid.

Where additional taxes, penalty and interest are assessed for one or more years against a taxpayer whose income is reported on the cash method of accounting, a partial payment thereon tendered to and accepted by the District Director of Internal Revenue with specific directions by the taxpayer as to its application, will be applied, as a general rule, in accordance with such directions. The amount of interest satisfied by such a partial payment will be deductible in computing taxable income for the year in which the payment is made.

Where an assessment is made for one or more years and there are no specific instructions as to the application of the partial payment tendered by the taxpayer, the amount of the payment will be applied by the District Director first to tax, penalty and interest, in that order, for the earliest year, then to tax, penalty and interest, in that order, for the next succeeding year, until the payment is absorbed. The portion of the payment applied to interest for any year will be deductible in computing taxable income for the year in which the partial payment is made.

Amounts tendered, in partial payment of deficiencies mutually agreed to as to the amount of liability but unassessed at the time of the tender, for one or more years, without instructions from the taxpayer, as to the application of the payment, will be applied by the District Director first to tax, penalty and interest, in that order, due for the earliest year, the interest to be computed under the applicable provisions of law, then to tax, penalty and interest, in that order, for the next succeeding year until the payment it absorbed. The deficiencies and interest will be immediately assessed and notice and demand issued for any unpaid tax and interest due for any year. The portion of the payment applied to interest for any year will be deductible in computing taxable income for the year in which the partial payment is made. However, where a lump sum is accepted in compromise of tax, penalty and interest, which sum is less than the principal amount of the tax and penalty claimed by the Government, no part of the amount of such compromise is deductible as interest. See I. T. 3852, C. B. 1947–1, 15.

SECTION 164.—TAXES

26 CFR 1.164–1: Deduction for taxes. Rev. Rul. 58–25
(Also Section 141; 1.141–1.)

The tax imposed by the City of Cincinnati Ordinance No. 42–1954 constitutes an income tax and, where imposed upon and paid by an individual on the net profits of a business owned by him and conducted in Cincinnati, is not deductible in determining adjusted gross income, but is deductible in computing taxable income, provided that the taxpayer does not elect to claim the standard deduction. Furthermore, such tax imposed upon and paid by a partnership on the net profits of its business conducted in Cincinnati is deductible in determining taxable income of the partnership and the individual partners are not precluded from electing to claim the standard deduction. Such tax imposed upon a resident's share of the net profits of an unincorporated business not attributable to Cincinnati, and paid by such resident, is not deductible in computing adjusted

gross income, but is deductible in determining taxable income, provided that the taxpayer does not elect to claim the standard deduction.

I. T. 3829, C. B. 1946–2, 38 and Revenue Ruling 54–598, C. B. 1954–2, 121, distinguished.

Advice has been requested whether the earned income tax, imposed by the City of Cincinnati Ordinance No. 42–1954 with respect to income during the period April 1, 1954, to October 31, 1954, both inclusive, is deductible as a business expense by unincorporated businesses, proprietorships and partnerships when the individual or partner elects to take the standard deduction on their individual Federal income tax returns.

Under section 2 of the City of Cincinnati Earned Income Tax Ordinance No. 42–1954, as far is applicable, a tax is levied at the rate of 1 percent upon the net profits of all unincorporated businesses, etc., as follows:

(3) On the net profits of all unincorporated businesses, professions, or other activities, on sales made, work done, and services performed, or businesses or other activities conducted in the City of Cincinnati, whether or not such unincorporated businesses, professions, or other activities have an office or place of business in the City of Cincinnati.

(4) On a resident's share of the net profits of an unincorporated business, profession, or other activity whether located in or outside the City of Cincinnati, not attributable to Cincinnati, under the formula or separate accounting method provided for herein.

Section 1 of the ordinance defines "net profits" as "the net gain from the operation of a business, profession, or enterprise after provision for all ordinary and necessary expenses paid or incurred in the conduct thereof, except taxes imposed by the Ordinance and the Federal taxes based on income." Section 1 also defines a "business" as "an enterprise, activity, profession, or undertaking of any nature conducted for profit or ordinarily conducted for profit, whether by an individual, copartnership, association, corporation, or any other entity."

Section 3 of Article II–C of the Earned Income Tax Regulations provides, "The tax imposed on unincorporated businesses owned by two or more persons is upon the entity rather than the individual members or owners thereof but the tax imposed on an unincorporated business owned by one person is upon the individual owner."

Section 1 of Article II–D of the Earned Income Tax Regulations provides, "In the case of a resident individual partner or part owner of an unincorporated business, profession or other activity, there is imposed a tax of one percent (1%) on such individual's distributive share of net profits earned during the period April 1, 1954, to October 31, 1954, both inclusive, and not attributable to Cincinnati under the formula or separate accounting method provided for in section 2 of the Ordinance and not taxed against the entity."

In general, as provided in sections 161 and 164(a) of the Internal Revenue Code of 1954, in computing taxable income under section 63(a) of the Code, there shall be allowed as a deduction taxes paid or accrued within the taxable year.

Section 141 of the Code provides that, in the case of an individual, the standard deduction referred to in section 63(b) of the Code shall be an amount equal to 10 percent of the adjusted gross income, or $1,000, whichever is the lesser, except that in the case of a separate

return by a married individual, the standard deduction shall not exceed $500. An individual may elect to take such deduction in lieu of all nonbusiness deductions, that is, deductions other than those allowable under section 62 of the Code, and in lieu of certain other credits allowable had he not so elected. See section 1.141–1(c) of the Income Tax Regulations.

Section 62 of the Code defines adjusted gross income in the case of an individual as gross income minus trade or business expenses, as well as minus certain other specified items.

Section 1.62–1(d) of the Income Tax Regulations, in defining adjusted gross income provides, in part:

> * * * To be deductible for the purpose of determining adjusted gross income, expenses must be those directly, and not those merely remotely, connected with the conduct of a trade or business. For example, taxes are deductible in arriving at adjusted gross income only if they constitute expenditures directly attributable to a trade or business or to property from which rents or royalties are derived. Thus, property taxes paid or incurred on real property used in a trade or business are deductible but State taxes on net income are not deductible even though the taxpayer's income is derived from the conduct of a trade or business.

A general income tax has been held not deductible in computing adjusted gross income. See, for example, I. T. 3370, C. B. 1940–1, 32, and I. T. 3722, C. B. 1945, 78, relating to the treatment of the income tax imposed by the City of Philadelphia. See also I. T. 3753, C. B. 1945, 82, relating to the treatment of the New York temporary emergency tax on net incomes of unincorporated businesses.

However, certain State taxes pertaining to income have been held deductible in computing adjusted gross income in the case of an individual taxpayer engaged in a trade or business. See, for example, I. T. 3766, C. B. 1945, 83, as modified by I. T. 3829, C. B. 1946–2, 38, which involve the Indiana gross income tax. It was further stated in these published rulings that such tax paid by a partnership is deductible under section 23(c) of the 1939 Code in computing partnership income. Section 22(n) of the 1939 Code was not applicable since in the case of a partnership, no provision was made for the computation of adjusted gross income.

Similar conclusions were reached with respect to an annual license fee imposed by the City of Louisville, Ky., upon every person, association, corporation, or other entity engaged in an occupation, trade, profession, or other activity for the privilege of engaging in such activity. See Revenue Ruling 54–598, C. B. 1954–2, 121, which holds that any such tax paid by a partnership is deductible from partnership gross income but that such deduction shall not preclude the partners from claiming the standard deduction. It further holds that any such tax imposed upon the profits of a sole proprietorship is deductible in computing the taxpayer's adjusted gross income since it is directly attributable to a trade or business carried on by taxpayer.

The earned income tax in the instant case is distinguishable from the Indiana gross income tax (I. T. 3766 and I. T. 3829, *supra*) inasmuch as such tax as respects businesses is imposed upon the net profits thereof rather than gross receipts. Similarly, it is distinguishable from the tax involved in Revenue Ruling 54–598, *supra*, because in that ruling the tax imposed was a license fee for the privi-

lege of doing business within the city. See *J. D. Adams Manufacturing Co.* v. *Storen et al*, 304 U. S. 307; *Howard et al.* v. *Commissioners of the Sinking Fund of the City of Louisville et al.*, 344 U. S. 624; *Cook et al.* v. *Commissioners of the Sinking Fund of the City of Louisville et al* (Ky.), 226 S. W. (2d) 328, and *City of Louisville et al.* v. *Sebree et al.* (Ky.), 214 S. W. (2d) 248.

In view of the above, the instant tax imposed by the City of Cincinnati constitutes an income tax within the meaning of section 1.62–1 of the Income Tax Regulations. Accordingly, it is held (1) that any such tax imposed upon and paid by an individual on the net profits of a business owned by him and conducted in Cincinnati is not deductible by him in computing adjusted gross income, but is deductible in computing taxable income, provided that the taxpayer does not elect to claim the standard deduction; (2) that any tax imposed upon and paid by a partnership on the net profits of its business conducted in Cincinnati is deductible in computing the taxable income of the partnership and the partners are not precluded from claiming the standard deduction; and (3) that the tax imposed upon a resident's share of the net profits of an unincorporated business not attributable to Cincinnati and paid by such resident is allowable as a deduction provided that the taxpayer does not elect to use the standard deduction, but the tax may not be deducted from gross income in determining adjusted gross income.

I. T. 3829, C. B. 1946–2, 38, and Revenue Ruling 54–598, C. B. 1954–2, 121, are distinguished from the instant case.

(Also Part II, Section 23(c), Regulations 118, Section 39.23(c)–1.) Rev. Rul. 58–44

Nebraska State motor vehicle fuel taxes are not imposed on the consumer and are not deductible under section 164(a) of the Internal Revenue Code of 1954. However, amounts representing such taxes paid by a consumer (other than in connection with his trade or business) are deductible under section 164(c) of the Code.

I. T. 3669, C. B. 1944, 112, is revoked.

Further consideration has been given to I. T. 3669, C. B. 1944, 112, which holds that the motor vehicle fuel taxes imposed by the State of Nebraska are, by virtue of amendments to Nebraska law indicating an intent on the part of the State legislature to place the tax on the consumer or user, deductible for Federal income tax purposes under section 23(c)(1) of the Internal Revenue Code of 1939 by the consumer or user.

The State of Nebraska imposes a tax upon dealers on the basis of the number of gallons of motor vehicle fuel received or imported and unloaded and emptied or caused to be received and unloaded in the State and the number of gallons of motor vehicle fuels produced, refined, manufactured, blended or compounded by such dealer. The tax is currently at the rate of six cents per gallon.

Legislative Bill 294, Laws of Nebraska, 1943, 482, approved May 7, 1943, was enacted to amend section 66–405, C. S. Supp. 1941, as amended by section 2 of Legislative Bill 60, fifty-sixth session of the Nebraska Legislature, 1943, and section 66–417 C. S. Supp. 1941,

relating to taxation upon the sale, distribution and use of motor fuels; to provide that dealers or other persons having paid the tax or liable for its payment shall collect the amount thereof from any person, firm or corporation to whom said motor vehicle fuel is sold in the State and along with the selling price thereof; and to repeal the original section 66–405, C. S. Supp. 1941, as amended.

The direction contained in the 1943 amendments, specifying that "Dealers or other persons having paid said tax, or being liable for its payment, shall collect the amount thereof from any person, firm or corporation to whom said motor vehicle fuel is sold in this State along with the selling price thereof," is not sufficient to classify the tax in question as being imposed on the consumer and therefore deductible by him under section 23(c)(1) of the 1939 Code.

Amounts representing the Nebraska State motor vehicle fuel taxes paid by a consumer (other than in connection with his trade or business) are deductible, however, under the provisions of section 23(c)(3) of the 1939 Code, as amended by Public Law 29, 82nd Congress, approved May 12, 1951, effective for taxable years beginning after December 31, 1950, and under section 164(c) of the Internal Revenue Code of 1954 for taxable years beginning after December 31, 1953 (except short years ending on or before the date of enactment of the 1954 Code).

Accordingly, I. T. 3669, *supra*, to the extent that it provides that the Nebraska motor vehicle fuel tax is deductible by the consumer under section 23(c)(1) of the 1939 Code, is revoked.

Rev. Rul. 58–45

The tax imposed by the State of Nebraska, Section 77–2602 of Article 26 of Revised Statutes of Nebraska 1943, Reissue of 1950, as amended, on cigarettes distributed and sold at wholesale and on the use of all cigarettes in the State evidenced by stamps affixed to the containers or printed thereon by the use of the cigarette tax meter, is, on and after September 20, 1957, deductible under section 164(a) of the Internal Revenue Code of 1954 by the consumer in computing taxable income, except that, in the case of an individual who elects to use the optional standard deduction, the tax is not deductible unless attributable to the trade or business carried on by him which does not consist of the performance of services by the taxpayer as an employee. In the latter event, the tax is deductible from gross income in computing adjusted gross income.

Effective September 20, 1957, no deduction is allowable to the licensees (distributors or dealers) paying the tax to the State of Nebraska, and the portion of the price paid by the consumer to the licensees for cigarettes which represents the Nebraska State tax on cigarettes is not includible in the gross income of such licensees.

Revenue Ruling 55–266, C. B. 1955–1, 23, is not applicable to the tax on cigarettes sold in the State of Nebraska on or after September 20, 1957.

Advice has been requested whether the tax on cigarettes imposed by the State of Nebraska under the amendments provided in Legislative Bill 130, passed at the 1957 Session of the Nebraska State Legislature and effective September 20, 1957, is deductible for Federal income tax purposes by the consumer.

Section 164(a) of the Internal Revenue Code of 1954 provides the general rule that in computing taxable income there shall be allowed

as a deduction taxes paid or accrued within the taxable year, with certain exceptions not here material.

Section 1.164–1 of the Income Tax Regulations provides that, in general, taxes are deductible only by the person upon whom they are imposed.

Revenue Ruling 55–266, C. B. 1955–1, 23, holds that the tax imposed by the State of Nebraska, section 77–2602 and section 77–2616 of Article 26 of Revised Statutes of Nebraska, 1943, Reissue of 1950, on cigarettes distributed and sold at wholesale and on the use of all cigarettes in the State, evidenced by stamps affixed to the containers or printed thereon by the use of a cigarette tax meter, is deductible for Federal income tax purposes under section 164 of the Code by the wholesale distributor or wholesale dealer or the user who pays for and affixes the stamp or meter impressions; and that the tax is not a retail sales tax imposed on persons selling tangible personal property at retail and is not deductible under section 164(c) of the Code by the consumer or purchaser of the cigarettes. Insofar as the ultimate consumer or purchaser is concerned, Revenue Ruling holds that the tax represents an additional cost of the article and is not deductible as a tax in computing his taxable income except where imposed directly upon him as a use tax.

An amendment, approved May 29, 1955, which added section 77–2602.01 to the Revised Statutes, Laws 1955, C. 305, section 1, provided that wholesale dealers or other persons having paid the Nebraska cigarette tax, or being liable for its payment, should collect the amount thereof from any person, firm, or corporation to whom cigarettes are sold in the State, along with the selling price thereof. Such amendment did not operate so as to change the classification of the Nebraska cigarette tax to that of a State or local sales tax within the meaning of section 164(c)(2) of the Code. It did not shift the incidence of the tax from the wholesale dealer (or other person paying the tax or liable therefor) to the consumer. In the absence of statutory language which specifically states that it is the intent of the State Legislature to impose the tax on the purchaser or consumer, no inference may be drawn that such intent existed.

Legislative Bill 130, entitled "an Act to amend section 77–2602, Reissue Revised Statutes of Nebraska, 1943, and section 77–2601.01, Revised Statutes Supplement, 1955, relating to revenue and taxation; to increase the tax on cigarettes to four cents; to restate that the tax collected shall be a tax collected from the user or consumer; and to repeal the original section," contains the following provisions:

SECTION 1. That section 77–2602, Reissue Revised Statutes of Nebraska, 1943, be amended to read as follows:

"77–2602. Every person, engaged in distributing or selling cigarettes at wholesale in this state, shall pay to the Director of the Department of Agriculture and Inspection of this state a special privilege tax. This shall be in addition to all other taxes. It shall be paid prior to or at the time of the sale, gift, or delivery to the retail dealer in the several amounts as follows: On all cigarettes four cents per package containing not more than twenty cigarettes, and on packages containing more than twenty cigarettes a tax of four cents for the first twenty cigarettes and four cents for each twenty cigarettes or fractional part thereof in excess of twenty cigarettes. The proceeds of such tax shall be placed in the General Fund to be appropriated by the Legislature.

"SECTION 2. That section 77-2602.01, Revised Statutes Supplement, 1955, be amended to read as follows:

"77-2602.01. The impact of the tax levied by Chapter 77, article 26, Reissue Revised Statutes of Nebraska, 1943, and amendments thereto, is hereby declared to be on the vendee, user, consumer, or possessor of cigarettes in this state, and when such tax is paid by any other person, such payment shall be construed as an advance payment, and shall thereafter be added to the price of the cigarettes and recovered from the ultimate consumer or user. In making sales of cigarettes in this state, a wholesaler or jobber may separately state and show upon the invoice covering such sale the amount of the tax on cigarettes sold. The tax shall be evidenced by appropriate stamps attached to each package of cigarettes sold, and the tax shall be collected by the retailer from the user or consumer. The provisions of this section shall in no way effect the method of collection of such tax on cigarettes as now provided by existing law.

"SECTION 3. That original section 77-2602, Reissue Revised Statutes of Nebraska, 1943, and section 77-2602.01, Revised Statutes Supplement, 1955, are repealed."

In view of the evident intent of the Nebraska Legislature to impose the cigarette tax upon the consumer in the State of Nebraska, it is held the tax imposed by the State of Nebraska, Section 77-2602 of Article 26 of Revised Statutes of Nebraska, 1943, Reissue of 1950, as amended, on cigarettes distributed and sold at wholesale and on the use of all cigarettes in the State evidenced by stamps affixed to the containers or printed thereon by the use of the cigarette tax meter, is, on and after September 20, 1957, the effective date of Legislative Bill 130, 1957 session of the Nebraska State Legislature, deductible under section 164(a) of the Code by the consumer in computing taxable income, except that, in the case of an individual who elects to use the optional standard deduction, the tax is not deductible unless attributable to the trade or business carried on by him which does not consist of the performance of services by the taxpayer as an employee. In the latter event, the tax is deductible from gross income in computing adjusted gross income.

Effective September 20, 1957, no deduction is allowable to the licensees (distributors or dealers) paying the tax to the State of Nebraska, and the portion of the price paid by the consumer to the licensees for cigarettes which represents the Nebraska State tax on cigarettes is not includible in the gross income of such licensees.

Revenue Ruling 55-266, C. B. 1955-1, 23 is not applicable to the tax on cigarettes sold in the State of Nebraska on or after September 20, 1957.

Rev. Rul. 58-141

An Iowa State statute which imposes a "tax" on public employees in connection with the Iowa Public Employees' Retirement System is not a "tax" within the purview of section 164(a) of the Internal Revenue Code of 1954, but rather a payment by the employee on the purchase of an annuity as provided for by the Iowa statute itself. Therefore, the amount deducted and withheld from the employee's wages is not deductible by such employee in computing his taxable income for Federal income tax purposes.

Advice has been requested whether the so-called "tax" imposed on public employees by the State of Iowa under chapter 97B, Volume I, of the Code of Iowa, 1954, relative to the Iowa Public Employees' Retirement System, is an allowable deduction for Federal income tax purposes by such employees.

Section 164(a) of the Internal Revenue Code of 1954 provides, that in computing taxable income, there shall be allowed as a deduction taxes paid or accrued within the taxable year, with certain exceptions not here material.

In a general sense, the terms "tax" and "taxes" include every burden which may be lawfully laid on the citizen by virtue of the taxing power, but their application in constitutional and statutory provisions varies to some extent according to the intention and purpose of the particular provision. The question of whether a particular contribution, charge, or burden is to be regarded as a tax depends on its real nature and, if it is in its nature a tax, it is not material that it may be called by a different name; and, conversely, if it is not in its nature a tax, it is not material that it may have been so called. See I. T. 2796, C. B. XIII-2, 48 (1934).

The nature of a tax was defined in I. T. 2796, *supra*, as an enforced contribution, exacted pursuant to legislative authority in the exercise of taxing power, and imposed and collected for the purpose of raising revenue to be used for public or governmental purposes, and not as a payment for some special privilege granted or service rendered. Taxes are, therefore, distinguishable from various other contributions and charges imposed for particular purposes under particular powers or functions of the Government.

In the instant case, Chapter 97B of the Code of Iowa, 1954, relating to the Iowa Public Employees' Retirement System states, in part, that the purpose of this chapter is to provide a retirement system which will provide for the payment of annuities to public employees. Section 97B.2, under that chapter there is levied on each employer and employee, respectively, a "tax" equal to three and one-half percent of the wages paid by the employer to the employee for any service performed after June 30, 1953. Section 97B.11. Taxes deducted from the wages of the employee shall be matched by the employer and deposited with the State treasurer to the credit of the Iowa Public Employees' Retirement Fund. Section 97B.14. "Contributions" or "taxes" are defined to mean the payments to the fund by the employer and/or by the members, necessary to provide the benefits of the retirement system. Section 97B.41. Membership is, with certain exceptions, mandatory. Section 97B.42. In the case of an employee who terminates his employment prior to his retirement, other than by death, the accumulated contribution by the member at the date of such termination will be paid to the member unless he elects to receive a retirement allowance as provided in such chapter. Section 97B.53.

In view of the foregoing, it is held that, although the Iowa State statute designates the amount withheld from the employee's wages as a "tax," the amount deducted is not a tax within the meaning of section 164(a) of the Code but, as indicated by the statute itself, constitutes the employee's cost of the annuity provided for by the Iowa law. Such contributions are not, therefore, deductible by the employees in computing their taxable incomes for Federal income tax purposes. See Treasury Decision 3112, C. B. 4, 76 (1921), which holds that amounts withheld from basic salary paid to employees in the Civil Service of the United States are includible in gross income, for income tax purposes, and that no corresponding deduction can be taken for the amounts withheld, since such amounts are payments

made toward the purchase of annuities. See Rev. Rul. 57–326, C. B. 1957–2, 42; Rev. Rul. 56–473, C. B. 1956–2, 22.

Rev. Rul. 58–212

The tax imposed by the State of Washington upon the retail sale of spirits, wine, or strong beer in the original package under the provisions of section 82.08.150 of the Revised Code of Washington, as amended, is deductible under section 164 (a) of the Internal Revenue Code of 1954 by the purchaser in computing taxable income, except that in the case of an individual who elects to use the optional standard deduction, the tax is not deductible unless attributable to a trade or business carried on by him which does not consist of the performance of services by the taxpayer as an employee. In the latter event, the tax is deductible from gross income in computing adjusted gross income.

Advice has been requested as to the deductibility by the consumer, for Federal income tax purposes, of the State of Washington tax on retail sales of intoxicating liquor imposed under section 82.08.150 of the Revised Code of Washington, as amended.

The Revised Code of Washington, as amended, contains the following provisions with respect to the tax on retail sales and the tax on intoxicating liquors:

82.0.020 Retail sales tax imposed. There is levied and there shall be collected a tax on each retail sale in this state equal to three and one-third percent of the selling price. The tax imposed under this chapter shall apply to successive retail sales of the same property and to the retail sale of intoxicating liquor by the Washington state liquor stores.

82.08.050 Buyer to pay, seller to collect tax penalties. The tax hereby imposed shall be paid by the buyer to the seller, and each seller shall collect from the buyer the full amount of the tax payable in respect to each taxable sale in accordance with the schedule of collections adopted by the tax commission pursuant to the provisions of RWC 82.08.060. The tax required by this chapter, to be collected by the seller, shall be deemed to be held in trust by the seller until paid to the commission, and any seller who appropriates or converts the tax collected to his own use * * * shall be guilty of a misdemeanor.

* * * * * * *

The amount of tax, until paid by the buyer to the seller or to the commission, shall constitute a debt from the buyer to the seller * * * and any buyer who refuses to pay any tax due under this chapter shall be guilty of a misdemeanor.

Where a buyer has failed to pay to the seller the tax imposed by this chapter and the seller has not paid the amount of the tax to the commission, the commission may, in its discretion, proceed directly against the buyer for collection of the tax, * * *.

82.08.120. Rebating or absorption of tax by seller prohibited.—Whoever, excepting as expressly authorized by this chapter, refunds, remits, or rebates to a buyer, either directly or indirectly and by whatever means, all or any part of the tax levied by this chapter, or makes in any form of advertising, verbal or otherwise, any statements which might infer that he is absorbing the tax or paying the tax for the buyer by an adjustment of prices, or at a price including the tax or in any other manner whatsoever shall be guilty of a misdemeanor. * * *.

82.08.150. There is levied and shall be collected from and after the first day of November 1951, a tax upon each retail sale of spirits, wine, or strong beer in the original package and at the rate of ten percent of the selling price, and the term 'retail sale' as used herein shall include, in addition to the meaning ascribed thereto in chapter 82.04 RCW, any sale not for resale in such original package. The tax imposed in this section shall apply to the sale of spirits, wine, or strong beer by the Washington state liquor stores and agencies, including sales to Class H licensees. The tax imposed in RCW 82.08.020 shall not apply to sales subject to the tax imposed by this section. * * *.

Section 164(a) of the Internal Revenue Code of 1954 provides that in computing taxable income there shall be allowed as a deduction taxes paid or accrued within the taxable year, with certain exceptions not here material.

Section 1.164–1 of the Income Tax Regulations provides that, in general, taxes are deductible only by the person, upon whom they are imposed.

It is clear that it was the legislative intent to impose the tax provided in section 82.08.150 of the Revised Code of Washington, as amended, upon the purchaser and to make the seller, the Washington State liquor stores and agencies, the collector of the tax for and on behalf of the State. See, in this regard, *Morrow* v. *Heneford*, 182 Wash. 625, 47 Pac. (2d) 1016 (1935), in which the Supreme Court of Washington held that the sales tax authorized under the Laws of Washington of 1935 was imposed upon the buyer. See also, I. T. 2955, C. B. XV–1, 94 (1936).

Accordingly, it is held the tax imposed by the State of Washington upon the retail sale of spirits, wine, or strong beer in the original package under the provisions of section 82.08.150 of the Revised Code of Washington, as amended, is deductible under section 164(a) of the Internal Revenue Code of 1954 by the purchaser in computing taxable income, except that, in the case of an individual who elects to use the optional standard deduction, the tax is not deductible unless attributable to a trade or business carried on by him which does not consist of the performance of services by the taxpayer as an employee. In the latter event, the tax is deductible from gross income in computing adjusted gross income.

Rev. Rul. 58–291

Treatment, for Federal income tax purposes, of the tax imposed by the State of Michigan on the sale of cigarettes pursuant to Act No. 265 of the Public Acts of 1947, as amended, and Act No. 312 of the Public Acts of 1957.

Advice has been requested whether the tax imposed by the State of Michigan on the sale of cigarettes, pursuant to Act No. 265 of the Public Acts of 1947, as amended (section 7.411(1) et seq. Michigan Statutes Annotated, 1957 Cumulative Supplement) and Act No. 312 of Public Acts of 1957 (section 15.1919(89) Michigan Statutes Annotated, 1957 Cumulative Supplement) is deductible for Federal income tax purposes.

Under the provisions of Act No. 265 of the Public Acts of 1947, as amended, *supra*, no person shall sell, purchase, possess or acquire cigarettes or act as manufacturer, wholesaler, secondary wholesaler, vending machine operator, unclassified acquirer, transportation company or transporter, in the State unless licensed to do so by the Michigan department of revenue. Section 7.411(3), Michigan Statutes Annotated. Every licensee, other than an unclassified acquirer, is required to file a monthly return with the department, stating therein, among things, the number of cigarettes purchased and sold by such licensee in the State during the preceding calendar month. Such licensee shall, at the time of filing the return, pay to the department an excise tax equal to one and one-half mills for each cigarette so sold

during the calendar month covered by the return, less one percent compensation from the total amount of tax due to cover the cost of expenses of the wholesaler incurred in the administration of the Act. Cigarettes with respect to which the tax has once been imposed and has not been refunded, if paid, are not subject upon a subsequent sale to the tax imposed by the Act. Each unclassified acquirer is required, upon importation or acquisition of cigarettes from any source whatsoever, to file a return with the department, stating therein, among other things, the number of cigarettes imported or acquired, and to pay to the department an excise tax equal to one and one-half mills for each cigarette so imported or acquired and held for sale or consumption; but cigarettes with respect to which the tax has once been imposed and has not been refunded, if paid, are not subject, when subsequently sold, to any further tax under the Act. Section 7.411(7), Michigan Statutes Annotated.

An "unclassified acquirer" means, for the purposes of Act No. 265, *supra*, any person except a transportation company or a purchaser at retail from a retailer licensed under Act No. 167 of the Public Acts of 1933, as amended, being sections 205.51 to 205.78, inclusive of the Compiled Laws of 1948, who imports or acquires cigarettes for use, sale or distribution from any source other than a manufacturer, a wholesaler, or a secondary wholesaler licensed under Act No. 265, *supra*. Section 7.411(1)(6), Michigan Statutes Annotated.

Section 39 of Act No. 312 of the Public Acts of 1957, *supra*, provides, in part, as follows:

> Section 39. (1) For the purpose of supplementing the school aid fund established by section 23 of article 10 of the state constitution, there shall be levied and collected, and there is hereby imposed, the following excise taxes which shall be in addition to any and all taxes now imposed by law:
>
> "(a) An excise tax equal to one mill on each cigarette, said tax to be paid monthly to the state department of revenue in the same manner and at the same time and subject to the same rules and regulations as are provide in Act No. 265 of the Public Acts of 1947, as amended. Every manufacturer, wholesaler, secondary wholesaler, vending machine operator, unclassified acquirer, transportation company and retailer as defined in Act No. 265 of the Public Acts of 1947, as amended, who has on hand on July 1, 1957, any cigarettes upon which a tax of one and one-half mills has been previously paid under said Act No. 265 of the Public Acts of 1947, as amended, shall file a complete inventory thereof with the state department of revenue and, at the same time, pay an excise tax of one mill on each such cigarette, said inventory and payment to be filed and paid on or before July 20, 1957.

Section 164(a) of the Internal Revenue Code of 1954 provides that, in computing taxable income, there shall be allowed as a deduction taxes paid or accrued within the taxable year, with certain exceptions not here material.

Subsection (c)(1) of section 164 relates to the deduction of retail sales taxes and gasoline taxes in computing taxable income. Such subsection provides, that in the case of any State or local sales tax, if the amount of the tax is separately stated, then, to the extent that the amount so stated is paid by the consumer (otherwise than in connection with the consumer's trade or business) to his seller, such amount shall be allowed as a deduction to the consumer as if it constituted a tax imposed on, and paid by, such consumer.

Subsection (c)(2) of section 164 provides that as used therein the term "State or local sales tax" means a tax imposed by a State, Terri-

tory, a possession of the United States, or a political subdivision of any of the foregoing, or by the District of Columbia, which tax—(A) is imposed on persons engaged in selling tangible personal property at retail (or on persons selling gasoline or other motor vehicle fuels at wholesale or retail) and is a stated sum per unit of property sold or is measured either by the gross sales price or by the gross receipts from the sale; or (B) is imposed on persons engaged in furnishing services at retail and is measured by the gross receipts for furnishing such services.

Section 1.164–1 of the Income Tax Regulations provides that, in general, taxes are deductible only by the person upon whom they are imposed.

Accordingly, it is held that the tax imposed by the State of Michigan on cigarettes pursuant to the provisions of Act No. 265 of the Public Acts of 1947, as amended, *supra*, and the additional tax imposed pursuant to section 39 of Act No. 312 of the Public Acts of 1957 are deductible under section 164(a) of the Code by the licensee making payment of such tax to the State. The tax is not a retail sales tax and, therefore, is not deductible by the purchasers of the cigarettes under section 164(c) of the Code. Insofar as the ultimate consumer or purchaser is concerned the tax represents an additional cost of the article and is not deductible as a tax in computing his taxable income. However, where the taxes have been imposed directly on the consumer by reason of his becoming an "unclassified acquirer", as defined, such taxes, to the extent they are paid by him directly to the department of revenue, may be deducted by such consumer under section 164(a) of the Code.

(Also Section 266.) Rev. Rul. 58–292

Treatment for Federal income tax purposes of the sales tax and the "use" tax imposed by the State of North Carolina pursuant to section 105–164.4 and section 105–164.6, respectively, of the General Statutes of North Carolina.

Advice has been requested as to the treatment, for Federal income tax purposes, of the sales tax and the use tax imposed by the State of North Carolina pursuant to section 105–164.4 and section 105–164.6, respectively, of the General Statutes of North Carolina, Chapter 105, Article 5, Volume 2C, as amended by the North Carolina State Sales and Use Tax Act, Session Laws 1957, Chapter 1340, Section 5, effective July 1, 1957 (1957 Cumulative Supplement to Volume 2C). Advice has also been requested as to how this treatment applies to the case of an individual (1) who enters into a general contract for the construction of his personal residence for a stated amount; (2) who acts as general contractor himself; or (3) who employs a general contractor but purchases all of the materials required for building the house.

Section 105–164.4 of the General Statutes of North Carolina, *supra*, provides, in pertinent part, that there is levied and imposed, in addition to all other taxes imposed by law, a privilege or license tax upon every person who engages in the business of selling tangible personal property at retail, renting or furnishing tangible personal property or the renting and furnishing of rooms, lodgings and ac-

commodations to transients, in the State, the same to be collected and the amount to be determined by the application of specified rates against gross sales and rentals. The tax shall be collected from the retailer and paid by him at the time and in the manner provided. Any person who shall engage or continue in any business for which a privilege tax is imposed shall obtain a license from the Commissioner of Revenue of the State of North Carolina to engage in and conduct such business.

Section 105–164.6 of the General Statutes of North Carolina, *supra*, provides, in pertinent part, that an excise tax is levied and imposed on the storage, use or consumption in the State of tangible personal property purchased within and without the State for storage, use or consumption in the State, the same to be collected and the amount to be determined by the application of specified rates against the sales price.

Subsection (3) of section 105–164.6 of the General Statutes, *supra*, provides that there is levied and there shall be collected from every person, firm or corporation an excise tax of three percent of the purchase price of all tangible personal property purchased or used which shall enter into or become a part of any building or other kind of structure in the State, including all materials, supplies, fixtures, and equipment of every kind and description which shall be annexed thereto or in any manner become a part thereof. Such tax shall be levied against the purchaser of the articles named. If purchases of building materials that are not exempt from tax are made by a contractor there shall be joint liability for the tax against both contractor or owner, but the liability of the owner shall be satisfied if an affidavit is required of the contractor, and furnished by him, before final settlement is made, showing that the tax levied has been paid.

Subsection (4) of section 105–164.6 of the General Statutes, *supra*, provides that where a retail sales tax has already been paid by the purchaser with respect to tangible personal property in the State, such retail sales tax shall be credited upon the use tax imposed under section 105–164.6, *supra*.

Section 105–164.7 of the General Statutes, *supra*, provides, in part, that every retailer engaged in the business of selling or delivering or taking orders for the sale or delivery of tangible personal property for storage, use or consumption in the State shall, at the time of selling or delivering or taking an order for the sale or delivery of said tangible personal property or collecting the sales price thereof or any part thereof, add to the sales price of such tangible personal property the amount of the tax on the sale thereof, and when so added the tax shall constitute a part of such purchase price, shall be a debt from the purchaser to the retailer until paid and shall be recoverable at law in the same manner as other debts. The tax shall be stated and charged separately from the sales price, shown separately on the retailer's sales records, and paid by the purchaser to the retailer as trustee for and on account of the State. The retailer shall be liable for the collection thereof and for its payment to the State Commissioner of Revenue, and the retailer's failure to charge to or collect the tax from the purchaser shall not affect such liability.

Section 105–164.9 of the General Statutes, *supra*, provides, in part,

that any retailer who shall by any character or public advertisement offer to absorb the tax levied by Article 5 of Chapter 105 of the General Statutes, or in any manner directly or indirectly advertise that the tax therein imposed is not considered an element in the price to the purchaser, shall be guilty of a misdemeanor.

Section 105–164.17 of the General Statutes, *supra*, relating to reports and payment of the use tax, provides that every person storing, using or consuming tangible personal property in the State shall file with the State Commissioner of Revenue a return for the preceding month in such form as may be prescribed by him showing the total cost price of the tangible personal property purchased or received by such person during such preceding month, the storage, use or consumption of which is subject to the tax imposed by such article, and such other information as the Commissioner may deem necessary. The returns shall be accompanied by a remittance of the tax imposed during the month covered and shall be signed by the person liable for the tax or his duly authorized agent.

Section 164(a) of the Internal Revenue Code of 1954 provides that, in computing taxable income, there shall be allowed as a deduction taxes paid or accrued within the taxable year, with certain exceptions not here material.

Section 164(c)(1) of the Code relates to the deduction of retail sales taxes and gasoline taxes in computing taxable income. Such subsection provides that in the case of any state or local sales tax, if the amount of the tax is separately stated, then, to the extent that the amount so stated is paid by the consumer (otherwise than in connection with the consumer's trade or business) to his seller, such amount shall be allowed as a deduction to the consumer as if it constituted a tax imposed on, and paid by, such consumer.

Section 164(c)(2) of the Code provides that, as used therein, the term "State or local sales tax" means a tax imposed by a State, Territory, a possession of the United States, or a political subdivision of any of the foregoing, or by the District of Columbia, which tax—(A) is imposed on persons engaged in selling tangible personal property at retail (or on persons selling gasoline or other motor vehicle fuels at wholesale or retail) and is a stated sum per unit of property sold or is measured either by the gross sales price or by the gross receipts from the sale; or (B) is imposed on persons engaged in furnishing services at retail and is measured by the gross receipts for furnishing such services.

Section 1.164–1 of the Income Tax Regulations provides that, in general, taxes are deductible only by the person upon whom they are imposed.

Accordingly, it is held that the sales tax imposed by the State of North Carolina pursuant to section 105–164.4 of the General Statutes of North Carolina, *supra*, constitutes a "retail sales tax," within the meaning of section 164(c) of the code. The tax is deductible by the vendor under section 164(a) of the Code. If the vendor is an individual, the deduction must be taken in arriving at adjusted gross income. In the case of all other vendors, the deduction is allowable in computing taxable income. The retail sales tax collected by a vendor from a purchaser must be included in the vendor's income for Federal income tax purposes. To the extent that such tax is

paid by the purchaser, otherwise than in connection with his trade or business, it is deductible by the purchaser under section 164(c) of the Code in computing taxable income, provided the taxpayer itemizes his deductions and does not elect to use the standard deduction or compute his tax liability from the tax table. If paid in connection with a trade or business carried on by the taxpayer, which does not consist of the performance of services by the taxpayer as an employee, such tax is deductible from gross income in computing adjusted gross income, unless the amount thereof is properly chargeable to capital account. In the case of taxpayers (other than individuals) engaged in a trade or business, the deduction is allowable as a business expense in computing taxable income, unless the amount thereof is properly chargeable to capital account.

It is also held that the use tax imposed by the State of North Carolina pursuant to section 105–164.6 of the General Statutes of North Carolina, *supra*, is deductible by the purchaser under section 164(a) of the Code, except that in the case of an individual who elects to use the optional standard deduction, no deduction is allowable under section 164(a) of the Code unless the use tax is attributable to a trade or business carried on by him. Where the use tax is attributable to a trade or business carried on by an individual, the amount of such tax is deductible as a tax from gross income in computing adjusted gross income. In the case of taxpayers (other than individuals) engaged in trade or business, the use tax is deductible as a tax in computing taxable income. The amount of use tax collected by a vendor from a purchaser should not be included in the vendor's gross income, and no deduction is allowable to the vendor with respect to the amount of such tax remitted by him to the Commissioner of Revenue of the State of North Carolina.

The foregoing treatment is applied to the specific questions in this Revenue Ruling, as follows:

(1) Where an individual contracts with a builder for the construction of his personal residence for a stated amount, the retail tax paid by the builder on materials purchased by him and used in the construction of the residence is not paid as a tax by the purchaser of the residence. Further, since it is paid in connection with the trade or business of the builder, it is not deductible by the builder as a tax, but constitutes an additional cost of the material purchased. Insofar as the purchaser of the home is concerned, such retail sales tax, as well as the use tax which may be imposed on the builder or contractor under section 105–164.6 of the General Statutes, *supra*, may be indirectly reflected in the contract price of the home purchased, but there is no basis for the deduction of such taxes by such purchaser. (2) Where an individual acts as his own contractor, or (3) employs a contractor but has the material billed to him, the retail sales tax may, to the extent that such tax is paid by the purchaser, be deducted under section 164(c) of the Code in computing taxable income, provided the taxpayer itemizes his deductions and does not elect to use the standard deduction or compute his tax liability from the tax table. To the extent an individual who constructs his own residence incurs a liability for the payment of the use tax imposed on him under section 105–164.6 of the General Statutes, *supra*, and pays such tax to the State Commissioner of Revenue, he may deduct

the amount thereof under section 164(a) of the Code in computing taxable income, provided he itemizes his deductions, unless he elects to capitalize such tax under the provisions of section 266 of the Code.

Rev. Rul. 58-304

Treatment for Federal income taxes of the tax imposed by the State of Michigan on the sale of liquor pursuant to section 39 of Act No. 312 of the Public Acts of 1957.

Advice has been requested as to the deductibility, for Federal income tax purposes, of the excise tax on liquor sales imposed by the State of Michigan under section 39 of Act No. 312 of the Public Acts of 1957, effective July 1, 1957.

The State of Michigan conducts a substantial business through stores operated directly by the State Liquor Control Commission. The Commission establishes the retail price at which liquor is to be sold both by its own stores and by licensed State-designated dealers. Licensees purchasing liquor are allowed a discount from the established retail price.

Section 39 of Act No. 312, *supra*, (section 15.1919(89), Chapter 146, Title 15 of Michigan Statutes Annotated, 1953 Revision, Volume 11, 1957 Cumulative Supplements) provides, in pertinent part, as follows:

Section 39. (1) For the purpose of supplementing the school aid fund established by section 23 of article 10 of the state constitution, there shall be levied and collected, and there is hereby imposed, the following excise taxes which shall be in addition to any and all taxes now imposed by law:

(a) * * *

(b) An excise tax equivalent to 4% of the retail selling price of spirits, as defined in section 2 of Act No. 8 of the Public Acts of the Extra Session of 1933, as amended, being section 436.2 of the Compiled Laws of 1948, other than those containing an alcoholic content of less than 22%. The tax shall be collected by the state liquor control commission at the time of sale by the commission. In the case of sales to licensees, the tax shall be computed on the retail selling price established by the commission without allowance of discount.

(2) Upon collection, the department of revenue and the state liquor commission shall deposit the entire proceeds in the state treasury to the credit of the state school aid fund established by section 23 of article 10 of the state constitution.

Section 164(a) of the Internal Revenue Code of 1954 provides that, in computing taxable income, there shall be allowed as a deduction taxes paid or accrued within the taxable year, with certain exceptions not here material.

Section 164(c)(1) of the Code relates to the deduction of retail sales taxes and gasoline taxes in computing taxable income. Such section provides that in the case of any state or local sales tax, if the amount of the tax is separately stated, then, to the extent that the amount so stated is paid by the consumer (otherwise than in connection with the consumer's trade or business) to his seller, such amount shall be allowed as a deduction to the consumer as if it constituted a tax imposed on, and paid by, such consumer.

Section 164(c)(2) of the Code provides that, as used therein, the term "State or local sales tax" means a tax imposed by a State, a Territory, a possession of the United States, or a political subdivision of any of the foregoing, or by the District of Columbia, which tax (A) is imposed on persons engaged in selling tangible personal property at retail (or on persons selling gasoline or other motor vehicle

fuels at wholesale or retail) and is a stated sum per unit of property sold or is measured either by the gross sales price or by the gross receipts from the sale; or (B) is imposed on persons engaged in furnishing services at retail and is measured by the gross receipts for furnishing such services.

Section 1.164–1 of the Income Tax Regulations provides that, in general, taxes are deductible only by the person upon whom they are imposed.

Accordingly, it is held that the tax imposed by the State of Michigan on the sale of liquor by the State Liquor Control Commission pursuant to section 39 of Act No. 312 of the Public Acts of 1957, *supra*, is deductible under section 164(a) of the Code by the purchaser who purchases such liquor from State Liquor Control Commission stores only. The amount of such tax is deductible in computing taxable income, except that in the case of an individual who elects to use the optional standard deduction or computes his tax from the tax table, the tax is not deductible unless attributable to a trade or business carried on by him which does not consist of the performance of services by the taxpayer as an employee. In the latter event the tax is deductible from gross income in computing adjusted gross income. The tax is not a retail sales tax and therefore is not deductible under section 164(c) of the Code.

Insofar as consumers or purchasers who buy liquor from licensed State-designated dealers are concerned, the tax which is reflected in the retail selling price paid to such licensees represents an additional cost of the liquor and is not deductible as a tax in computing taxable income. It should be noted that the licensed State-designated dealers who pay the tax to the State Liquor Control Commission when they purchase the liquor are entitled to a deduction for that tax.

Rev. Rul. 58–323

Treatment for Federal income tax purposes of the cigarette, consumers sales and the use taxes imposed by the State of West Virginia under Chapter 11, West Virginia Code of 1955, as amended.

Advice has been requested as to the treatment for Federal income tax purposes of the cigarette, consumers sales and the use taxes imposed by the State of West Virginia under Chapter 11, West Virginia Code of 1955, as amended.

The West Virginia statutes relating to the taxation of cigarettes in that State are contained in Chapter 11 of the West Virginia Code of 1955 and in the 1957 Cumulative Supplement thereto. Article 17 of Chapter 11, sections 999(50a) through 999(50v), relates to the excise tax on sale of cigarettes. Article 18 of Chapter 11, sections 999(50w) through 999(50cc), relates to the excise tax on the use, consumption or storage of cigarettes.

The excise tax imposed on the sale of cigarettes in the State, aggregating two and one-half cents on each ten cigarettes or fractional part thereof, is required to be paid by the purchase, by licensed wholesale and retail dealers, from the state tax commissioner, of stamps to be affixed to the packages of cigarettes. When authorized, the stamps may be affixed by means of a metering device, payment of tax due the

State being made by the licensees using the metering devices. See section 999(50b1), 999(50b2), 999(50d), 999(50f) and 999(50i).

The excise tax imposed on the use, consumption or storage of cigarettes by consumers in the State, currently at the rate of two and one-half cents on each ten cigarettes or fractional part thereof, is required to be paid directly to the state tax commissioner by every person who has acquired cigarettes for use, storage, or consumption, except that no tax applies if the tax levied in Article 17 of Chapter 11, *supra*, has been paid. See sections 999(50x) and 999(50y).

The statutes relating to the consumers sales tax in West Virginia are contained in Article 15 of Chapter 11, Sections 999(1) through 999(30), *supra*. The law provides that for the privilege of selling tangible personal property and of dispensing certain selected services the vendor shall collect from the purchaser the tax as provided by the statutes and shall pay the amount of tax collected to the state tax commissioner. There is no tax on sales where the monetary consideration is five cents or less. The amount of the tax is computed at the following rates: (1) On each sale, where the monetary consideration is from six to fifty cents; both inclusive, one cent; (2) On each sale where the monetary consideration is from fifty-one cents to one dollar, both inclusive, two cents; (3) On each fifty cents of monetary consideration, or fraction thereof in excess of one dollar, one cent. See section 999(3). The purchaser shall pay to the vendor the amount of the tax which shall be added to and constitute a part of the sales price and shall be collectible as such by the vendor who shall account to the State for all tax paid by the purchaser. Except as otherwise authorized, the vendor shall keep the amount of tax paid separate from the proceeds of sale exclusive of the tax. A vendor shall not represent to the public, in any manner, directly or indirectly, that he will absorb all or any part of the tax, or that the tax is not to be considered an element in the price to the purchaser. See section 999(4). No profit shall accrue to any person as a result of the collection of the tax notwithstanding the total amount of such taxes collected may be in excess of the amount for which such person would be liable by the application of the levy of two percent to the gross proceeds of his sales and the total of all taxes collected by any such person shall be returned and remitted to the tax commissioner as provided. See section 999(5). It is the intent of the law that the tax levied thereunder shall be passed on to and be paid by the ultimate consumer. See section 999(10).

The statutes relating to the use tax in West Virginia are contained in Article 15A of Chapter 11, sections 999(30a) through 999(30aa), *supra*. The law imposes an excise tax on the use in the State of tangible property furnished or delivered within the State to consumers or users at the rate of two percent of the purchase price of such property. The tax is imposed upon every person using such property within the State until such tax has been paid directly to a retailer, or to the State tax commissioner as provided. See section 999(30b). The law exempts certain specified tangible personal property from the tax, including, the gross receipts or the gross proceeds from the sale of which are required to be included in the measure of the tax imposed by Article 15 of Chapter 11, *supra*. See section 999(30c). It is the purpose of the law to rest a fair share of the tax burden, commensurate with the benefits received, upon those exer-

cising the privilege taxed thereby within the State. See section 999(30w).

Section 164(a) of the Internal Revenue Code of 1954 provides, that in computing taxable income, there shall be allowed as a deduction taxes paid or accrued within the taxable year with certain exceptions not here material.

Subsection (c)(1) of section 164 of the Code relates to the deduction of retail sales taxes and gasoline taxes in computing taxable income. Such subsection provides, that in the case of any State or local sales tax, if the amount of the tax is separately stated, then, to the extent that the amount so stated is paid by the consumer (otherwise than in connection with the consumer's trade or business) to his seller, such amount shall be allowed as a deduction to the consumer as if it constituted a tax imposed on, and paid by, such consumer.

Subsection (c)(2) of section 164 of the Code provides that as used therein the term "State or local sales tax" means a tax imposed by a State, Territory, a possession of the United States, or a political subdivision of any of the foregoing or by the District of Columbia, which tax (A) is imposed on persons engaged in selling tangible personal property at retail (or on persons selling gasoline or other motor vehicle fuels at wholesale or retail) and is a stated sum per unit of property sold or is measured either by the gross sales price or by the gross receipts from the sales; or (B) is imposed on persons engaged in furnishing services at retail and is measured by the gross receipts for furnishing such services.

Section 1.164–1 of the Income Tax Regulations provides that, in general, taxes are deductible only by the person upon whom they are imposed.

Therefore it is held that the tax imposed by the State of West Virginia on the sale of cigarettes by Article 17 of Chapter 11, West Virginia Code of 1955, as amended, is deductible under section 164(a) of the Internal Revenue Code of 1954, by the licensed wholesale or retail dealer who purchases and affixes the stamps, or impresses such stamps by means of a metering device and makes payment of the tax due the State therefor. The tax is not a retail sales tax and therefore is not deductible by the purchasers of the cigarettes under section 164(c) of the Code. Insofar as the ultimate consumer or purchaser is concerned the tax represents an additional cost of the article and is not deductible as a tax in computing his taxable income. However, in those instances where the tax imposed under Article 18 of Chapter 11, *supra*, in respect of the use, storage, or consumption of cigarettes, has been imposed directly on the consumer, it may be deducted by the consumer under section 164(a) of the Code.

From the provisions of the State law relating to the consumers sales tax, referred to above, it is clear that the legislative intent was to impose such tax upon the purchaser or consumer and to make the vendor the collector of the tax for and on behalf of the State. The use tax is also imposed on the consumer or user subject thereto.

Accordingly, it is held that both the West Virginia consumers sales tax and the use tax imposed under Article 15 and Article 15A, respectively, of Chapter 11 of the West Virginia Code of 1955, as amended, are deductible by the purchaser or consumer under sectiton 164(a) of the Code, except that in the case of an individual who elects

to use the optional standard deduction or computes his tax liability from the tax table, no deduction is allowable under section 164(a) of the Code unless the sales or use taxes are attributable to a trade or business carried on by him. Where the sales or use taxes are attributable to a trade or business carried on by an individual, the amounts of such taxes are deductible as taxes from gross income in computing adjusted gross income. In the case of taxpayers (other than individuals) engaged in trade or business, the sales or use taxes are deductible as taxes in computing taxable income. The amounts of such sales and use taxes collected by a vendor should not be included in the vendor's gross income, and no deduction is allowable to the vendor with respect to the amounts of such taxes remitted by him to the State tax commissioner of the State of West Virginia. Compare I. T. 2953, C. B. XV-1, 92 (1936).

Accrual of the deduction for foreign taxes where the liability for such foreign taxes is contested. See Rev. Rul. 58-55, page 266.

---

26 CFR 1.164-6: Apportionment of taxes on real property between seller and purchaser. (Also Section 6655; 1.6655-2.) T. D. 6293[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I. SUBCHAPTER A. PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Amendment of regulations prescribed under sections 164 and 6655 of the Internal Revenue Code of 1954.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

In order to clarify the application of certain provisions of example (2) of section 1.164-6(d)(4) of the Income Tax Regulations, relating to taxes, issued as Treasury Decision 6256 (22 F. R. 7989), approved October 3, 1957 (I. R. B. 1957-42, 8), and to clarify certain provisions of section 1.6655-2(c)(3) of the Income Tax Regulations, relating to the failure by a corporation to pay estimated tax, issued as Treasury Decision 6267 (22 F. R. 9059), approved November 7, 1957 (I. R. B. 1957-47, 66), such regulations are hereby amended as follows:

Paragraph 1. Example (2) of paragraph (d)(4) of section 1.164-6 is amended to read as follows:

Example (2). In County Y, the real property tax year is the calendar year. The real property tax becomes a lien on January 1, 1955, and is payable on April 30, 1955. There is no personal liability for the real property tax imposed by County Y. On April 30, 1955, C, the owner of real property in County Y on January 1, 1955, pays the real property tax for the 1955 real property tax year. On May 1, 1955, C sells the real property to D. On September 1, 1955, D sells the real property to E. C, D, and E use the cash receipts and disbursements method of accounting. Under the provisions of section 164(d)(1), 120/365

[1] 23 F. R. 3446.

(January 1–April 30, 1955) of the real property tax is treated as imposed upon C and may be deducted by him for his taxable year in which the tax is actually paid. Under section 164(d)(1), 123/365 (May 1–August 31, 1955) of the real property tax is treated as imposed upon D and, under the provisions of section 164(d)(2)(A), is treated as having been paid by him on May 1, 1955, and may be deducted by D for his taxable year in which the sale from C to him occurs (whether or not such portion is actually paid by him in that year), or for his taxable year in which an amount representing such tax is paid. Since, according to paragraph (d)(3) of this section, the prior sale by C to D is disregarded, under the provisions of section 164(d)(1), 122/365 (September 1–December 31, 1955) of the real property tax is treated as imposed on E and, under the provisions of section 164(d)(2)(A), is treated as having been paid by him on September 1, 1955, and may be deducted by E for his taxable year in which the sale from D to him occurs (whether or not such portion is actually paid by him in that year), or for his taxable year in which an amount representing such tax is paid.

PAR. 2. Paragraph (c)(3) of section 1.6655–2 is amended to read as follows:

(3) X determined that its taxable income for the first 6 months and the first 8 months of the taxable year ended March 31, 1956, was $180,000 and $200,000, respectively, and that its taxable income for the first 9 months and the first 11 months was $264,000 and $319,000, respectively. The income for each period is annualized as follows:

$180,000×12÷ 6=$360,000
$200,000×12÷ 8=$300,000
$264,000×12÷ 9=$352,000
$319,000×12÷11=$348,000

To determine whether the installment payment made on December 15, 1955, equals or exceeds the amount which would have been required to be paid if the estimated tax were equal to 70 percent of the tax computed on the annualized income for either the 6- or 8-month period, the following computation is necessary:

	6 months	*8 months*
(1) Annualized income	$360,000.00	$300,000.00
(2) Tax on item (1) reduced by $100,000	81,700.00	50,500.00
(3) 70 percent of item (2)	57,190.00	35,350.00
(4) 5 percent of item (3)	2,859.50	1,767.50

Since the amount actually paid on December 15, 1955, $1,775, exceeds the amount which would have been required to be paid on such date ($1,767.50) if the estimated tax were 70 percent of the tax determined by placing on an annualized basis the taxable income for the first 8 months of the taxable year, the exception described in paragraph (a)(3) of this section applies and no addition to tax will be imposed for the underpayment of the installment paid on December 15, 1955. A similar computation must be made with respect to the annualized income for the 9- and 11-month periods to determine whether or not the addition to the tax will be imposed with respect to the underpayment of the March 15, 1956, installment. The computation follows:

	9 months	*11 months*
(1) Annualized income	$352,000.00	$348,000.00
(2) Tax on item (1) reduced by $100,000	77,540.00	75,460.00
(3) 70 percent of item (2)	54,278.00	52,822.00
(4) 10 percent of item (3)	5,427.80	5,282.20

Since the total amount of all payments of estimated tax actually paid on or before March 15, 1956, $3,550 ($1,775 x 2), does not equal or exceed the total amount which would have been required to be paid on or before such date if the estimated tax were 70 percent of the tax determined by placing on an annual basis the taxable income for either the 9- or 11-month period, the addition to the tax with respect to the underpayment of the March 15, 1956, installment must be imposed.

Because this Treasury Decision merely makes clerical and clarifying changes in the regulations issued under sections 164 and 6655 of the Internal Revenue Code of 1954, it is found unnecessary to issue this

Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U. S. C. 7805).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved May 15, 1958.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on May 20, 1958, 8:51 a. m., and published in the issue of the Federal Register for May 21, 1958, 23 F. R. 3446.)

SECTION 165.—LOSSES

Securities purchased for the purpose of obtaining inventory items, which securities subsequently become worthless. See Rev. Rul. 58–40, page 275.

SECTION 166.—BAD DEBTS

Rev. Rul. 58–259

For purposes of computing additions to a reserve for bad debts under Mimeograph 6209 and Revenue Ruling 54–148, loans made by banks under Title I of the National Housing Act, as amended, known as Title I F. H. A. loans, are considered to be Government insured to the extent of either 90 percent of the amount of such loans outstanding (100 percent on loans made prior to October 1, 1954) or the balance in the bank's insurance reserve account maintained by the Federal Housing Administration, whichever is the lesser.

Advice has been requested as to the extent that property improvement and modernization loans made by banks under Title I of the National Housing Act, 48 Stat. 1246, as amended, 12 U. S. C. 1703, known as Title I F. H. A. loans, are Government insured or guaranteed and therefore excludable in computing additions to a reserve for bad debts maintained by banks under Mimeograph 6209, C. B. 1947–2, 26, and Revenue Ruling 54–148, C. B. 1954–1, 60.

Revenue Ruling 57–210, C. B. 1957–1, 94, holds, *inter alia*, that the term "Government insured loans," as used in paragraph 4 of Mimeograph 6209, *supra*, applies to Government insured or guaranteed loans to the extent or percent insured or guaranteed.

Regulations of the Federal Housing Administration applicable to Title I F. H. A. loans provide for the establishment of an insurance reserve for each partcipating lending institution. For each eligible loan reported by an insured lender and accepted for insurance registry by the Federal Housing Administration, an amount equal to ten percent of the net proceeds of the loan is credited to the lender's insurance reserve. The cumulative credits to the insurance reserve for each lender will equal ten percent of the net amount advanced

by it on all eligible loans. The lending institution is thus insured against losses on its overall lending operations. From the credits to the insurance reserve accumulated for each lender, the amount of each eligible claim paid to the lender is deductible. For loans made on and subsequent to October 1, 1954, the amount of any claim is limited to 90 percent of the calculated principal loss sustained by the lender, plus other allowances permitted by the regulations. The amount of claim cannot exceed the credit balance in the lender's insurance reserve.

On July 1 next following the expiration of a period of 30 months after the issuance of the contract of insurance to a lending institution, the amount of insurance reserve to the credit of such insured is adjusted by carrying forward into the next annual period 85 percent of the unused reserves outstanding on such date. The insurance reserve of each insured is adjusted in like manner on each subsequent July 1. The amount of unused reserves to be carried forward at the beginning of each annual period is determined according to the records of the Federal Housing Administration, and a statement showing the amount of such unused reserve is furnished each insured as promptly as possible after the close of each annual period.

A lender's entire Title I portfolio is not 90 percent (or 100 percent prior to October 1, 1954) insured at any one time, unless the balance in its reserve account sufficiently equals 90 percent of the amount of the whole portfolio. This could occur if a lender's outstanding Title I loans are declining faster than the balance in its reserve.

Accordingly, it is held that, for the purpose of computing additions to a reserve for bad debts under Mimeograph 6209, *supra*, and Revenue Ruling 54–148, *supra*, loans made by banks under Title I of the National Housing Act, as amended, *supra*, known as Title I F. H. A. loans, are considered to be Government insured to the extent of either 90 percent of the amount of such loans outstanding (100 percent on loans made prior to October 1, 1954) or the balance in the bank's insurance reserve account maintained by the Federal Housing Administration, whichever is the lesser.

Rev. Rul. 58–305

The provisions of section 166(c) of the Internal Revenue Code of 1954, providing for a reserve for bad debts, do not apply to a reserve for bail forfeitures.

A taxpayer has asked whether he may establish a reserve for bail forfeitures under section 166 of the Internal Revenue Code of 1954. The reserve would be established and maintained in a manner similar to that allowed for bad debts under that section.

For several years the taxpayer has been engaged in the business of issuing bail and administrative bonds. During the past year, through the failure of several individuals to appear in court, the taxpayer has suffered heavy losses.

Section 166(c) of the Code authorizes the deduction of reasonable additions to a reserve for bad debts. The reserve contemplated under

such section, however, relates only to amounts set aside from the gross income of a business to provide for probable losses with respect to accounts and notes receivable on which credit has been extended.

The general proposition that amounts credited to a reserve to cover contigent liabilities may not be deducted for Federal income tax purposes until such liabilities become fixed is well settled. *Lucas* v. *American Code Co., Inc.*, 280 U. S. 445, Ct. D. 168, C. B. IX–1, 314 (1930); *Arthur M. Brown* v. *Helvering*, 291 U. S. 193, Ct. D. 786, C. B. XIII–1, 223 (1934); *Lane Construction Corporation* v. *Commissioner*, 17 B. T. A. 826.

Accordingly, it is held that the provisions of section 166(c) of the Code, providing for a reserve for bad debts, do not apply to a reserve for bail forfeitures.

SECTION 167.—DEPRECIATION

26 CFR 1.167(a)–1: Depreciation in general. Rev. Rul. 58–77
(Also Sections 61, 1231; 1.61–3, 1.1231–1.)

> Large durable containers used by a taxpayer in the shipment of its products are subject to the allowance for depreciation where all of the facts and circumstances indicate the presence of the essential elements necessary for treating such containers as property used in the trade or business. However, in such cases, gain realized or loss sustained because of the failure of customers to return the containers, for which deposits are required, within the period specified, constitutes ordinary income or loss.

Advice has been requested (1) whether returnable containers, under the circumstances set forth below, may be considered as property used in a trade or business and subject to allowances for depreciation provided in section 167 of the Internal Revenue Code of 1954, and (2) whether amounts realized because of the failure of customers to return such containers may be considered as gains or losses falling within the scope of section 1231 of the Code.

The taxpayer corporation manufactures a product which is sold to its customers in large durable containers which have a useful life of approximately ten years and for which a deposit is required. The contracts under which the products and the containers are shipped provide that the containers are the property of the taxpayer corporation and are loaned for transportation purposes only; that they are to be returned within a specified period from the date of shipment; and, upon return to the taxpayer corporation in good condition within such period, the entire deposit will be refunded. The contracts provide further that, if the containers are not returned within the period specified, title and ownership thereto will pass to the customer and the deposit will be retained by the taxpayer as the agreed price for such containers. Charges for deposits are shown as separate items on the taxpayer's sales invoices and are set up as a liability on the taxpayer's books and records. Moreover, the sales invoices include a statement that the containers are the property of the taxpayer. The taxpayer's records indicate that the returnable containers are not treated as sold when shipped. Approximately 90 percent of the containers are returned by the customers to whom they are originally shipped.

The taxpayer has capitalized the cost of all returnable containers purchased and maintains its books and records in such a manner as to properly reflect the unadjusted basis upon which depreciation of the returnable containers may be computed, the computation of such depreciation, and the adjusted basis and other factors involved in the computation of gain or loss on the sale or other disposition of the containers.

Section 167(a) of the Code provides that there shall be allowed as a depreciation deduction a reasonable allowance for exhaustion, wear and tear of property used in the trade or business. Section 1.167(a)-2 of the Income Tax Regulations provides, insofar as here pertinent, that the depreciation allowance in the case of tangible property applies only to that part of the property which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence. The allowance does not apply to inventories or to stock in trade.

Section 471 of the Code provides the general rule for the use of inventories. Section 39.22(c)-1 of Regulations 118, applicable by virtue of Treasury Decision 6091, C. B. 1954–2, 47, provides that a taxpayer's inventory should include containers he owns "whether returnable or not, if title thereto will pass to the purchaser of the product to be sold therein." In such cases, since containers are inventoriable items while the vendor has title to them, they are not property for which he normally may be allowed a deduction for depreciation.

Where it has been found that title to containers was retained by the shipper, and the facts disclosed that a deduction for depreciation has been allowed (although it was not an issue), the Tax Court of the United States has not criticized such allowance although the deduction was indirectly involved in the decisions rendered. See *Nehi Beverage Co.* v. *Commissioner*, 16 T. C. 1114; *Farmers Creamery Co. of Fredericksburg, Virginia* v. *Commissioner*, 14 T. C. 879.

From the foregoing it will be noted that the allowance of depreciation on containers depends to some extent upon whether or not title thereto is retained by the shipper. The courts have generally held that title to containers passes to the vendee of the merchandise contained therein unless there is formal notice that title is retained by the vendor. Such formal notice may be indicated in the sales contract, on the sales invoice, acknowledgement of order, or in any other formal manner. See *LaSalle Cement Co. et al.* v. *Commissioner*, 59 Fed. (2d) 361, certiorari denied 287 U.S. 624; compare *Okonite Company* v. *Commissioner*, 4 T. C. 618; *Iten Biscuit Company* v. *Commissioner*, 25 B. T. A. 880, acquiescence C. B. XI–1, 4 (1932).

On the basis of the facts presented, it is concluded, with respect to the first question, that the essential elements for treating the containers as property used in trade or business, such as retention of title, the treatment thereof as separate items on the sales invoices, and the proper reflection of the basis thereof in the books and records, are present. It is accordingly held that, under the circumstances presented, the containers here under consideration constitute depreciable business property within the meaning of section 167 of the Code.

The second question presented in the instant case relates to whether gain or loss, if any, realized by the reason of the failure of customers

to return containers within the specified period may be treated as gain or loss, as the case may be, under the provisions of section 1231 of the Internal Revenue Code.

Section 1.1231–1(c) of the Income Tax Regulations so far as pertinent, provides as follows:

> TRANSACTIONS TO WHICH SECTION APPLIES.—Section 1231 applies to recognized gains and losses from the following:
>
> (1) The sale, exchange, or involuntary conversion of property held for more than 6 months and used in the taxpayer's trade or business, which is either real property or is of a character subject to the allowance for depreciation under section 167 (even though fully depreciated), and which is not—
>
> (i) Property of a kind which would properly be includible 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 to customers in the ordinary course of business;

In the foregoing discussion it was concluded, under the circumstances in the instant case, that the returnable containers are property used in the trade or business of a character subject to the allowance for depreciation provided in section 167 of the Code. However, it does not necessarily follow that such containers are subject to the treatment provided for in section 1231 of the Code merely because they are property used in the taxpayer's trade or business and held for more than six months. If the required container deposit is viewed as a liability, its forfeiture by the customer by reason of non-return of the container is the extinguishment of a liability and not a sale. If the deposit is viewed as an advance payment upon an implied sale to be made upon a condition subsequent, the seller is engaged in the trade or buisness of selling those containers which the customers do not return within the specified period.

G. C. M. 6630, C. B. VIII–2, 179 (1929), so far as pertinent, states:

> * * *, it has been held that a taxpayer may "regularly" carry on more than one business * * *. (Oscar E. Eysenbach, 10 B. T. A., 716, C. B. VII–2, 12). This office has held, further, that, since some degree of regularity is essential in order to distinguish isolated or sporadic transactions from a "business," any course of action, which is sufficiently regular to constitute a business at all, is also a business "regularly carried on." * * *.

In *Corn Products Refining Company* v. *Commissioner*, 350 U. S. 46, Ct. D. 1787, C. B. 1955–2, 511, the Supreme Court of the United States stated:

> * * * Congress intended that profits and losses arising form the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by section 117 [of the Internal Revenue Code of 1939] applies to transactions in property which are not the normal source of business income. It was intended to "relieve the taxpayer from * * * excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversion." *Burnet* v. *Harmel*, 287 U. S. at 106. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose.

In the *Corn Products Refining Company* case, the Supreme Court of the United States sustained the findings of the lower court that the taxpayer's dealings in futures constituted "an integral part of its manufacturing business" with the result that gains or losses from such dealings were held to be ordinary income or loss. Under the rationale

there used, the disposition of containers, in the instant case, which are treated as sold when not returned within the specified time, constitutes an "integral part" of the regular business of the taxpayer. Although a small proportion of the containers are sold, the agreement with all customers in advance is that all containers coming within a certain category, namely, those not returned within a specified period, will be considered sold to them upon the termination of that period. The facts show that the containers are property used in the taxpayer's business and are subject to depreciation until the time specified for their return has expired. At that time depreciation ceases and the containers become property sold to customers during the regular course of business.

In the *Nehi Beverage Co.* case, *supra*, the court stated:

* * * if unreturned containers are "sold" any gain should receive the same treatment as the gain from the sale of the beverage itself, and not the special treatment provided for certain types of gain in section 117(j) [of the 1939 Code, now section 1231 of the 1954 Code].

While there are certain differences between the facts in the instant case and the facts in the *Nehi Beverage Co.* case, the above quoted opinion is nevertheless equally applicable to both situations.

Accordingly, it is held, with respect to the second question, that the gain realized or loss sustained because of the failure of customers to return the containers within the time specified constitute ordinary income or loss falling within the scope of section 61 of the Code. Further, any gain or loss applicable to deposits which the taxpayer is not required to refund, due to reasons other than the nonreturn of containers at the end of the specified period, or to deposits retained by the taxpayer where containers are returned in poor condition, shall also be taken into account as ordinary gain or loss.

(Also Sections 1012, 1014, 1016; 1.1012–1, 1.1014–6, 1.1016–1.) Rev. Rul. 58–130

In computing the adjusted basis for depreciation of a farm and an apartment house owned by a husband and wife as tenants by entirety in the State of Indiana at the date of the husband's death, the basis (unadjusted) of the interest in the properties purchased by the wife must be reduced by depreciation thereof allowed or allowable to the wife prior to the husband's death in accordance with section 1016(a)(2) of the Internal Revenue Code of 1954. Adjustment must also be made for depreciation allowed to the wife prior to the husband's death with respect to the portion of the interest acquired from the decedent prior to his death, the basis of such portion to be determined under section 1014(b)(9) of the Code. No adjustment need be made for depreciation allowed to the husband before his death with respect to the interest in properties which is acquired from him by reason of his death if not actually acquired prior to the date of his death.

Revenue Ruling 56–519, C. B. 1956–2, 123, is amplified.

The Internal Revenue Service has been requested to amplify Revenue Ruling 56–519, C. B. 1956–2, 123, with respect to the adjustment of basis for depreciation of a farm and an apartment house owned by a husband and wife as tenants by entirety at the date of the husband's death in 1955.

Revenue Ruling 56–519, *supra*, holds, in part, as follows:

> The adjusted basis for depreciation of a farm and an apartment house owned by a husband and wife as tenants by entirety in the State of Indiana is, at the date of the husband's death, the wife's basis (unadjusted) of the interest in the property acquired from her husband by reason of his death, plus the basis (unadjusted) of her interest acquired by purchase, reduced by the amounts allowed as deductions for the depreciation thereof prior to the husband's death * * *.

The facts set forth in Revenue Ruling 56–519, *supra*, indicate that the wife acquired a portion of her interest in the properties involved through investment of her own capital and earnings during her husband's lifetime. A further portion of her interest was derived during her husband's lifetime from his earnings and investments to the extent they exceeded one-half the cost of the properties. The balance of the properties representing the one-half interest of the husband was acquired from him at his death.

The basis (unadjusted) to the wife of her interest in the properties acquired by purchase is the cost thereof to her in accordance with section 1012 of the Code. The basis (unadjusted) to her of the remaining interest is to be determined under section 1014(b)(9) of the Code since these interests are considered as having been acquired from the decedent; however, a portion of these latter interests was actually acquired from the decedent prior to his death.

Section 1014(b) provides, in part, as follows:

> * * * For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:
>
> * * * * * * *
>
> (9) In the case of decedents dying after December 31, 1953, property acquired from the decedent by reason of death, * * *, if by reason thereof the property is required to be included in determining the value of the decedent's gross estate under chapter 11 of subtitle B or under the Internal Revenue Code of 1939. In such case, if the property is acquired before the death of the decedent, the basis shall be the amount determined under subsection (a) reduced by the amount allowed to the taxpayer as deductions in computing taxable income under this subtitle or prior income tax laws for exhaustion, wear and tear, obsolescence, amortization, and depletion on such property before the death of the decedent. Such basis shall be applicable to the property commencing on the death of the decedent. * * *

The following statement is contained in the Report of Committee on Finance, United States Senate No. 1622, 83d Congress, 2d Session, page 424:

> Paragraph (9) has been substantially revised by your committee. It has been made clear that this paragraph does not apply to property described under any other paragraph. Thus the special basis rules prescribed in paragraphs (5) and (7) will continue to apply in the case of decedents dying after December 31, 1953, as well as the general rules set out in other paragraphs (except where the paragraph is specifically made inapplicable after a certain date).

Section 1016(a)(2) of the Code provides that for taxable years beginning on or after January 1, 1952, the cost or other basis of property shall be decreased for depreciation by the greater of the following amounts: (a) the amount allowed as deductions in computing taxable income, to the extent resulting in a reduction of the taxpayer's income taxes; or (b) the amount allowable for the years involved. Where the taxpayer makes an appropriate election, the above rule is applicable for periods since February 28, 1913, and before January 1, 1953.

Therefore, in computing the adjusted basis for depreciation of a farm and an apartment house owned by a husband and wife as tenants by entirety in the State of Indiana at the date of the husband's death, the basis (unadjusted) of the interest in the properties purchased by the wife must be reduced by depreciation thereof allowed or allowable to the wife prior to the husband's death in accordance with section 1016(a)(2) of the Code. Adjustment must also be made for depreciation allowed to the wife for the period prior to the husband's death with respect to the portion of the interest acquired from the decedent prior to his death, the basis of which portion is to be determined under section 1014(b)(9) of the Code. No adjustment need be made for depreciation allowed to the husband before his death with resepct to the interest in properties which is acquired from him by reason of his death if not actually acquired prior to the date of his death.

Revenue Ruling 56–519, C. B. 1956–2, 123, is amplified.

No depreciation allowed of buildings constructed under certain contracts with Post Office Department. See Rev. Rul. 58–281, page 235.

---

26 CFR 1.167(a)–7: Accounting for depreciable property. (Also Section 6001.) Rev. Rul. 58–306

Work sheets maintained by a taxpayer for the purpose of reconciling the book depreciation with the tax depreciation do not meet the requirement of the Income Tax Regulations that permanent auxiliary records be maintained if reserves for book purposes do not correspond with reserves maintained for tax purposes.

Advice has been requested whether "work sheets" used by a taxpayer may be considered as fulfilling the requirement of the regulations that permanent auxiliary records be maintained for reconciling differences in depreciation reserves maintained for tax and book purposes.

Section 167 of the Internal Revenue Code of 1954 provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of (1) property used in the trade or business, or (2) property held for the production of income.

Section 1.167(a)–7(c) of the Income Tax Regulations provides that if reserves for book purposes do not correspond with reserves maintained for tax purposes, permanent auxiliary records shall be maintained with the regular books of account reconciling the differences in depreciation for tax and book purposes because of different methods of depreciation, bases, rates, salvage, or other factors.

Section 6001 of the Code also requires that every person liable for any tax, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary of the Treasury or his delegate may from time to time prescribe. Whenever the Secretary or his delegate deems it necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary or his delegate deems sufficient to show whether or not such person is liable for tax.

Certain taxpayers using the "fast write-off" methods provided by the 1954 Code for claiming depreciation for tax purposes have not been maintaining the permanent auxiliary records required to be maintained as indicated by the above cited section of the regulations. However, most of them are able to present "work sheets" from which their book depreciation may be reconciled with their reported tax depreciation. In some cases, these "work sheets" are kept in the same office as the other books of accounts, while in other cases they are prepared and maintained by independent accountants in the office of the accountant.

Where a taxpayer maintains only "work sheets" from which the difference in depreciation for book and tax purposes may be reconciled, the Internal Revenue Service holds that there has been a failure to comply with the requirements of the regulations and with section 6001 of the Code. Accordingly, the taxpayer is required to keep such auxiliary records as are permanent in nature, are maintained with the regular books of account, and in themselves reconcile the difference in depreciation for book and tax purposes.

---

26 CFR 1.167(f)-1: Basis for depreciation.

Basis for depreciation in the case of depreciable assets partially certified as emergency facilities. See Rev. Rul. 58-131, below.

SECTION 168.—AMORTIZATION OF EMERGENCY FACILITIES

(Also Section 167, 26 CFR 1.167(f)-1.) Rev. Rul. 58-131

In the case of depreciable assets, partially certified as emergency facilities, the portion subject to amortization and the portion subject to depreciation must be considered separately. Consequently, the estimated salvage value attributable only to the uncertified portion of the facility should be taken into account in determining the depreciation allowance.

Advice has been requested regarding the proper treatment to be accorded estimated salvage value of depreciable assets which are partially certified as emergency facilities.

The relation of the salvage value to cases involving emergency facilities and the problem resulting therefrom may best be illustrated by the following case:

Assume an 80 percent necessity certificate is issued on an emergency facility costing $100x$ dollars of which 80 percent will be amortized over a period of 60 months. The balance of 20 percent will be depreciable over a normal expected life of 25 years. The salvage recovery on the entire asset is estimated to 10 percent of the entire cost.

The problem for consideration based on the above facts is whether the salvage value on the entire facility is to be taken into account with respect to the uncertified portion, that is, that portion which may be depreciated under section 168(f) of the Internal Revenue Code of 1954.

Section 168 of the Code, relating to amortization of emergency facilities, provides in part as follows:

(a) GENERAL RULE.—Every person, at his election, shall be entitled to a reduction with respect to the amortization of the adjusted basis (for determining gain) of any emergency facility * * * based on a period of 60 months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the facility at the end of such month divided by the number of months * * * remaining in the period. * * * The amortization deduction above provided with respect to any month shall, except to the extent provided in subsection (f), be in lieu of the depreciation deduction with respect to such facility for such month provided by section 167. * * *

* * * * * * *

(f) Depreciation deduction. If the adjusted basis of the emergency facility (computed without regard to this section) is in excess of the adjusted basis computed under subsection (e), the depreciation deduction provided by section 167 shall, despite the provisions of subsection (a) of this section, be allowed with respect to such emergency facility as if its adjusted basis for the purpose of such deduction were an amount equal to the amount of such excess.

Thus, it is apparent that in those cases, where only a portion of a facility is certified, the balance of the depreciable property will be subject to the allowance for depreciation.

The deduction for amortization of a properly certified emergency facility is allowed in lieu of the deduction for exhaustion, wear and tear and obsolescence otherwise allowable under the depreciation provisions of the Code. No provision has been made in section 168 for the treatment of any salvage value of the certified part of such facility, neither is there any provision requiring that the salvage value on the certified part be taken into account in determining the depreciation allowance for the uncertified part.

Accordingly, it is held that the uncertified cost of the emergency facility is considered separately and, therefore, the estimated salvage value on the uncertified part only is to be taken into account in determining the depreciation allowance attributable to such uncertified cost.

---

26 CFR 1.168; Statutory provisions; amortization of emergency facilities.

Regulations under the Internal Revenue Code of 1954. See T. D. 6291, page 63.

SECTION 170.—CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS

Rev. Rul. 58–154

Contributions made by third parties to pension funds established under a State law for the benefit of municipal employees, municipal policemen, or municipal firemen, which are deposited by the administering pension board to the credit of the particular fund for the use and benefit of the respective pension system, are deductible by the donors in computing their taxable income in the manner and to the extent provided by section 170 of the Internal Revenue Code of 1954.

Advice has been requested whether contributions made by third parties to pension funds established under a state law for the benefit

of municipal employees, municipal policemen, or municipal firemen are deductible by the donors for Federal income tax purposes.

In the instant case, separate pension systems were established under a state law for the benefit of municipal employees, policemen, and firemen of certain cities in the state. The funds are administered by a pension board organized pursuant to state law. The funds are maintained from certain state taxes and by deductions from the pay of the employees covered by the systems. Occasionally, residents of a city make gratuitous donations to the pension funds. The pension laws of the state provide, in general, that the pension boards acting for the pension funds are authorized and empowered to accept donations or contributions from any source for their respective funds and to deposit the donations to the credit of the particular pension fund for the use and benefit of the pension system.

Section 170 of the Internal Revenue Code of 1954 provides for the deduction, in computing taxable income, of any charitable contribution, as defined in subsection (c) of that section, payment of which is made within the taxable year. Section 170 (c) of the Code provides that a charitable contribution means, among other items, a gift to or for the use of a State, a Territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, if the contribution is made for exclusively public purposes.

Accordingly, it is held that contributions made by third parties to pension funds established under a state law for the benefit of municipal employees, municipal policemen, or municipal firemen, which are deposited by the administering pension board to the credit of the particular fund for the use and benefit of the respective pension system, are deductible by the donors in computing their taxable income in the manner and to the extent provided by section 170 of the Code.

Rev. Rul. 58–260

The fair market value of an undivided present interest in a patent, which is contributed by the owner of the patent to an organization described in section 170(c) of the Internal Revenue Code of 1954, constitutes an allowable deduction as a charitable contribution, to the extent provided in section 170, in the taxable year in which such property is contributed.

Advice has been requested with respect to the treatment for Federal income tax purposes of the transfer, under the circumstances described below, of an undivided one-fourth present interest in a patent by the owner of the patent to an organization described in section 170(c) of the Internal Revenue Code of 1954.

A, the inventor and owner of a patented process, granted to *M* Corporation a nonexclusive license to practice the process and sell the products of such process. *A* and his wife own all of the outstanding capital stock of *M* Corporation. *A* is also a trustee of an organization described in section 170(c) of the Code. *A* contributed to that organization an undivided one-fourth present interest in his patent.

Since the transfer of the undivided present interest in the patent is a transfer of a substantial interest in property, any royalties attributable to that interest in the patent, which are earned subsequent to the transfer and paid to the organization as a result of such transfer, constitute income to the organization and not to *A*.

Section 170 of the Internal Revenue Code of 1954 provides in part as follows:

> (a) ALLOWANCE OF DEDUCTION.—
> (1) GENERAL RULE.—There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary or his delegate.

Section 1.170–1(c) of the Income Tax Regulations provides that if a contribution is made in property other than money, the amount of the deduction is determined by the fair market value of the property at the time of the contribution.

Accordingly, it is held that a deduction will be allowable to *A*, to the extent provided by section 170 of the Code, for his contribution of the undivided one-fourth present interest in the patent, and such deduction will be allowable for the taxable year in which the property is contributed. The amount of the allowable deduction will be the fair market value of the patent interest transferred, such fair market value being a question of fact to be determined upon the examination of *A*'s income tax return for the year in which the contribution is claimed as a deduction.

Rev. Rul. 58–265

Where the legislature of a state passed a joint resolution to establish an official committee to receive unsolicited voluntary contributions and to disburse the fund thereby created in defraying the expense of providing state units for a parade incident to a Presidential Inauguration, with any unexpended balance remaining in the fund to be deposited in the general fund of the state, the amounts contributed constitute contributions or gifts to or for the use of a state for exclusively public purposes under section 170 of the Internal Revenue Code of 1954, and are therefore deductible, for Federal income tax purposes, by the donors in the manner and to the extent provided by that section.

Deductibility of payments to or for the use of a cemetery company or corporation, including that part of the purchase price of burial lots or mausoleum crypts which is paid into an irrevocable trust fund dedicated to the perpetual care of a cemetery or particular lots or mausoleum crypts. See Rev. Rul. 58–190, page 15.

---

26 CFR 1.170: Statutory provisions; charitable, etc., contributions and gifts. T. D. 6285 [1]

[1] 23 F. R. 1759.

Regulations prescribed under section 170 of the Internal Revenue Code of 1954, relating to charitable, etc., contributions and gifts.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On August 7, 1956, notice of proposed rule making regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954 (except as otherwise provided therein), under section 170 of the Internal Revenue Code of 1954 was published in the Federal Register (21 F. R. 5867). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted. Such regulations supersede paragraph 4 of Treasury Decision 6118 [C. B. 1955–1,698], approved December 30, 1954 (19 F. R. 9896; 26 CFR Parts 1 to 169 (1956 Rev.), par. 4, p. 6). The regulations so adopted do not give effect to the amendment to section 170(b) (1) (A) (iii), relating to contributions to certain medical research organizations by individuals, made by the Act of August 7, 1956, (Public Law 1022 [C. B. 1956–2,1207], 84th Cong., 70 Stat. 1117). Regulations under such amendment will be published in the Federal Register at a later date.

Table of Contents

Section
1.170 Statutory provisions; charitable, etc., contributions and gifts.
1.170–1 Charitable, etc., contributions and gifts; allowance of deduction.
1.170–2 Charitable deductions by individuals; limitations.
1.170–3 Contributions or gifts by corporations.

AUTHORITY: §§ 1.170 to 1.170–3, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

§ 1.170 STATUTORY PROVISIONS; CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.—

(a) ALLOWANCE OF DEDUCTION.—

(1) GENERAL RULE.—There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary or his delegate.

(2) CORPORATIONS ON ACCRUAL BASIS.—In the case of a corporation reporting its taxable income on the accrual basis, if—

(A) The board of directors authorizes a charitable contribution during any taxable year, and

(B) Payment of such contribution is made after the close of such taxable year and on or before the 15th day of the third month following the close of such taxable year,

then the taxpayer may elect to treat such contribution as paid during such taxable year. The election may be made only at the time of the filing of the return for such taxable year, and shall be signified in such manner as the Secretary or his delegate shall by regulations prescribe.

(b) LIMITATIONS.—

(1) INDIVIDUALS.—In the case of an individual the deduction provided in subsection (a) shall be limited as provided in subparagraphs (A), (B), (C), and (D).

(A) SPECIAL RULE.—Any charitable contribution to—

(i) A church or convention or association of churches,

(ii) An educational organization referred to in section 503(b)(2), or

(iii) A hospital referred to in section 503(b)(5), shall be allowed to the extent that the aggregate of such contributions does not exceed 10 percent of the taxpayer's adjusted gross income computed without regard to any net operating loss carryback to the taxable year under section 172.

(B) GENERAL LIMITATION.—The total deductions under subsection (a) for any taxable year shall not exceed 20 percent of the taxpayer's adjusted gross income computed without regard to any net operating loss carryback to the taxable year under section 172. For purposes of this subparagraph, the deduction under subsection (a) shall be computed without regard to any deduction allowed under subparagraph (A) but shall take into account any charitable contributions to the organizations described in clauses (i), (ii), and (iii) which are in excess of the amount allowable as a deduction under subparagraph (A).

(C) UNLIMITED DEDUCTION FOR CERTAIN INDIVIDUALS.—The limitation in subparagraph (B) shall not apply in the case of an individual if, in the taxable year and in 8 of the 10 preceding taxable years, the amount of the charitable contributions, plus the amount of income tax (determined without regard to chapter 2, relating to tax on self-employment income) paid during such year in respect of such year or preceding taxable years, exceeds 90 percent of the taxpayer's taxable income for such year, computed without regard to—

(i) This section,

(ii) Section 151 (allowance of deductions for personal exemptions), and

(iii) Any net operating loss carryback to the taxable year under section 172.

(D) DENIAL OF DEDUCTION IN CASE OF CERTAIN TRANSFERS IN TRUST.—No deduction shall be allowed under this section for the value of any interest in property transferred after March 9, 1954, to a trust if—

(i) The grantor has a reversionary interest in the corpus or income of that portion of the trust with respect to which a deduction would (but for this subparagraph) be allowable under this section; and

(ii) At the time of the transfer the value of such reversionary interest exceeds 5 percent of the value of the property constituting such portion of the trust.

For purposes of this subparagraph a power exercisable by the grantor or a nonadverse party (within the meaning of section 672(b)), or both, to revest in the grantor property or income therefrom shall be treated as a reversionary interest.

(2) CORPORATIONS.—In the case of a corporation, the total deductions under subsection (a) for any taxable year shall not exceed 5 percent of the taxpayer's taxable income computed without regard to—

(A) This section,

(B) Part VIII (except section 248),

(C) Any net operating loss carryback to the taxable year under section 172, and

(D) Section 922 (special deduction for Western Hemisphere trade corporations).

Any contribution made by a corporation in a taxable year to which this section applies in excess of the amount deductible in such year under the foregoing limitation shall be deductible in each of the two

succeeding taxable years in order of time, but only to the extent of the lesser of the two following amounts: (i) the excess of the maximum amount deductible for such succeeding taxable year under the foregoing limitation over the contributions made in such year; and (ii) in the case of the first succeeding taxable year the amount of such excess contribution, and in the case of the second succeeding taxable year the portion of such excess contribution not deductible in the first succeeding taxable year.

(c) CHARITABLE CONTRIBUTION DEFINED.—For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of—

(1) A State, a Territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

(2) A corporation, trust, or community chest, fund, or foundation—

(A) Created or organized in the United States or in any possession thereof, or under the law of the United States, any State or Territory, the District of Columbia, or any possession of the United States;

(B) Organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals;

(C) No part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) No substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation.

A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B).

(3) A post or organization of war veterans, or an auxiliary unit or society of, or trust or foundation for, any such post or organization—

(A) Organized in the United States or any of its possession, and

(B) No part of the net earnings of which inures to the benefit of any private shareholder or individual.

(4) In the case of a contribution or gift by an individual, a domestic fraternal society, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

(5) A cemetery company owned and operated exclusively for the benefit of its members, or 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, if such company or corporaton is not operated for profit and no part of the net earnings of such company or corporation inures to the benefit of any private shareholder or individual.

(d) DISALLOWANCE OF DEDUCTIONS IN CERTAIN CASES.—

(1) For disallowance of deductions in case of contributions or gifts to charitable organizations engaging in prohibited transactions, see section 503(e).

(2) For disallowance of deductions for contributions to or for the use of communist controlled organizations, see section 11(a) of the Internal Security Act of 1950 (64 Stat. 996; 50 U. S. C. 790).

(e) OTHER CROSS REFERENCES.—

(1) For charitable contributions of estates and trusts, see section 642(c).

(2) For nondeductibility of contributions by common trust funds, see section 584.

(3) For charitable contributions of partners, see section 702.

(4) For charitable contributions of nonresident aliens, see section 873.

(5) For treatment of gifts for benefit of or use in connection with the Naval Academy as gifts to or for the use of the United States, see section 3 of the Act of March 31, 1944 (58 Stat. 135; 34 U. S. C. 1115b).

(6) For treatment of gifts for benefit of the library of the Post Office Department as gifts to or for the use of the United States, see section 2 of the Act of August 8, 1946 (60 Stat. 924; 5 U. S. C. 393).

(7) For treatment of gifts accepted by the Secretary of State under the Foreign Service Act of 1946 as gifts to or for the use of the United States, see section 1021(e) of that Act (60 Stat. 1032; 22 U. S. C. 809(e)).

(8) For treatment of gifts of money accepted by the Attorney General for credit to the "Commissary Funds Federal Prisons" as gifts to or for the use of the United States, see section 2 of the Act of May 15, 1952 (66 Stat. 73, as amended by the Act of July 9, 1952, 66 Stat. 479, 31 U. S. C. 725s–4).

§ 1.170–1 CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS; ALLOWANCE OF DEDUCTION.—(a) *General rule.*—Any charitable contribution (as defined in section 170(c)) actually paid during the taxable year is allowable as a deduction in computing taxable income, regardless of the method of accounting employed or when pledged. In addition, contributions by corporations may under certain circumstances be deductible even though not paid during the taxable year (see § 1.170–3). The deduction is subject to the limitations of section 170(b) (see §§ 1.170–2 and 1.170–3) and is subject to verification by the district director. In connection with claims for deductions for charitable contributions, taxpayers shall state in their income tax returns the name and address of each organization to which a contribution was made and the amount and approximate date of the actual payment of each contribution. Any deduction for a charitable contribution must be substantiated, when required by the district director, by a statement from the organization to which the contribution was made indicating whether the organization is a domestic organization, the name and address of the contributor, the amount of the contribution, and the date of its actual payment, and by such other information as the district director may deem necessary.

(b) *Time of making contribution.*—Ordinarily a contribution is made at the time delivery is effected. In the case of a check, the unconditional delivery (or mailing) of a check which subsequently clears in due course will constitute an effective contribution on the date of delivery (or mailing). If a taxpayer unconditionally delivers a properly endorsed stock certificate to a charitable donee or the donee's agent, the gift is completed on the date of delivery. If the donor delivers the certificate to his bank or broker as the donor's agent, or to the issuing corporation or its agent, for transfer into the name of the donee, the gift is completed on the date the stock is transferred on the books of the corporation.

(c) *Contribution in property.*—If a contribution is made in property other than money, the amount of the deduction is determined by the fair market value of the property at the time of the contribution. The fair market value is the price at which the property would change

hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. If the contribution is made in property of a type which the taxpayer sells in the course of his business, the fair market value is the price which the taxpayer would have received if he had sold the contributed property in the lowest usual market in which he customarily sells, at the time and place of the contribution (and in the case of a contribution of goods in quantity, in the quantity contributed). The usual market of a manufacturer or other producer consists of the wholesalers or other distributors to or through whom he customarily sells, unless he sells only at retail in which event it is his retail customers. If a donor makes a charitable contribution of, for example, stock in trade at a time when he could not reasonably have been expected to realize its usual selling price, the value of the gift is not the usual selling price but is the amount for which the quantity of merchandise contributed would have been sold by the donor at the time of the contribution. Costs and expenses incurred in the year of contribution in producing or acquiring the contributed property are not deductible and are not a part of the cost of goods sold. Similarly, to the extent that costs and expenses incurred in a prior taxable year in producing or acquiring the contributed property are reflected in the cost of goods sold in the year of contribution, cost of goods sold must be reduced by such costs and expenses. Transfers of property to an organization described in section 170(c) which bear a direct relationship to the taxpayer's business and are made with a reasonable expectation of financial return commensurate with the amount of the transfer may constitute allowable deductions as trade or business expenses rather than as charitable contributions. See section 162 and the regulations thereunder.

(d) *Transfers of income and remainder interests.*—A deduction may be allowed for a contribution of an interest in the income from property or an interest in the remainder. The income or remainder interest shall be valued according to the tables referred to in § 1.170–2 (d). For rules with respect to certain transfers to a trust, see § 1.170–2(d).

(e) *Transfers subject to a condition or a power.*—If as of the date of a gift a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an interest passes to or is vested in charity on the date of the gift and the interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable on the date of the gift, the deduction is allowable. The deduction is not allowed in the case of a transfer in trust conveying a present interest in income if by reason of all the conditions and circumstances surrounding the transfer it appears that the charity may not receive the beneficial enjoyment of the interest. For example, assume that assets placed in trust consist of stock in a corporation the fiscal policies of which are controlled by the donor and his family, that the trustees and remaindermen are likewise members of the donor's family, and that

the governing instrument contains no adequate guarantee of the requisite income to the charitable organization. Under such circumstances, no deduction will be allowed. Similarly, if the trustees were not members of the donor's family but had no power to sell or otherwise dispose of closely held stock, or otherwise insure the requisite enjoyment of income to the charitable organization, no deduction would be allowed.

(f) *Exceptions.*—(1) This section does not apply to contributions by estates and trusts (see section 642(c)). For disallowance of certain charitable deductions otherwise allowable under section 170, see sections 503(e) and 681(b)(5) (relating to organizations engaged in prohibited transactions). For disallowance of deductions for contributions to or for the use of communist controlled organizations, see section 11(a) of the Internal Security Act of 1950 (64 Stat. 996; 50 U. S. C. 790), as amended. For denial of deduction for charitable contributions as trade or business expenses and rules with respect to treatment of payments to organizations other than those described in section 170(c), see section 162 and the regulations thereunder.

(2) No deduction shall be allowed under section 170 for amounts paid to an organization—

(i) A substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, or

(ii) Which participates in or intervenes in any political campaign on behalf of any candidate for public office.

For purposes of determining whether an organization is attempting to influence legislation or is engaging in political activities, see section 501(c)(3) and the regulations thereunder. Moreover, no deduction shall be allowed under section 170 for expenditures for lobbying purposes, promotion or defeat of legislation, etc. See also the regulations under section 162.

(3) No deduction for charitable contributions is allowed in computing the taxable income of a common trust fund or of a partnership. See sections 584(d) and 703(a)(2)(D). However, a partner's distributive share of charitable contributions actually paid by a partnership during its taxable year may be allowed as a deduction in the partner's separate return for his taxable year with or within which the taxable year of the partnership ends, to the extent that the aggregate of his share of the partnership contributions and his own contributions does not exceed the limitations in section 170(b). In the case of a nonresident alien individual, or a citizen of the United States entitled to the benefits of section 931, see sections 873(c), 876, and 931.

§ 1.170–2 Charitable Deductions by Individuals; Limitations.—(a) *In general.*—(1) A deduction is allowable to an individual under section 170 only for charitable contributions actually paid during the taxable year, regardless of when pledged and regardless of the method of accounting employed by the taxpayer in keeping his books and records. A contribution to an organization described in section 170(c) is deductible even though some portion of the funds of the organization may be used in foreign countries for charitable

or educational purposes. The deduction by an individual for charitable contributions under section 170 is limited generally to 20 percent of the taxpayer's adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under section 172). If a husband and wife make a joint return, the deduction for contributions is the aggregate of the contributions made by the spouses, and the limitation in section 170(b) is based on the aggregate adjusted gross income of the spouses. The 20-percent limitation applies to amounts contributed during the taxable year "to or for the use of" those recipients described in section 170(c). The limitation is computed without regard to contributions qualifying for the additional 10-percent deduction. For examples of the application of the 10- and 20-percent limitation, see paragraph (b)(5) of this section.

(2) No deduction is allowable for contribution of services. However, unreimbursed expenditures made incident to the rendition of services to an organization contributions to which are deductible may constitute a deductible contribution. For example, the cost of a uniform without general utility which is required to be worn in performing donated services is deductible. Similarly, out-of-pocket transportation expenses necessarily incurred in rendering donated services are deductible. Reasonable expenditures for meals and lodging necessarily incurred while away from home in the course of rendering donated services also are deductible. For the purposes of this section, the phrase "while away from home" has the same meaning as that phrase is used for purposes of section 162.

(3) (i) In the case of an annuity or portion thereof purchased from an organization described in section 170(c), there shall be allowed as a deduction the excess of the amount paid over the value at the time of purchase of the annuity or portion purchased.

(ii) The value of the annuity or portion is the value of the annuity determined in accordance with section 101(b) and the regulations thereunder.

(b) *Additional 10-percent deduction.*—(1) *In general.*—In addition to the deduction which may be allowed for contributions subject to the general 20-percent limitation, an individual may deduct contributions made during the taxable year "to", but not merely "for the use of", a church or a convention or association of churches, an educational organization referred to in section 503(b)(2) and defined in subparagraph (3) of this paragraph, or a hospital defined in subparagraph (4) of this paragraph, to the extent that such contributions in the aggregate do not exceed 10 percent of his adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under section 172). A contribution made to a trust, community chest, or other organization referred to in section 170(c), which in turn makes the contribution available to a church, school, or hospital, will not qualify under the 10-percent limitation, unless such trust, community chest, or other organization acts merely as an agent of the taxpayer in delivering the contribution. The computation of this additional deduction is not necessary unless the total contributions paid during the taxable year are in excess of the general

20-percent limitation. Where the total contributions exceed the 20-percent limitation, the taxpayer should first ascertain the amount of charitable contributions subject to the 10-percent limitation, and any excess over the 10-percent limitation should then be added to all other contributions and limited by the 20-percent limitation.

(2) *Church.*—For definition of "church", see the regulations under section 511.

(3) *Educational organization.*—An "educational organization" within the meaning of section 170(b)(1)(A) is one whose primary function is the presentation of formal instruction and which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The term, therefore, includes institutions such as primary, secondary, preparatory, or high schools, and colleges and universities. It includes Federal, State, and other public-supported schools which otherwise come within the definition. It does not include organizations engaged in both educational and noneducational activities unless the latter are merely incidental to and growing out of the educational activities. A recognized university which incidentally operates a museum or sponsors concerts is an educational organization. However, the operation of a school by a museum does not necessarily quality the museum as an educational organization. A gift to an educational institution through an alumni association or a class organization, which acts simply as a fund-raising or collection agency through which gifts may be made currently to the institution, is a gift to the educational organization if the entire gift inures to its benefit, but not if any part of it inures to the general or operating fund of the agency. Similarly, a gift to one or more educational institutions through an association of educational institutions will be considered a gift to the institutions if it inures entirely to their benefit.

(4) *Hospital.*—The term "hospital", as used in section 170(b)(1)(A), means an organization the principal purposes or functions of which are providing hospital or medical care. The term includes Federal and State hospitals otherwise coming within the definition but does not include medical education or research organizations. (See, however, the Act of August 7, 1956 (Public Law 1022, 84th Cong., 70 Stat. 1117), relating to contributions to certain medical research organizations.) A rehabilitation institution or an outpatient clinic may qualify as a hospital if its principal purposes or functions are the providing of hospital or medical care. The term "hospital" does not include convalescent homes or homes for children or the aged, nor does the term include institutions whose principal purposes or functions are to train handicapped individuals to pursue some vocation.

(5) *Examples.*—The application of the special 10-percent limitation and the general 20-percent limitation on contributions by individuals may be illustrated by the following examples:

Example (1). A, an individual, reports his income on the calendar year basis and for the year 1957 has an adjusted gross income of $10,000. During 1957 he made the following charitable contributions:

1.	Contributions qualifying for the additional 10-percent deduction under section 170(b)(1)(A)	$2,400	
2.	Other charitable contributions	700	
3.	Total contributions paid	$3,100	
			Deductible contributions
4.	Contributions qualifying for the additional 10-percent deduction under section 170(b)(1)(A)	$2,400	
5.	Special limitation under section 170(b)(1)(A): 10% of adjusted gross income	1,000	
6.	Deductible amount: line 4 or line 5, whichever is the lesser		$1,000
7.	Excess of line 4 over line 5	$1,400	
8.	Add: Other charitable contributions	700	
9.	Contributions subject to the general 20-percent limitation under section 170(b)(1)(B)	$2,100	
10.	Limitation under section 170(b)(1)(B): 20% of the adjusted gross income	2,000	
11.	Deductible amount: line 9 or line 10, whichever is the lesser		$2,000
12.	Contributions not deductible	$100	
13.	Total deductions for contributions		$3,000

Example (2). B, an individual, reports his income on the calendar year basis and for the year 1957 has an adjusted gross income of $10,000. During 1957 he made the following charitable contributions:

1.	Contributions qualifying for the additional 10-percent deduction under section 170(b)(1)(A)	$700	
2.	Other charitable contributions	2,400	
3.	Total contributions paid	$3,100	
			Deductible contributions
4.	Contributions qualifying for the additional 10-percent deduction under section 170(b)(1)(A)	$700	
5.	Limitation described in section 170(b)(1)(A): 10% of the adjusted gross income	1,000	
6.	Deductible amount: line 4 or line 5, whichever is the lesser		$700
7.	Excess of line 4 over line 5	$-0-	
8.	Add: Other charitable contributions	2,400	
9.	Contributions subject to the general 20-percent limitation under section 170(b)(1)(B)	$2,400	
10.	Limitation under section 170(b)(1)(B): 20% of the adjusted gross income	2,000	
11.	Deductible amount: line 9 or line 10, whichever is the lesser		2,000
12.	Contributions not deductible	$400	
13.	Total deduction for contributions		$2,700

(c) *Unlimited deduction for individuals.*—(1) *In general.*—The deduction for charitable contributions made by an individual is not subject to the 10- and 20-percent limitations of section 170(b) if in the taxable year and each of 8 of the 10 preceding taxable years the sum of his charitable contributions paid during the year, plus

his payments during the year on account of Federal income taxes, is more than 90 percent of his taxable income for the year (or net income, in years governed by the Internal Revenue Code of 1939). For the purpose of the preceding sentence, taxable income under the 1954 Code is determined without regard to the deductions for charitable contributions under section 170, for personal exemptions under section 151, or for a net operating loss carryback under section 172. On the other hand, for this purpose net income under the 1939 Code is computed without the benefit only of the deduction for charitable contributions. See section 120 of the Internal Revenue Code of 1939. The term "income tax" as used in section 170(b)(1)(C) means only Federal income taxes, and does not include the taxes imposed on self-employment income, on employees under the Federal Insurance Contributions Act, or on railroad employees and their representatives under the Railroad Retirement Tax Act by chapters 2, 21, and 22, respectively, or corresponding provisions of the Internal Revenue Code of 1939. For purposes of section 170(b)(1)(C) and this paragraph, the amount of income tax paid during a taxable year shall be determined by including all payments made by the taxpayer during such taxable year on account of his Federal income taxes (whether for the taxable year or for preceding taxable years). Such payments would include any amount paid during the taxable year as estimated tax for that year, payment of the final installment of estimated tax for the preceding taxable year, final payment for the preceding taxable year, and any payment of a deficiency for an earlier taxable year, to the extent that such payments do not exceed the tax for the taxable year for which payment is made. However, any payment of income tax with respect to which the taxpayer receives a refund or credit shall be reduced by the amount of such refund or credit. Any such refund or credit shall be applied against the most recent payments for the taxable year in respect of which the refund or credit arose.

(2) *Joint returns.*—(i) *Joint return for current taxable year.*—If a husband and wife make a joint return for any taxable year, their deduction for charitable contributions is not subject to the 10- and 20-percent limitations of section 170(b), if, under the rules of subparagraph (1) of this paragraph, in the taxable year and in each of 8 of the 10 preceding taxable years (regardless of whether separate or joint returns were filed) the aggregate charitable contributions of both spouses paid during the year, plus their aggregate payments during the year on account of Federal income taxes, exceeds 90 percent of their aggregate taxable incomes for the year.

(ii) *Separate return by spouse or by unremarried widow or widower.*—If a spouse, or the unremarried widow or widower of a deceased spouse, makes a separate return for any taxable year, his deduction for charitable contributions is not subject to the 10- and 20-percent limitations of section 170(b), if, under the rules of subparagraph (1) of this paragraph, in the taxable year and each of 8 of the 10 preceding taxable years—

(*a*) For which the taxpayer filed a joint return with his spouse, either their aggregate charitable contributions and payments of Federal income taxes made during the year exceed 90 percent of their aggregate taxable income for the year, or the taxpayer's

separate charitable contributions and payments of Federal income taxes (allocable to his separate income) made during the year exceed 90 percent of his separate taxable income for the year, and

(*b*) For which the taxpayer did not file a joint return with his spouse, his charitable contributions and payments on account of Federal income taxes made during the year exceed 90 percent of his taxable income for the year.

For the purpose of the preceding sentence, the word "spouse" does not include a spouse from whom the taxpayer has been divorced.

(iii) *Joint return with former spouse for prior taxable year.*—A divorced or remarried taxpayer who filed a joint return for a prior taxable year with a former spouse shall, for puposes of applying this paragraph, be treated in the same manner as if he had filed a separate return for such prior taxable year, and as if his Federal income tax liability and taxable income for such prior taxable year were his allocable portions of the joint tax liability and combined taxable income, respectively, for such year.

(iv) *Allocation.*—Whenever it is necessary to allocate the joint tax liability or the combined taxable income, or both, for a taxable year for which a joint return was filed, a computation shall be made for the taxpayer and for his spouse or former spouse showing for each of them the Federal income taxes and taxable income which would be determined if separate returns had been filed by them for such taxable year. The joint tax liability and combined taxable income for such taxable year shall then be allocated proportionately to the income taxes and taxable income, respectively, so computed. Whenever it is necessary to determine the separate payments made by a taxpayer in respect of a joint tax liability, the amount paid by him during the taxable year as estimated tax for that year shall be included to the extent it does not exceed his allocable portion of the joint tax for the taxable year, and any amount paid by him for a prior year (whether as the final installment of estimated tax for the preceding taxable year, or a final payment for the preceding year, or the payment of a deficiency for an earlier year) shall be included to the extent such amount, when added to amounts previously paid by him for such prior year, does not exceed his allocable portion of the joint tax liability for the prior year.

(d) *Denial of deduction in case of certain transfers in trust.*—(1) *Reversionary interest in grantor.*—No charitable deduction will be allowed for the value of any interest in property transferred to a trust after March 9, 1954, if the grantor at the time of the transfer has a reversionary interest in the corpus or income and the value of such reversionary interest exceeds 5 percent of the total value on which the charitable deduction would, but for section 170(b)(1)(D), be determined. For purposes of this paragraph, the term "reversionary interest" means a possibility that after the possession or enjoyment of property or its income has been obtained by a charitable donee, the property or its income may revest in the grantor or his estate, or may be subject to a power exercisable by the grantor or a nonadverse party (within the meaning of section 672(b)), or both, to revest in, or return to or for the benefit of, the grantor or his estate the property or income therefrom. An interest of the grantor which,

in any event, will terminate before the ripening of the assured charitable gift for which a deduction is claimed is not considered a reversionary interest for purposes of this section. For example, assume that a taxpayer conveyed property to a trust under the terms of which the income is payable to the taxpayer's wife for her life, and, if she predeceases him, to him for his life, and after the death of both the property is to be transferred to a charitable organization.

(2) *Valuation of interests.*—The present value of the remainder interest in the property, taking into account the value of the life estates reserved to the taxpayer and his wife, may be allowed as a charitable deduction. Where the corpus of the trust is to return to the grantor after a number of years certain, the value of the reversionary interest at the time of the transfer may be computed by the use of tables showing the present value at 3½ percent a year, compounded annually, of $1 payable at the end of a number of years certain. See Table II of § 81.10(i) of Regulations 105 (26 CFR (1939) Part 81). Where the value of a reversionary interest is dependent upon the continuation or termination of the life of one or more persons, it must be determined on the basis of Table 38 of United States Life Tables and Actuarial Tables 1939–1941, published by the United States Department of Commerce, Bureau of the Census, and interest at the rate of 3½ percent a year, compounded annually. See Table I of § 81.10(i) of Regulations 105 for valuations based on one life, and Internal Revenue Service Publication No. 11 (1955) (Actuarial Values for Estate and Gift Tax) for values based on more than one life. In an actual case (not merely hypothetical), the grantor or his legal representative may, upon request, obtain the information necessary to determine such a value from the district director with whom the grantor files his return. The request must be accompanied by a statement showing the date of birth of each person the duration of whose life may affect the value of the reversionary interest and by copies of the instruments relevant to the transfer.

(e) *Fiscal years and short taxable years ending after March 9, 1954, subject to the Internal Revenue Code of 1939.*—Pursuant to section 7851(a)(1)(C), the regulations prescribed in paragraph (d) of this section, to the extent that they relate to transfers in trust occurring after March 9, 1954, shall apply to all taxable years ending after March 9, 1954, even though those years may be subject to the Internal Revenue Code of 1939.

§ 1.170–3 Contributions or Gifts by Corporations.—(a) *In general.*—The deduction by a corporation in any taxable year for charitable contributions, as defined in section 170(c), is limited to 5 percent of its taxable income for the year, computed without regard to:

(1) The deduction for charitable contributions,

(2) The special deductions for corporations allowed under sections 241 through 247,

(3) Any net operating loss carryback to the taxable year under section 172, and

(4) The special deduction for Western Hemisphere trade corporations under section 922.

A contribution by a corporation to a trust, 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 is deductible only if the contribution is to be used in the United States or its possessions for those purposes. See section 170(c)(2). For the purposes of section 170, amounts excluded from the gross income of a corporation under section 114 (relating to sports programs conducted for the American National Red Cross) are not to be considered contributions or gifts. For disallowance of certain charitable, etc., deductions, see § 1.170–1(e).

(b) *Election by corporations on an accrual method.*—A corporation reporting its taxable income on an accrual method may elect to have a charitable contribution (as defined in section 170(c)) considered as paid during the taxable year, if payment is actually made on or before the fifteenth day of the third month following the close of the year and if, during the year, the board of directors authorized the contribution. The election must be made at the time the return for the taxable year is filed, by reporting the contribution on the return. There shall be attached to the return when filed a written declaration that the resolution authorizing the contribution was adopted by the board of directors during the taxable year, and the declaration shall be verified by a statement signed by an officer authorized to sign the return that it is made under the penalties of perjury. There shall also be attached to the return when filed a copy of the resolution of the board of directors authorizing the contribution.

(c) *Charitable contributions carryover of corporations.*—(1) Any contributions made by a corporation in a taxable year subject to the Internal Revenue Code of 1954 in excess of the amount deductible in that year under the 5-percent limitation of section 170(b)(2) are deductible in each of the two succeeding taxable years in order of time, but only to the extent of the lesser of the following amounts:

(i) The excess of the maximum amount deductible for the succeeding year under the 5-percent limitation of section 170 (b) (2) over the contributions made in that year; and

(ii) In the case of the first succeeding taxable year, the amount of the excess contributions; and, in the case of the second succeeding taxable year, the portion of the excess contributions not deductible in the first succeeding taxable year.

(2) The application of the rule in subparagraph (1) of this paragraph may be illustrated by the following example:

Example. A corporation which reports its income on the calendar year basis makes a charitable contribution of $10,000 in June 1957, anticipating taxable income for 1957 of $200,000. Its actual taxable income (without regard to any deduction for charitable contributions) for 1957 is only $50,000 and the charitable deduction for that year is limited to $2,500 (5 percent of $50,000). The excess charitable contribution not deductible in 1957 ($7,500) represents a carryover potentially available as a deduction in the two succeeding taxable years. The corporation has taxable income (without regard to any deduction for charitable contributions) of $150,000 in 1958 and makes a charitable contribution of $2,500 in that year. For 1958, the corporation may deduct as a charitable contribution the amount of $7,500 (5 percent of $150,000). This amount consists first of the $2,500 contribution made in 1958, and $5,000 of the $7,500 carried over from 1957. The remaining $2,500 carried over from 1957 and not allowable as a deduction in 1958 because of the 5-percent limitation may be carried over to

1959. The corporation has taxable income (without regard to any deduction for charitable contributions) of $100,000 in 1959 and makes a charitable contribution of $3,000. For 1959, the corporation may deduct under section 170 the amount of $5,000 (5 percent of $100,000). This amount consists first of the $3,000 contributed in 1959, and $2,000 of the $2,500 carried over from 1957 to 1959. The remaining $500 of the carryover from 1957 is not allowable as a deduction in any year because of the 2-year limitation provision of section 170(b)(2).

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved March 10, 1958.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on March 13, 1958, at 8:48 a. m. and published in the issue of the Federal Register for March 14, 1958, 23 F. R. 1759.)

---

26 CFR 1.170–1: Charitable, etc., contributions and gifts; allowance of deduction. Rev. Rul. 58–240

Unreimbursed expenses incurred by a lay member of a church in attending a church convention as a delegate, the unreimbursed expenses incurred by a member of the American Legion in attending an American Legion Convention, as a delegate, and unreimbursed expenses directly connected with and solely attributable to the rendition of such volunteer services by them to the church or to the American Legion, constitute contributions within the meaning of section 170 of the Internal Revenue Code of 1954 which are deductible in computing taxable income to the extent provided therein.

I. T. 1988, C. B. III–1, 198 (1924), revoked.

Advice has been requested whether expenses incurred by a lay member of a church who is appointed as a delegate to and attends a general convention of his church, or by a member of the American Legion who is appointed as a delegate to and attends an American Legion Convention, are deductible under the provisions of section 170 of the Internal Revenue Code of 1954.

Section 170 provides that there shall be allowed as a deduction any charitable contribution, as defined in subsection (c), payment of which is made within the taxable year. Section 170(c) provides, in part, as follows:

CHARITABLE CONTRIBUTION DEFINED.—For purposes of this section, the term "charitable contributions" means a contribution or gift to or for the use of—

* * * * * * *

(2) A corporation, trust, or community chest, fund, or foundation—

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State or Territory, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation.

A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within

the United States or any of its possessions exclusively for purposes specified in subparagraph (B).

(3) A post or organization of war veterans, or an auxiliary unit or society of, or trust or foundation for, any such post or organization—

(A) organized in the United States or any of its possessions, and

(B) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

I. T. 1988, C. B. III–1, 198 (1924), holds that the expenses of a delegate to a church conference or to an American Legion Convention paid by himself are not charitable contributions but personal expenses and are, therefore, not deductible.

Revenue Ruling 55–4, C. B. 1955–1, 291, holds that a taxpayer who gives his services gratuitously to an association, contributions to which are deductible under section 23(o) of the Internal Revenue Code of 1939, and who incurs unreimbursed traveling expenses, including the cost of meals and lodging, while away from home in connection with the affairs of the association and at its direction, may deduct the amount of such unreimbursed expenses in computing his net income subject to the limitations provided by section 23(o) of the 1939 Code. See also Revenue Ruling 57–327, C. B. 1957–2, 155.

Actual unreimbursed expenses incurred by civil defense volunteers in the performance of their volunteer duties, such as traveling expenses to watch atomic bomb tests and the expenses of attending state meetings of civil defense volunteers, have been held to constitute contributions or gifts within the meaning of section 170 of the 1954 Code. See Revenue Ruling 56–509, C. B. 1956–2, 129, and also I. T. 3571, C. B. 1942–2, 108.

Revenue Ruling 56–508, C. B. 1956–2, 126, holds that out-of-pocket expenses incurred by individuals for transportation to and from a local hospital or a local church for the purpose of rendering volunteer services to the American Red Cross or to the church constitute contributions within the meaning of section 170 of the 1954 Code and are deductible in computing taxable income. However, the cost of meals, unless such meals are necessarily incurred while away from home overnight in the course of rendering the volunteer services, constitutes a nondeductible personal expense.

In view of the foregoing, it is held that the actual unreimbursed expenses incurred by a lay member of a church in attending, as a delegate, a church convention, the unreimbursed expenses incurred by a member of the American Legion in attending, as a delegate, an American Legion Convention, and unreimbursed expenses directly connected with and solely attributable to the rendition of such volunteer services by them to the church or to the American Legion, constitute contributions within the meaning of section 170 of the 1954 Code and are deductible in computing taxable income to the extent provided therein. As to situations where the cost of meals and other personal expenses are nondeductible, see Rev. Rul. 56–508, *supra*.

I. T. 1988, C. B. III–1, 198 (1924), which holds that the expenses of a delegate to a church conference or to an American Legion Convention paid by himself are not charitable contributions but personal expenses and, therefore, not deductible, is hereby revoked.

This ruling is equally applicable to similar situations involving unreimbursed expenses of members of any other organization attend-

ing a convention as a delegate, where the organization meets the qualifications of section 170(c) of the Code.

Rev. Rul. 58–261

The taxpayer executed a special warranty deed in 1956 transferring and assigning an undivided two-fifths present interest in certain land and improvements thereon, as a gift, to an organization described in section 170(c) of the Internal Revenue Code of 1954. Further, it is the intention of the taxpayer to make a gift to the same organization of the remaining undivided three-fifths interest in the property, a part thereof to be so conveyed in 1958 and the remainder in 1959, although he is in no way obligated to do so. The three-fifths interest is now under lease to the organization for a term of three years at a fair rental value, with an option to buy such interest. If, during the term of the lease, the taxpayer makes further gifts to the organization of all or a part of the three-fifths interest, the rent payable under the lease will be proportionately reduced. *Held*, that the fair market value of the undivided two-fifths present interest in the property contributed to the organization in 1956 constitutes an allowable deduction from income for that year, to the extent provided by section 170 of the Code. If the taxpayer makes a gift of all or a part of the remaining three-fifths interest in the property to such organization, he will be entitled to a deduction equal to the fair market value of the interest so transferred, in the manner and to the extent provided by section 170 of the Code, for the year in which the gift is made. See Revenue Ruling 57–293, C. B. 1957–2, 153.

Rev. Rul. 58–262

The amount paid by a taxpayer to purchase building bonds issued by a church is not a gift made to the church, and the taxpayer is not entitled to deduct the price paid for the bonds as a contribution to or for the use of the church for Federal income tax purposes. However, in the event of a subsequent gift of such bonds to the church, the donor is entitled to a charitable deduction for their fair market value at the time of the gift, subject to the limitations of section 170(b) of the Internal Revenue Code of 1954, provided also that the church qualifies as an organization described in section 170 of the Code.

Advice has been requested whether an amount paid for bonds issued by a church, an organization referred to in section 170 of the Internal Revenue Code of 1954, is deductible by the purchaser as a charitable contribution, and whether the fair market value of such bonds when donated to the church may also be deducted as a contribution by the donor for Federal income tax purposes.

Section 170 of the Internal Revenue Code of 1954 provides, in part, that in computing taxable income an individual may deduct, subject to certain limitations, charitable contributions or gifts payment of which is made within the taxable year to or for the use of a corporation, trust, community chest, fund, or foundation which is organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals.

In order for a contribution to be deductible under the provisions of section 170 of the Code, it must, in addition to meeting the above requirements, be made without any consideration or benefit coming to the donor by reason of making the contribution. Thus, the purchase price of bonds issued by a church does not constitute a contribution to the church, since the purchaser clearly receives something of value in return for payment of the purchase price. However, a subsequent gift of the bonds by the taxpayer to the church will constitute, within certain limitations, a deductible charitable contribution. In the case of a gift made in property other than money, the amount of the contribution is determined by the fair market value of the property at the time of the gift.

In view of the above, it is held that the amount paid by a taxpayer to purchase building bonds issued by a church, an organization referred to in section 170 of the Code, is not a gift made to the church, and the taxpayer is not entitled to deduct the price of the bonds as a contribution to or for the use of the church for Federal income tax purposes. However, in the event of a subsequent gift of such bonds to the church, the donor is entitled to a charitable deduction for their fair market value at the time of the gift, subject to the limitations of section 170(b) of the Code, provided the church qualifies as an organization described in section 170 of the Code.

(Also Section 262.) Rev. Rul. 58–264

Payments made by clergymen to a pension fund administered by a church for their benefit, or for the benefit of their widows and dependent children, are not deductible under section 170 of the Internal Revenue Code of 1954 as charitable contributions to the church. Such payments constitute personal expenses, the deduction of which is prohibited by section 262 of the Code.

Advice has been requested whether payments made by clergymen to a pension fund administered by a church for their benefit are deductible under section 170 of the Internal Revenue Code of 1954.

Under the pension plan in the instant case, the clergymen are required to make a payment of three percent of their annual salary to the pension fund. A clergyman failing to make the required payment will have the benefits which he is entitled to receive on retirement, or that which his widow or children are entitled to receive upon his death, decreased accordingly. No part of the clergyman's payment is returnable except through retirement benefits.

Section 170 of the Code provides that in computing taxable income there shall be allowed as a deduction any charitable contributions, as defined in subsection (c) of section 170, payment of which is made within the taxable year. The term "charitable contribution" as defined in section 170(c) includes contributions to certain charitable and religious organizations.

The annual pension which a clergyman receives upon retirement is equal to the amount voted at the annual meeting of the church times his number of years of approved service. This amount is the same for all retired clergymen, although some will have contributed more than others because the pension payment is a percentage of their annual salary. However, while the pensions received by the clergy-

men do not have a direct relation to the payments they have made, the participants do derive a benefit from payments to the fund. As has been noted, the failure to make the required payments serves to reduce the amount one is entitled to received upon retirement or the amount which his widow or dependent children are entitled to receive upon his death. Inasmuch as each clergyman making payments to the pension fund provides protection for himself as well as for his widow and dependent children, the payments to the fund cannot be said to be without adequate consideration.

Accordingly, it is held that payments made by clergymen to a pension fund administered by a church for their benefit, or for the benefit of their widows and dependent children, are not deductible under section 170 of the Code as charitable contributions to the church. Such payments constitute personal expenses, the deduction of which is prohibited by section 262 of the Code.

Rev. Rul. 58–279

The taxpayer, an aircraft pilot, performs various services gratuitously for the Civil Air Patrol, an organization of the type described in section 170(c) of the Internal Revenue Code of 1954. He uses his personally owned aircraft, automobile, and other equipment hereinafter mentioned in performing such volunteer services; pays the entire cost of their maintenance and repair; purchases the gasoline and oil used therein, except for fuel and lubricants consumed on "Air Force-authorized missions;" and is not otherwise reimbursed for any such expenses. *Held*, since the organization is a qualified donee under section 170(c) of the Code, the taxpayer may, to the extent of the limitations prescribed in section 170, deduct the nonreimbursed, out-of-pocket expenses directly attributable to the performance of such volunteer services, such as those incurred by the taxpayer for the operation, maintenance, and repair of a personally owned aircraft, automobile, communication system, and telescope, as well as those similarly incurred for the purchase and maintenance of distinctive uniforms which the taxpayer is required to wear while engaged in official Civil Air Patrol activities and is prohibited from wearing except on such occasions. Such expenses are deductible as contributions "for the use of" that organization. Only those expenditures incurred for operation, maintenance, and repair, which are directly attributable to the use of such aircraft, automobile, communication system, and telescope in performing gratuitous services for such organization are deductible. No deduction is allowed for a proportionate share of general maintenance or general repairs of such equipment. *Held further*, the foregoing principle is not extended to allow a deduction either for the fair rental value of such use, or for the depreciation occasioned by such use, of the aircraft, automobile, communication system, or telescope, in performing volunteer services for the organization. See I. T. 3918, C. B. 1948–2, 33. Furthermore, since liability and property damage insurance carried on a motor vehicle is for the protection of the individual, the premiums paid on such insurance do not qualify as an expense attributable to the use of a vehicle and, consequently, cannot be considered a contribution or gift within the meaning of section 170 of the Code.

For other published rulings on this issue, see Revenue Rulings 55–4, C. B. 1955–1, 291; 56–508, C. B. 1956–2, 126; and 56–509, C. B. 1956–2, 129.

Rev. Rul. 58–293

A bar association, exempt from Federal income taxation as a business league, maintains a legal library as a quasi-public institution, the facilities of which are used free of charge by Federal, State, and local judges, elected officials and heads of the various administrative departments of the city and county, and such other public officials as the chairman of the library committee may designate. *Held*, the value of a gift of books to a library maintained as a part of the activity of an association exempt from Federal taxation as a business league under section 501(c)(6) of the Internal Revenue Code of 1954, is not deductible by the donor as a charitable contribution in computing taxable income inasmuch as the association is not one of those organizations to which charitable contributions are deductible under section 170(c) of the Code. If, however, the library is organized and operated as a separate fund and it meets the requirements for exemption under section 501(c)(3) of the Code, contributions to it would be deductible in the manner and to the extent provided in section 170 of the Code. See Rev. Rul. 54–243, C. B. 1954–1, 92.

Lump sum payment to religious home for care of taxpayer's father. See Rev. Rul. 58–303, page 61.

---

26 CFR 1.170–2: Charitable deductions by individuals; limitations. Rev. Rul. 58–263

The *M* organization was incorporated as a nonprofit, charitable organization for the purpose of improving the well-being of animals held for research in drugs and surgery. Its principal activity consists of soliciting and receiving contributions from the general public, which amounts, in excess of those expended for office supplies and postage, are allocated directly to several university medical schools for improvement of their facilities in keeping such laboratory animals. All work connected with the organization is done by volunteers and no part of its net income inures to the benefit of any private individual. The organization, which is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, is not an integral part of any of the universities to which it allocates its funds, nor is it financed or supervised by such institutions. *Held*, a nonprofit corporation whose primary purpose and activity is soliciting and distributing donations to improve the welfare of animals held for research does not qualify under any of the classes of organizations set forth in section 170(b)(1)(A) of the Code, to which the additional deduction of ten percent of adjusted gross income provided in that section applies. It is further held that contributions made to the organization for the *use* of the university medical schools will not qualify as contributions paid *to* the universities; therefore, deductible contributions made by individuals to the instant organization are

limited to 20 percent of the donor's adjusted gross income as provided by section 170(b)(1)(B) of the Code.

SECTION 172.—NET OPERATING LOSS DEDUCTION

26 CFR 1.172–3: Net operating loss in case of a taxpayer other than a corporation. Rev. Rul. 58–142

In the case of an individual, state income taxes, interest on state and Federal income taxes, and litigation expenses in connection with such income taxes, even where related to income derived from his trade or business and even though deductible under section 212 of the Internal Revenue Code of 1954 in determining taxable income as defined in section 63 of the Code, are not "attributable to a trade or business carried on by the taxpayer" and are, therefore, not deductible for the purpose of determining adjusted gross income as defined in section 62(1) of the Code. Section 1.62–1(d) of the Income Tax Regulations. However, a state tax on gross income directly attributable to a trade or business carried on by an individual, as distinguished from a state tax on net income (whether or not derived from the conduct of a trade or business), is deductible for the purpose of determining adjusted gross income as defined in section 62(1) of the Code, See, for example, I. T. 3766, C. B. 1945, 83, as modified by I. T. 3829, C. B. 1946–2, 38, involving the Indiana gross income tax. See also Rev. Rul. 58–25, page 95; compare Rev. Rul. 54–598, C. B. 1954–2, 121.

Further, section 172(d)(4) of the Code provides that, in determining a net operating loss of a taxpayer other than a corporation, the deductions allowed by Chapter 1 of the Code "which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business." Here also, state income taxes (except a state tax on gross income such as mentioned above), interest on state and Federal income taxes, and litigation expenses in connection with such taxes, even though related to income derived from a trade or business carried on by the taxpayer, are not "attributable to a taxpayer's trade or business," and under section 172(d)(4) of the Code are allowable as deductions in determining a net operating loss of a taxpayer, other than a corporation, only to the extent of the amount of the gross income not derived from such trade or business. See I. T. 3951, C. B. 1949–1, 84; *Wilma Aaron* v. *Commissioner*, 22 T. C. 1370; *Guignard Maxcy* v. *Commissioner*, 26 T. C. 526; and section 1.212–1(d) and (l) of the Income Tax Regulations.

---

26 CFR 1.172–4: Net operating loss carrybacks and net operating loss carryovers.

Carryover of a consolidated net operating loss attributable to a member of an affiliated group to a taxable year in which such member ceases to be a member of the group and files a separate income tax return. See Rev. Rul. 58–329, page 337.

SECTION 174.—RESEARCH AND EXPERIMENTAL EXPENDITURES

26 CFR 1.174–3: Treatment as expenses. Rev. Rul. 58–74

The deduction by a taxpayer of research or experimental expenditures on his income tax return for his first taxable year beginning after December 31, 1953, and ending after August 16, 1954, in which he pays or incurs research or experimental expenditures constitutes the adoption of the expense method provided by section 174(a) of the Internal Revenue Code of 1954, pursuant to the provisions of section 1.174(b)(1) of the Income Tax Regulations. The expense method of treating research or experimental expenditures so adopted is binding and is inclusive of all such expenditures as to the project or projects involved for the taxable year adopted and for all subsequent taxable years, until a change to another method is properly effected. Section 1.174–3(a) of the Income Tax Regulations.

If the taxpayer has adopted the expense method but has failed to include expenses relative to cost of obtaining a patent, such as attorneys' fees expended in making and perfecting a patent application, or other items of research or experimental expense in such deduction for prior taxable years to which the expense method is applicable (see section 1.174–3(b) of the Income Tax Regulations), he should file a timely claim (Form 843) or amended return and claim the additional research or experimental expenses for the year or years in which they were omitted. Since adoption of the expense method cannot be changed without the Commissioner's consent, such additional expenses cannot be treated under section 174(b) or capitalized and subsequently amortized or written off upon abandonment of the project or projects, and the deduction thereof in taxable years closed by the statute of limitations will be lost if claims or amended returns are not timely filed.

Rev. Rul. 58–78

Research and experimental expenditures which are otherwise properly deductible currently for Federal income tax purposes, under section 174(a) of the Internal Revenue Code of 1954, may be so deducted regardless of the manner in which such expenditures are recorded by the taxpayer on its books and financial statements.

Advice has been requested as to the deductibility, under section 174(a) of the Internal Revenue Code of 1954, of research and experimental expenditures which are reflected on corporate books and financial statements as capital account charges or deferred expenses.

The taxpayer is a manufacturing company and keeps its books on the accrual method. During the taxable year, certain research and experimental expenditures were recorded on its books as capital account charges or deferred expenses to be amortized over future production related to such charges. Research and experimental expenditures had not been paid or incurred by the corporation in any prior year and no election had been made as to the treatment to be afforded these expenditures for Federal income tax purposes. The taxpayer now proposes to deduct these expenditures from gross income, for Federal income tax purposes, in the year in which incurred, as provided in section 174(a) of the Code, but to continue to reflect such expenditures

on its books and in its financial statements as capital account charges or deferred expenses.

Section 174 of the Code, relating to research and experimental expenditures, provides, in part, as follows:

> (a) TREATMENT AS EXPENSES.—
> (1) IN GENERAL.—A taxpayer may treat research or experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.
>
> * * * * * * *
>
> (3) SCOPE.—The method adopted under this subsection shall apply to all expenditures described in paragraph (1). * * *

Section 1.174–3(b) of the Income Tax Regulations, pertaining to the adoption and change of the method of accounting for research and experimental expenditures provided for in section 174(a), provides that the consent of the Commissioner is not required if the taxpayer adopts the method for the first taxable year in which he pays or incurs research or experimental expenditures.

The taxpayer, having complied with the requirements of the Code and Income Tax Regulations with regard to research and experimental expenditures, may use its discretion in accounting for such expenditures for its own record keeping purposes. Section 1.446–1(a)(1) of the Income Tax Regulations, pertaining to methods of accounting, provides, in effect, that where a special method of accounting may be used for special items such as research and experimental expenditures, such method does not have to be consistent with the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. Furthermore, section 1.446–1(a)(4) of the regulations provides that the taxpayer must maintain such accounting records as will enable him to file a correct return, and such data as may be necessary to support his return as, for example, a reconciliation of any differences between such books and his return.

Therefore, it is held that research and experimental expenditures which are otherwise properly deductible currently for Federal income tax purposes, under section 174(a) of the Code, may be so deducted regardless of the manner in which such expenditures are recorded by the taxpayer on its books and in its financial statements.

SECTION 175.—SOIL AND WATER CONSERVATION EXPENDITURES

26 CFR 1.175–3: Definition of "the business of farming." Rev. Rul. 58–191

(Also Section 642; 1.642(h)–1, 1.642(h)–2.)

Income received by a taxpayer as beneficiary from a trust engaged in farming cannot be used by him for the purpose of computing the amount of his deductions for soil or water conservation expenditures of his own farm within the purview of section 175 of the Internal Revenue Code of 1954. If, on termination, the trust has for its last taxable year, deductions including expenditures for soil or water conservation to the extent deductible under section 175 of the Code) in excess of gross income for such year,

then such excess (including the aforesaid soil or water conservation expenditures to the extent deductible by the trust) is allowable under section 642(h)(2) of the Code as a deduction to the beneficiary succeeding to the property of the trust.

Advice has been requested (1) whether income received by a beneficiary from a trust engaged in farming may be used by the beneficiary in computing his allowable deduction for soil or water conservation expenses for his own form, and (2) whether, upon termination of the trust, the beneficiary may claim a deduction for such expenses of the trust which exceed the gross income of the trust for its year of termination.

Section 175 of the Internal Revenue Code of 1954 provides generally that a taxpayer engaged in the business of farming may treat expenditures which are paid or incurred by him during the taxable year for the purpose of soil or water conservation in respect of land used in farming as expenses which are not chargeable to capital account. Under the Code and expenditure properly so treated is allowed as a deduction, but the deduction thus allowed is limited to an amount which does not exceed 25 per cent of the gross income derived by the taxpayer from farming in the taxable year. However, the excess of such expenditures over 25 per cent of the gross income derived from farming in the taxable year is deductible in succeeding taxable years to the extent that, when combined with like deductions in a succeeding taxable year, the total does not exceed 25 percent of the gross income from farming for such succeeding year.

In the instant case, the first question presented is whether, for purposes of computing the 25 per cent limitation on the deduction allowable under section 175 of the Code for soil or water conservation expenditures, the amount of the "gross income derived from farming," on which said computation is based, is restricted to gross income derived by the taxpayer during the taxable year from farms which the taxpayer owned, or includes also sums received by the taxpayer in the taxable year as sole distributee of a trust which derives income from farms of its own. No expenditures were made by the trust for soil or water conservation.

The taxpayer contends that a trust is conduit through which the income flows except where accumulated for future distribution; and that income derived by the trust from farming and distributed to the taxpayer-beneficiary should be regarded for purposes of section 175 as income derived by the taxpayer-beneficiary himself from farming. However, it is a well established principle of income tax law that only as there is clear provision therefor can any particular deduction be allowed. *New Colonial Ice Company* v. *Helvering*, 292 U. S. 435, Ct. D. 841, C. B. XIII-1, 194 (1934). Further, the Internal Revenue Service considers the conduit principle to be superseded in the instant case by the explicit provisions of section 175 of the Code and regulations pertaining thereto. See sections 652 and 662 of the Code.

In section 175(a) of the Code the election to deduct, rather than to capitalize, soil or water conservation expenditures is granted only to a "taxpayer engaged in the business of farming," for expenditures made or incurred by him "in respect of land used in farming." Therefore, any amount determined pursuant to section 175(b) of the Code in connection with the 25 per cent limitation of the gross income from

farming must, in order to be deductible, meet first of all the basic requirements of section 175(a) of the Code. Section 1.175–3 of the Income Tax Regulations states that a taxpayer is "engaged in the business of farming" if he cultivates, operates, or manages a farm for gain or profit either as owner, tenant, or as the recipient of a rental based upon farm production. The regulations provide further that a taxpayer who receives a fixed rental for the use of farm land without reference to production is engaged in the business of farming only if he participates to a material extent in the operation or management of the farm. Moreover, under section 1.175–5(a)(2) of the regulations, the term "gross income from farming", on the basis of which the 25 per cent limitation in issue is determined, is said to mean the gross income of the taxpayer derived in the "business of farming" as defined in section 1.175–3.

The taxpayer in the instant case did not cultivate, operate, or manage the farm land held by the trust, either as owner, tenant or as the recipient of a fixed rental based upon production. That being the case, it is clear that, as to the land held by the trust, he was not "engaged in the business of farming" and that such land was not "used in farming" by the "taxpayer" or "his tenant" within the meaning of section 175(a) and (c)(2) of the Code accordingly, it is held that the income received by the taxpayer from the trust does not, as to him, represent "income from farming" for the purpose of computing the 25 per cent limitation to his deductions for soil or conservation expenditures for his own farm.

With respect to the second question, section 1.642(h) of the Income Tax Regulations provides separate treatment for unused loss carryovers to the beneficiaries on termination of a trust or an estate, and for deduction by the beneficiaries of the excess of deductions over gross income of the trust or estate in its last taxable year. Section 1.642(h)–1 of the regulations provides, in part, that if, on the final termination of an estate or trust, a net operating loss carryover or a capital loss carryover would be allowable to the estate or trust in a taxable year subsequent to the taxable year of termination but for the termination, the carryovers are allowed under section 642(h)(1) of the Code to the beneficiaries succeeding to the property of the estate or trust.

Section 1.642(h)–2 of the regulations provides, in part, that if, on the termination of an estate or trust, the estate or trust has for its last taxable year, deductions (other than for personal exemption or relating to charitable contributions) in excess of gross income, the excess is allowed under section 642(h)(2) of the Code as a deduction to the beneficiaries succeeding to the property of the estate or trust; and that the deduction is allowable only in the taxable year of the beneficiary in which or with which the estate or trust terminates.

Accordingly, it is held that:

(1) In the absence of any specific provisions in the Code(other than section 642(h) for a carryover of a deduction from the trust to the beneficiary, the excess of the soil or water conservation expenditures of the trust over 25 per cent of its gross income from farming does not follow the income to the beneficiary, whether or not such beneficiary has farm income separate from that of the trust.

(2) Where the trust has had soil or water conservation expenditures and such expenditures (to the extent deductible under section 175 of the Code) have entered into the computation of a net operating loss carryover of the trust under section 172 of the Code, upon termination of the trust the beneficiary succeeding to its property would be entitled under section 642(h)(1) of the Code to the net operating loss carryover as thus computed subject to the limitations imposed by section 1.642(h)-2(b) and (c) of the regulations.

(3) If, on termination, the trust has for its last taxable year, deductions (including expenditures for soil or water conservation to the extent deductible under section 175 of the Code) in excess of gross income for such year, then such excess (including the aforesaid soil or water conservation expenditures to the extent deductible by the trust) is allowable under section 642(h)(2) of the Code as a deduction to the beneficiary succeeding to the property of the trust subject to the limitations imposed by section 1.642(h)-2(b) and (c) of the regulations.

(4) Since the trust for its last taxable year (as in any other taxable year) is not entitled to deduct soil or water conservation expenditures in excess of 25 per cent of its gross income for such taxable year derived from farming, the excess amounts which, except for the termination of the trust, would, under section 175(b) of the Code, carry over as deductions to successive years of the trust are lost to the beneficiary, since a deduction allowable under section 642(h)(2) of the Code to a beneficiary succeeding to the property of the trust is limited to the excess of allowable deductions of the trust over gross income for its last taxable year.

PART VII.—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

SECTION 212.—EXPENSES FOR PRODUCTION OF INCOME

(Also Section 671; 26 CFR 1.671-3.) Rev. Rul. 58-53

Where a grantor-beneficiary of a revocable trust, who keeps his accounts and files his income tax returns on the cash method, pays in one year to a trustee as compensation for management of the trust the entire commission to which the trustee would be entitled for five years, the grantor may deduct in each of the five taxable years that part of the total commission which is attributable to the services performed by the trustee in each such year. However, that part of the commission attributable to each year which is allocable to the production or collection of any trust income which is exempt from Federal income tax, or to the management, conservation, or maintenance of property, the income from which is tax exempt, would not be deductible by the grantor for such year.

Advice has been requested as to the taxable year in which a grantor of a revocable trust may deduct trustee's commissions which the grantor paid in advance.

A grantor established a revocable trust, the net income to be distributed to himself during his lifetime. The trustees of the trust are the grantor and a certain bank. Under the trust agreement, the bank is entitled for its services in managing the trust to a commission of one-half of one percent per annum upon and chargeable against the principal of the trust estate for a period of five years.

The grantor paid to the bank the entire amount of the commission in the first year of the trust and claimed the amount paid as a deduction in his Federal income tax return for that taxable year. The grantor keeps his accounts and files his income tax returns on the cash receipts and disbursements method.

Section 212 of the Internal Revenue Code of 1954 provides, in part, that in the case of an individual there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

Section 671 of the Code provides, in part, that where the grantor is considered to be the owner of any portion of a trust, there shall be included in computing the taxable income and credits of the grantor those items of income, deductions, and credits against the tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account in computing taxable income or credits against the tax of an individual.

The deductions under section 212 of the Code are not allowable with respect to any amount which is allocable to the production or collection of one or more classes of income which are not includible in gross income, or for any amount allocable to the management, conservation or maintenance of property held for the production of income which is not included in gross income.

Where, as in the instant case, the taxpayer reports income on the cash receipts and disbursements method, prepaid compensensation for personal services is deductible only in the taxable year the services are actually rendered. See Rev. Rul. 170, C. B. 1953–2, 141.

Accordingly, it is held, that where a grantor-beneficiary of a revocable trust, who keeps his accounts and files his income tax returns on the cash method, pays in one year to a trustee as compensation for management of the trust the entire commission to which the trustee would be entitled for five years, the grantor may deduct in each of the five taxable years that part of the total commission which is attributable to the services performed by the trustee in each such year. However, that part of the commission attributable to each year which is allocable to the production or collection of any trust income which is exempt from Federal income tax, or to the management, conservation or maintenance of property, the income from which is tax exempt, would not be deductible by the grantor for such year.

---

26 CFR 1.212–1: Nontrade or nonbusiness expenses. Rev. Rul. 58–180

> Appraisal fees paid in order to establish a casualty loss on residential property due to subsoil shrinkage resulting from prolonged drought are deductible by the taxpayer, under section 212(3) of the Internal Revenue Code of 1954, as expenses incurred in determining the extent of his Federal income tax liability.

Advice has been requested with respect to the deductibility of appraisal fees paid by a taxpayer in order to establish a casualty loss sustained to residential property as a result of subsoil shrinkage due to prolonged drought.

Section 212(3) of the Internal Revenue Code of 1954 allows an individual a deduction of all the ordinary and necessary expenses paid or incurred during the taxable year in connection with the determination, collection, or refund of any tax.

Section 1–212–1(8) of the Income Tax Regulations provides that expenses paid or incurred by an individual in connection with the determination of liability for taxes are deductible.

A loss sustained to residential property as a result of subsoil shrinkage during a period of drought has been held to constitute a casualty loss in Revenue Ruling 54–85, C. B. 1954–1, 58. The burden of proving that any damage to property is the result of subsoil shrinkage and the amount of the resulting loss rests on the individual taxpayer.

Accordingly, it is held that the appraisal fees paid in order to establish a casualty loss on residential property due to subsoil shrinkage resulting from prolonged drought are deductible by the taxpayer under section 212(3) of the Code as expenses incurred in determining the extent of his Federal income tax liability.

SECTION 213.—MEDICAL, DENTAL, ETC., EXPENSES

26 CFR 1.213–1 : Medical, dental, etc., expenses. Rev. Rul. 58–8

Where a sick or disabled person acquires an "autoette" or a wheel chair, either manually operated or self-propelled, and uses it primarily for the alleviation of his sickness or disability, and not merely to provide transportation between his residence and place of employment, the cost of the "autoette," or wheel chair, constitutes an allowable medical expense under section 213 of the Internal Revenue Code of 1954.

Revenue Ruling 55–261, item 13, C. B. 1955–1, 307, at 311, modified.

Reconsideration has been given to item 13 of Revenue Ruling 55–261, C. B. 1955–1, 307, at 311, which concerns the deductibility as a medical expense of the cost of a three-wheel motor vehicle commercially known as an "autoette," acquired by a total disabled taxpayer for his personal transportation.

Medical expenses incurred and paid within a taxable year by an individual taxpayer are allowable as a deduction for Federal income tax purposes under section 213 of the Internal Revenue Code of 1954, within the limitations prescribed by that section. For the purposes of section 213, the term "medical care" means amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body and for transportation primarily for and essential to medical care.

In item 13 of Revenue Ruling 55–261, *supra*, it was held that the cost of a small three-wheel vehicle commercially known as an "autoette," acquired for transportation purposes by a disabled taxpayer, is not an expense incurred primarily for the alleviation of a physical defect or illness as provided in section 39.23(x)–1(d)(2) of Regulations 118, but represented a nondeductible personal expense under section 24(a)(1) of the Internal Revenue Code of 1939. The regulations promulgated under section 23(x) and section 24(a)(1) of the 1939 Code were made applicable to the 1954 Code by T. D. 6091, C. B.

1954–2, 46, pending the issuance of the new regulations under the 1954 Code.

Upon reconsideration it is now held that where a person who is sick or disabled acquires an "autoette," or a wheel chair, either manually operated or self-propelled, and uses it primarily for the alleviation of his sickness or disability and not merely to provide transportation between his residence and place of employment, the cost of the "autoette," or the wheel chair, constitutes an allowable medical expense under section 213 of the Code.

Revenue Ruling 55–261, item 13, C. B. 1955–1, 307, at 311, is modified to the extent that it holds the cost of a small three-wheel vehicle commercially known as an "autoette," acquired for transportation purposes, irrespective of the taxpayer's physical condition, constitutes a nondeductible personal expense.

Rev. Rul. 58–110

Under the circumstances presented, the cost of transportation for both the taxpayer and his nurse to go to a specific location predetermined by his physician for the sole purpose of alleviating a specific chronic ailment of the taxpayer, may be deducted as a medical expense subject to the limitations prescribed in section 213 of the 1954 Code.

Advice has been requested whether amounts paid by a taxpayer for transportation under the circumstances set forth below may be deducted as medical expenses for Federal income tax purposes.

In 1950, the taxpayer who is 80 years of age, was stricken with arteriosclerotic heart disease. Due to this affliction and his advanced age, the taxpayer, even under normal weather conditions, has difficulty in breathing and, under summer temperatures, his condition gets considerably worse. In view of the taxpayer's condition, his physician advised him to go to a predetermined location where the temperature was suitable and where he would receive proper medical care. Any further travel or sightseeing was precluded by his physician's orders. The physician further advised him to have a nurse with him who was familiar with necessary injections, medications and other treatment which the taxpayer continually required, and to help him in and out of his wheel chair. Inquiry was made whether the cost of transportation for both of them may be deducted as a medical expense under section 213 of the Internal Revenue Code of 1954.

Section 213 of the Code provides in part as follows:

(a) ALLOWANCE OF DEDUCTION.—There shall be allowed as a deduction the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent (as defined in section 152)—

* * * * * * *

(e) DEFINITIONS.—For purposes of this section—

(1) The term "medical care" means amounts paid—

(A) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance), or

(B) for transportation primarily for and essential to medical care referred to in subparagraph (A).

In Senate Report No. 1622, 83d Cong., Second Session, at pages 219 and 220, the Committee on Finance, United States Senate, said in discussing section 213 of the Code:

> The deduction permitted for "transportation primarily for and essential to melical care" clarifies existing law in that it specifically excludes deduction of any meals and lodging while away from home receiving medical treatment. For example, if a doctor prescribes that a patient must go to Florida in order to alleviate specific chronic ailments and to escape unfavorable climatic conditions which have proven injurious to the health of the taxpayer, and the travel is prescribed for reasons other than the general improvement of a patient's health, the cost of the patient's transportation to Florida would be deductible but not his living expenses while there. * * * The subsection is not intended otherwise to change the existing definitions of medical care, to deny the cost of ordinary ambulance transportation, nor to deny the cost of food or lodging provided as part of a hospital bill.

Based on the facts presented, section 213 of the Code and the Committee reports regarding such section, it is the conclusion of the Service that the taxpayer made the trip on the advice of his doctor in order to "alleviate specific chronic ailments and to escape unfavorable climatic conditions which have proven injurious to the health of the taxpayer" and that the travel was prescribed for reasons other than the "general improvement" of the patient's health.

Since the taxpayer was not able to travel alone, it is the further conclusion of the Service that the cost of transportation both for the taxpayer and his nurse to go to the predetermined location for the sole purpose of alleviating his "specific chronic ailment," may be deducted as a medical expense, subject to the limitations prescribed in section 213 of the Code.

Rev. Rul. 58–155

The cost of a reclining chair acquired for the purpose of obtaining the maximum and optimum of rest by a taxpayer with a cardiac condition will qualify as a medical expense within the meaning of section 213 of the Internal Revenue Code of 1954, if it can be substantiated that the chair was prescribed by a cardiac specialist; that it served no purpose other than the mitigation of the physical condition of the patient; and that it was not to be used generally as an article of furniture.

Rev. Rul. 58–223

A taxpayer's child was afflicted with an eye condition which was diagnosed as a disease which would eventually cause him to become totally blind. The child was enrolled in a state university. Certain special aids, recommended by competent physicians, are necessary to facilitate the child's further education, without further deterioration of his eyesight. *Held*, the costs of special aids to assist in the education of a child progressively becoming blind, such as a tape recorder, special typewriter, projection lamp for enlarging written material, and special lenses, are considered to be for the purpose of mitigating the condition of losing the sense of sight and are deductible as expenses paid for medical care under section 213 of the Internal Revenue Code of 1954, subject to the limitations provided therein. Compare items 4 and 10 of Revenue Ruling 55–261, C. B. 1955–1, 307.

(Also Part II, Section 23x; Regulations 118, 39.23(x)-1.) Rev. Rul. 58-280

The cost of special education, training, and treatment afforded a mentally retarded child in an institution is deductible as a medical expense. The total cost of meals, lodging, and ordinary education, furnished a mentally retarded child attending a special school, is deductible as a medical expense only where the availability of medical care in such institution is a principal reason for the child's presence there. It is immaterial whether such medical care is furnished in a public or private institution.

Revenue Ruling 55-261, C. B. 1955-1, 307, modified.

Advice has been requested (1) whether the cost of special education, training, and treatment given a mentally retarded child in a public or private institution is considered medical care and (2) whether the cost of meals, lodging, and ordinary education, furnished a mentally retarded child attending a special school, is deductible as a medical expense.

Section 213(a) of the Internal Revenue Code of 1954, provides in part that "There shall be allowed as a deduction the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent * * *." Revenue Ruling 55-261, C. B. 1955-1, 307, holds that only the cost of special instruction or training designed to alleviate a physical or mental handicap was allowable as a medical expense. The cost of ordinary educational courses and meals and lodging, which were furnished incidental to the specialized services provided the individual by the school or institution, were not considered a cost of medical care.

However, it is now concluded that where an individual is in an institution because his condition is such that the availability of medical care in such institution is a principal reason for his presence there and meals and lodging are furnished as a necessary incident to such care, the entire cost of medical care and meals and lodging at the institution, which are furnished while the individual requires continual medical care, constitute an expense for medical care. In other words, medical care includes the entire cost of institutional care for a person who is mentally ill and unsafe when left alone.

While ordinary education is not medical care, the cost of medical care is considered to include the cost of attending a special school for a mentally or physically handicapped individual, if his condition is such that the resources of the institution for alleviating such mental or physical handicap are a principal reason for his presence there. In such a case, the cost of attending such a special school will include the cost of meals and lodging, if supplied, and the cost of ordinary education furnished which is incidental to the special services furnished by the school. Thus, the cost of medical care includes the cost of attending a special school designed to compensate for or overcome a physical handicap, in order to qualify the individual for future normal education or for normal living, such as a school for the teaching of braille or lip reading. Similarly, care, supervision, treatment and training of a mentally retarded individual at an institution is within the meaning of the term "medical care."

Where an individual is in an institution and his condition is such that the availability of medical care in such institution *is not* a principal reason for his presence there, only that part of the cost of care

in the institution as is attributable to medical care shall be considered as a cost of medical care. The cost of his meals and lodging at the institution in such a case are not considered a cost of medical care. For example, an individual is in a home for the aged for personal or family considerations and not because he requires medical or nursing attention. In such case, medical care consists only of that part of the cost for care in the home which is attributable to medical care or nursing attention furnished to him and the cost of his meals and lodging at the home are not considered a cost of medical care.

It is immaterial whether the medical care is furnished in a Federal or State institution or in a private institution.

A distinction must be made, however, in cases involving the costs of sending a problem child to a special school where the curriculum and disciplinary methods employed have a beneficial effect on the child's attitude. Such costs are not includible as a medical expense under either the 1939 Code or the 1954 Code. See *Gordon Pascal et ux* v. *Commissioner*, Tax Court Memorandum Opinion entered June 19, 1956.

Accordingly, it is held that (1) the cost of special education, training, and treatment afforded a mentally retarded child in an institution is deductible as a medical expense; (2) the total cost of meals, lodging, and ordinary education, furnished a mentally retarded child attending a special school, is deductible as a medical expense only if his condition is such that the resources of the institution for alleviating such mental or physical handicap is a principal reason for the child's presence there; and (3) it is immaterial whether medical care is furnished in a public or private institution.

Revenue Ruling 55–261, C. B. 1955–1, 307, to the extent that it holds that the cost of meals, lodging, and ordinary instruction or tuition for physically or mentally handicapped persons at schools which specialize in their medical treatment is not deductible as a medical expense, is modified.

SECTION 214.—EXPENSES FOR CARE OF CERTAIN DEPENDENTS

26 CFR 1.214–1: Expenses for the care of certain dependents.

Determination of status of woman who receives support under a nonsupport decree. See Rev. Rul. 58–321, page 35.

SECTION 215.—ALIMONY, ETC., PAYMENTS

26 CFR 1.215–1: Periodic alimony, etc., payments.

Alimony award for payment of installments of principal and interest due on mortgaged real estate owned as joint tenants, together with the taxes, insurance and utility expenses incurred on such property. See Rev. Rul. 58–52, page 29.

Payments by husband to cover tax deficiencies attributable to alimony payments. See Rev. Rul. 58–100, page 31.

Cognizance of an agreement subsequent to a final decree by a court in modifying a divorce decree gives effect to the continuing status of the legal obligation of support. See Rev. Rul. 58–152, page 32.

Monthly payments made by a husband to his divorced wife which payments are characterized by a state court as settlement of the wife's property rights. See Rev. Rul. 58–192, page 34.

PART IX.—ITEMS NOT DEDUCTIBLE

SECTION 262.—PERSONAL, LIVING AND FAMILY EXPENSES

Payments made by clergymen to a pension fund administered by a church. See Rev. Rul. 58–264, page 144.

SECTION 263.—CAPITAL EXPENDITURES

Certain payments made to facilitate the transfer of ships from American to foreign registry. See Rev. Rul. 58–296, page 276.

SECTION 266.—CARRYING CHARGES

Use tax imposed by State of North Carolina on building materials, See Rev. Rul. 58–292, page 106.

SECTION 272.—DISPOSAL OF COAL

26 CFR 1.272: Statutory provisions; disposal of coal. T. D. 6281 [1]

(Also Sections 631, 632; 1.631, 1.632.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations prescribed under sections 272, 631, and 632 of the Internal Revenue Code of 1954.

Department of the Treasury,
Office of Commissioner of Internal Revenue,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On November 3, 1956, notice of proposed rulemaking regarding the regulations under sections 272, 631, and 632 of the Internal Revenue

[1] The publication of this Treasury Decision in 22 F. R. 10450, dated December 21, 1957, contains (1) instructions for modifying the notice of proposed rulemaking published in 21 F. R. 8434, dated Nov. 3, 1956, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

Code of 1954 for taxable years beginning after December 31, 1953, and ending after August 16, 1954, was published in the Federal Register (21 F. R. 8434). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted.

TABLE OF CONTENTS

Section
1.272 Statutory provisions; disposal of coal.
1.272–1 Expenditures relating to disposal of coal.
1.631 Statutory provisions; gain or loss in the case of timber or coal.
1.631–1 Election to consider cutting as sale or exchange.
1.631–2 Gain or loss upon the disposal of timber under cutting contract.
1.631–3 Gain or loss upon the disposal of coal with a retained economic interest.
1.632 Statutory provisions; sale of oil or gas properties.
1.632–1 Surtax on sale of oil or gas properties.

AUTHORITY: §§ 1.272 and 1.272–1, 1.631 to 1.632–1, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

§ 1.272 STATUTORY PROVISIONS; DISPOSAL OF COAL.

SEC. 272. DISPOSAL OF COAL.

Where the disposal of coal is covered by section 631, no deduction shall be allowed for expenditures attributable to the making and administering of the contract under which such disposition occurs and to the preservation of the economic interest retained under such contract, except that if in any taxable year such expenditures plus the adjusted depletion basis of the coal disposed of in such taxable year exceed the amount realized under such contract, such excess, to the extent not availed of as a reduction of gain under section 1231, shall be a loss deductible under section 165(a). This section shall not apply to any taxable year during which there is no income under the contract.

§ 1.272–1 EXPENDITURES RELATING TO DISPOSAL OF COAL.—(a) *Introduction.*—Section 272 provides special treatment for certain expenditures paid or incurred by a taxpayer in connection with a contract (hereafter sometimes referred to as a "coal royalty contract") for the disposal of coal the gain or loss from which is treated under section 631(c) as a section 1231 gain or loss on the sale of coal. The expenditures covered by section 272 are those which are atttributable to the making and administering of such a contract or to the preservation of the economic interest retained under the contract. For examples of such expenditures, see paragraph (d) of this section. For a taxable year in which gross royalty income is realized under the contract of disposal, such expenditures shall not be allowed as a deduction. Instead, they are to be added to the adjusted depletion basis of the coal disposed of in such taxable year in computing gain or loss under section 631(c). However, where no gross royalty income is realized under the contract of disposal in a particular taxable year, such expenditures shall be treated without regard to section 272.

(b) *In general.*—(1) Where the disposal of coal is covered by section 631(c), the provisions of section 272 and this section shall be applicable for a taxable year in which there is income under the contract of disposal. (For purposes of section 272 and this section, the term "income" means gross amounts received or accrued which are royalties or bonuses in connection with a contract to which section 631(c) applies.) All expenditures paid or incurred by the taxpayer during such taxable year which are attributable to the making

and administering of the contract disposing of the coal and all expenditures paid or incurred during such taxable year in order to preserve the owner's economic interest retained under the contract shall be disallowed as deductions in computing taxable income for such taxable year. The sum of such expenditures and the adjusted depletion basis of the coal disposed of in such taxable year shall be used in determining the amount of gain or loss with respect to the disposal. See § 1.631–3. For special rule in case of loss, see paragraph (c) of this section. Section 272 and this section are not applicable to capital expenditures and such expenditures are not taken into account in computing gain or loss under section 631(c) except to the extent they are properly part of the depletable basis of such coal.

(2) The expenditures covered under section 272 and this section are disallowed as a deduction only with respect to a taxable year in which income is realized under the coal royalty contract to which such expenditures are attributable. Where no income is realized under such contract in a taxable year, these expenditures shall be deducted as expense for the production of income, as a business expense, or may be treated under section 266 (relating to taxes and carrying charges) if applicable.

(3) The provisions of section 272 and this section apply to a taxable year in which income from the disposal by the owner of coal held by him for more than six months is subject to the provisions of section 631(c) even though the actual mining of coal under the coal royalty contract does not take place during such year. Where the right under the contract to mine coal for which advance payment has been made expires, terminates, or is abandoned before such coal is mined, and § 1.631–3(c) requires the owner to recompute his tax with respect to such payment the recomputation must be made without applying the provisions of section 272 and this section.

(c) *Losses.*—If, in any taxable year, the expenditures referred to in section 272 and this section plus the adjusted depletion basis (as defined in paragraph (b)(2) of § 1.631–3) of the coal disposed of during the taxable year exceed the amount realized under the contract which is subject to section 631(c) during the taxable year, such excess shall be considered under section 1231 as a loss from the sale of property used in the trade or business and, to the extent not availed of as a reduction of gain under that section, shall be a loss deductible under section 165(a) (relating to the deduction of losses generally).

(d) *Examples of expenditures.*—(1) The expenditures referred to in section 272 include, but are not limited to, the following items, if such items are attributable to the making or administering of the contract or preserving the economic interest therein: Ad valorem taxes imposed by State or local authorities, costs of fire protection, costs of insurance (other than liability insurance), costs incurred in administering the contract (including costs of bookkeeping and technical supervision), interest on loans, expenses of flood control, legal and technical expenses, and expenses of measuring and checking quantities of coal disposed of under the contract. Whether the interest on loans is attributable to the making or administering of the contract or preserving the economic interest therein will depend upon the use to which the borrowed monies are put.

(2) Any expenditure referred to in this section which is applicable to more than one coal royalty contract shall be reasonably apportioned to each such contract. Furthermore, if an expenditure applies only in part to the making or administering of the contract or the preservation of the economic interest, then only such part shall be treated under section 272. The apportionment of the expenditure shall be made on a reasonable basis. For example, where a taxpayer has other income (such as income from oil or gas royalties, rentals, right of way fees, interest, or dividends) as well as income under section 631(c), and where the salaries of some of its employees or other expenses relate to both classes of income, such expenses shall be allocated reasonably between the income subject to section 631(c) and the other income. Where a taxpayer has more than one coal royalty contract, expenditures under this section relating to a contract from which no income has been received in the taxable year may not be allocated to income from another contract from which income has been received in the taxable year.

(3) The taxpayer may have expenses which are not attributable even partly to making and administering a coal royalty contract or to the preservation of the economic interest retained under the contract and, accordingly, are not included in the expenditures described in section 272. These include such items as ad valorem taxes imposed by State or local authorities on property not covered by the contract, salaries, wages, or other expenses entirely incident to the ownership and protection of such property and depreciation of improvements thereon, fire insurance on such property, charitable contributions, and similar expenses unrelated to the making or to the administering of coal royalty contracts or preserving the taxpayer's economic interest retained therein.

(e) *Nonapplication of section.*—For purposes of section 543(a)(8)(B), in determining whether the deductions allowable under section 162 constitute 15 percent or more of gross income, the provisions of section 272 shall have no application.

SALES AND EXCHANGES

§ 1.631 Statutory Provisions; Gain or Loss in the Case of Timber or Coal.

SEC. 631. GAIN OR LOSS IN THE CASE OF TIMBER OR COAL

(a) Election to Consider Cutting as Sale or Exchange.—If the taxpayer so elects on his return for a taxable year, the cutting of timber (for sale or for use in the taxpayer's trade or business) during such year by the taxpayer who owns, or has a contract right to cut, such timber (providing he has owned such timber or has held such contract right for a period of more than 6 months before the beginning of such year) shall be considered as a sale or exchange of such timber cut during such year. If such election has been made, gain or loss to the taxpayer shall be recognized in an amount equal to the difference between the fair market value of such timber, and the adjusted basis for depletion of such timber in the hands of the taxpayer. Such fair market value shall be the fair market value as of the first day of the taxable year in which such timber is cut, and shall thereafter be considered as the cost of such cut timber to the taxpayer for all purposes for which such cost is a necessary factor. If a taxpayer makes an election under this subsection, such election shall apply with respect to all timber which is owned by the taxpayer or which the taxpayer has a contract right to cut and shall be binding on the taxpayer for

the taxable year for which the election is made and for all subsequent years, unless the Secretary or his delegate, on showing of undue hardship, permits the taxpayer to revoke his election; such revocation, however, shall preclude any further elections under this subsection except with the consent of the Secretary or his delegate. For purposes of this subsection and subsection (b), the term "timber" includes evergreen trees which are more than 6 years old at the time severed from the roots and are sold for ornamental purposes.

(b) DISPOSAL OF TIMBER WITH A RETAINED ECONOMIC INTEREST.—In the case of the disposal of timber held for more than 6 months before such disposal, by the owner thereof under any form or type of contract by virtue of which such owner retains an economic interest in such timber, the difference between the amount realized from the disposal of such timber and the adjusted depletion basis thereof, shall be considered as though it were a gain or loss, as the case may be, on the sale of such timber. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. The date of disposal of such timber shall be deemed to be the date such timber is cut, but if payment is made to the owner under the contract before such timber is cut the owner may elect to treat the date of such payment as the date of disposal of such timber. For purposes of this subsection, the term "owner" means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber.

(c) DISPOSAL OF COAL WITH A RETAINED ECONOMIC INTEREST.—In the case of the disposal of coal (including lignite), held for more than 6 months before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal, the difference between the amount realized from the disposal of such coal and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272 shall be considered as though it were a gain or loss, as the case may be, on the sale of such coal. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal. This subsection shall not apply to income realized by any owner as a co-adventurer, partner, or principal in the mining of such coal, and the word "owner" means any person who owns an economic interest in coal in place, including a sublessor. The date of disposal of such coal shall be deemed to be the date such coal is mined. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. This subsection shall have no application, for purposes of applying subchapter G, relating to corporations used to avoid income tax on shareholders (including the determinations of the amount of the deductions under section 535(b)(6) or section 545(b)(5)).

§ 1.631–1 ELECTION TO CONSIDER CUTTING AS SALE OR EXCHANGE.—(a) *Effect of election.*—(1) Section 631(a) provides an election to certain taxpayers to treat the difference between the actual cost or other basis of certain timber cut during the taxable year and its fair market value as standing timber on the first day of such year as gain or loss from a sale or exchange under section 1231. Thereafter, any subsequent gain or loss shall be determined in accordance with paragraph (e) of this section.

(2) For the purposes of section 631(a) and this section, timber shall be considered cut at the time when in the ordinary course of business the quantity of timber felled is first definitely determined.

(3) The election may be made with respect to any taxable year even though such election was not made with respect to a previous taxable year. If an election has been made under the provisions of section

631(a), or corresponding provisions of prior internal revenue laws, such election shall be binding upon the taxpayer not only for the taxable year for which the election is made but also for all subsequent taxable years, unless the Commissioner on showing by the taxpayer of undue hardship permits the txapayer to revoke his election for such subsequent taxable years. If the taxpayer has revoked a previous election, such revocation shall preclude any further elections unless the taxpayer obtains the consent of the Commissioner.

(4) Such election shall apply with respect to all timber which the taxpayer has owned, or has had a contract right to cut, for a period of more than six months prior to the beginning of the taxable year in which such timber is cut for sale or for use in the taxpayer's trade or business, irrespective of whether such timber or contract right was acquired before or after the election. (For purposes of the preceding sentence, the rules with respect to the holding period of property contained in section 1223 shall be applicable.) However, timber which is not cut for sale or for use in the taxpayer's trade or business (for example, firewood cut for the taxpayer's own household consumption) shall not be considered to have been sold or exchanged upon the cutting thereof.

(b) *Who may make election.*—(1) A taxpayer who has owned, or has held a contract right to cut, timber for a period of more than six months before the beginning of the taxable year may elect under section 631(a) to consider the cutting of such timber during such year for sale or for use in the taxpayer's trade or business as a sale or exchange of the timber so cut. In order to have a "contract right to cut timber" within the meaning of section 631(a) and this section, a taxpayer must have a right to sell the timber cut under the contract on his own account or to use such cut timber in his trade or business.

(2) For purposes of section 631(a) and this section, the term "timber" includes evergreen trees which are more than six years old at the time severed from their roots and are sold for ornamental purposes, such as Christmas decorations. Section 631(a) is not applicable to evergreen trees which are sold in a live state, whether or not for ornamental purposes. Tops and other parts of standing timber are not considered as evergreen trees within the meaning of section 631(a). The term "evergreen trees" is used in its commonly accepted sense and includes pine, spruce, fir, hemlock, cedar, and other coniferous trees.

(c) *Manner of making election.*—The election under section 631(a) must be made by the taxpayer in his income tax return for the taxable year for which the election is applicable, and such election cannot be made in an amended return for such year. The election in the return shall take the form of a computation under the provisions of section 631(a) and section 1231.

(d) *Computation of gain or loss under the election.*—(1) If the cutting of timber is considered as a sale or exchange pursuant to an election made under section 631(a), gain or loss shall be recognized to the taxpayer in an amount equal to the difference between the adjusted basis for depletion in the hands of the taxpayer of the timber which has been cut during the taxable year and the fair market value of such timber as of the first day of the taxable year in which such timber is cut. The adjusted basis for depletion of the cut timber shall

be based upon the number of units of timber cut during the taxable year which are considered to be sold or exchanged and upon the depletion unit of the timber in the timber account or accounts pertaining to the timber cut, and shall be computed in the same manner as is provided in section 611 and the regulations thereunder with respect to the computation of the allowance for depletion.

(2) The fair market value of the timber as of the first day of the taxable year in which such timber is cut shall be determined, subject to approval or revision by the district director upon examination of the taxpayer's return, by the taxpayer 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, methods of exploitation, 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 that particular day. Due consideration will be given to the factors and the principles involved in the determination of the fair market value of timber as described in the regulations under section 611.

(3) The fair market value as of the beginning of the taxable year of the standing timber cut during the year shall be considered to be the cost of such timber, in lieu of the actual cost or other basis of such timber, for all purposes for which such cost is a necessary factor. See paragraph (e) of this section.

(4) For any taxable year for which the cutting of timber is considered to be a sale or exchange of such timber under section 631(a), the timber so cut shall be considered as property used in the trade or business for the purposes of section 1231, along with other property of the taxpayer used in the trade or business as defined in section 1231(b), regardless of whether such timber is property of a kind which would properly be includible 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 to customers in the ordinary course of his trade or business. Whether the gain or loss considered to have resulted from the cutting of the timber will be considered to be gain or loss resulting from the sale or exchange of capital assets held for more than six months depends upon the application of section 1231 to the taxpayer for the taxable year. See section 1231 and the regulations thereunder.

(e) *Computation of subsequent gain or loss.*—(1) In case the products of the timber are sold after cutting, either in the form of logs or lumber or in the form of manufactured products, the income from such actual sales shall be considered ordinary income. When the election under section 631(a) is in effect, the cost of standing timber cut during the taxable year is determined as if the taxpayer had purchased such timber on the first day of the taxable year. Thus, in determining the cost of the products so sold, the cost of the timber shall be the fair market value on the first day of the taxable year in which the standing timber was cut, in lieu of the actual cost or other basis of such timber.

(2) This is also the rule in case the products of the timber cut during one taxable year, with respect to which an election has been made

under section 631(a), are sold during a subsequent taxable year, whether or not the election provided in section 631(a) is applicable with respect to such subsequent year. If the products of the timber cut during a taxable year with respect to which an election under section 631(a) was made were not sold during such year and are included in inventory at the close of such year, the fair market value as of the beginning of the year of the timber cut during the year shall be used in lieu of the actual cost of such timber in computing the closing inventory for such year and the opening inventory for the succeeding year. With respect to the costs applicable in the determination of the amount of such inventories, there shall be included the fair market value of the timber cut, the costs of cutting, logging, and all other expenses incident to the cost of converting the standing timber into the products in inventory. See section 471 and the regulations thereunder. The fact that the fair market value as of the first day of the taxable year in which the timber is cut is deemed to be the cost of such timber shall not preclude the taxpayer from computing its inventories upon the basis of cost or market, whichever is lower, if such is the method used by the taxpayer. Nor shall it preclude the taxpayer from computing its inventories under the last-in-first-out inventory method provided by section 472 if such section is applicable to, and has been elected by, the taxpayer.

§ 1.631–2 Gain or Loss Upon the Disposal of Timber Under Cutting Contract.—(a) *In general.*—(1) If an owner disposes of timber held for more than six months before such disposal, under any form or type of contract whereby he retains an economic interest in such timber, the disposal shall be considered to be a sale of such timber. The difference between the amounts realized from disposal of such timber in any taxable year and the adjusted basis for depletion thereof shall be considered to be a gain or loss upon the sale of such timber for such year. Such adjusted basis shall be computed in the same manner as provided in section 611 and the regulations thereunder with respect to the allowance for depletion. See paragraph (e)(2) of this section for definition of "owner". For the purpose of determining whether or not the timber disposed of was held for more than six months before such disposal, the rules with respect to the holding period of property contained in section 1223 shall be applicable.

(2) In the case of such a disposal, the provisions of section 1231 apply and such timber shall be considered to be property used in the trade or business for the taxable year in which it is considered to have been sold, along with other property of the taxpayer used in the trade or business as defined in section 1231(b), regardless of whether such timber is property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Whether gain or loss resulting from the disposition of the timber which is considered to have been sold will be deemed to be gain or loss resulting from a sale of a capital asset held for more than six months will depend upon the application of section 1231 to the taxpayer for the taxable year.

(b) *Determination of date of disposal.*—(1) For purposes of section 631(b) and this section, the date of disposal of timber shall be deemed to be the date such timber is cut. However, if payment is

made to the owner under the contract for timber before such timber is cut the owner may elect to treat the date of payment as the date of disposal of such timber. Such election shall be effective only for purposes of determining the holding period of such timber. Neither section 631(b) nor the election thereunder has any effect on the time of reporting gain or loss. See subchapter E of chapter 1 of the Internal Revenue Code of 1954 and the regulations thereunder. See paragraph (c)(2) of this section for the effect of exercising the election with respect to the payment for timber held for six months or less. See paragraph (d) of this section for the treatment of payments received in advance of cutting.

(2) For purposes of section 631(b) and this section, the "date such timber is cut" means the date when in the ordinary course of business the quantity of timber felled is first definitely determined.

(c) *Manner and effect of election to treat date of payment as the date of disposal.*—(1) The election to treat the date of payment as the date of disposal of timber shall be evidenced by a statement attached to the taxpayer's income tax return filed on or before the due date (including extensions thereof) for the taxable year in which the payment is received. The statement shall specify the advance payments which are subject to the election and shall identify the contract under which the payments are made. However, in no case shall the time for making the election under section 631(b) expire before the close of the 90th day after the regulations adopted under section 631 are published in the Federal Register.

(2) Where the election to treat the date of payment as the date of disposal is made with respect to a payment made in advance of cutting, and such payment is made six months or less from the date the timber disposed of was acquired, section 631(b) shall not apply to such payment, irrespective of the date such timber is cut, since the timber was not held for more than six months prior to disposal.

(d) *Payments received in advance of cutting.*—(1) Where the conditions of paragraph (a) of this section are met, amounts received or accrued prior to cutting (such as advance royalty payments or minimum royalty payments) shall be treated under section 631 (b) as realized from the sale of timber if the contract of disposal provides that such amounts are to be applied as payment for timber subsequently cut. Such amounts will be so treated irrespective of whether or not an election has been made under paragraph (c) of this section to treat the date of payment as the date of disposal. For example, if no election has been made under paragraph (c), amounts received or accrued prior to cutting will be treated as realized from the sale of timber, provided the timber paid for is cut more than six months months after the date of acquisition of such timber.

(2) However, if the right to cut timber under the contract expires, terminates, or is abandoned before the timber which has been paid for is cut, the taxpayer shall treat payments attributable to the uncut timber as ordinary income and not as received from the sale of timber under section 631(b). Accordingly, the taxpayer shall recompute his tax liability for the taxable year in which such payments were received or accrued. The recomputation shall be made in the form of an amended return where necessary.

(3) (i) Bonuses received or accrued by an owner in connection with the grant of a contract of disposal shall be treated under section 631(b) as amounts realized from the sale of timber to the extent attributable to timber held for more than six months.

(ii) The adjusted depletion basis attributable to the bonus shall be determined under the provisions of section 612 and the regulations thereunder.

Example. Taxpayer A has held timber having a depletion basis of $90,000 for two months when he enters into a contract of disposal with B. B pays A a bonus of $5,000 upon the execution of the contract and agrees to pay X dollars per unit of timber to A as the timber is cut. A does not exercise the election to treat the date of payment as the date of disposal. It is estimated that there are 50,000 units of timber subject to the contract and that the total estimated royalties to be paid to A will be $95,000. A must report the bonus in the taxable year it is received or accrued by him. The portion of the basis of the timber attributable to the bonus is determined by the following formula:

$$\frac{\text{Bonus}}{\text{Bonus} + \text{amount of expected royalties}} \times \text{Basis of Timber} = \text{Basis attributable to bonus}$$

$$\frac{\$5,000}{\$100,000} \times \$90,000 = \$4,500$$

(iii) To the extent attributable to timber not held for more than six months, such bonuses shall be treated as ordinary income subject to depletion. In order to determine the amount of the bonus allocable to timber not held for more than six months, the bonus shall be apportioned ratably over the estimated number of units of timber covered by the contract of disposal. This subdivision may be illustrated as follows:

Example. Assume under the facts stated in the example in subdivision (ii) of this subparagraph that B cuts 10,000 units of timber that have been held by A for six months or less. The amount of the bonus (as well as the royalties) attributable to these units must be reported as ordinary income subject to depletion. The amount of the bonus attributable to these units is determined by the following formula:

$$\frac{\text{Number of units cut held for six months or less}}{\text{Total units covered by the contract}} \times \text{Amount of bonus} = \text{Amount of bonus treated as ordinary income subject to depletion}$$

$$\frac{10,000}{50,000} \times \$5,000 = \$1,000$$

The amount of the depletion attributable to the portion of the bonus received for timber held for six months or less is determined by the following formula:

$$\frac{\text{Amount of bonus attributable to timber held for six months or less}}{\text{Total bonus}} \times \text{Adjusted basis for depletion of bonus} = \text{Depletion allowance on timber held for six months or less}$$

$$\frac{\$1,000}{\$5,000} \times \$4,500 = \$900$$

The amount of the bonus attributable to timber held for more than six months, and which is treated under section 631(b) as realized from the sale of timber would be $4,000. The gain on such amount is $400 ($4,000 − $3,600).

(iv) If the right to cut timber under the contract of disposal expires, terminates, or is abandoned before any timber is cut, the taxpayer shall treat the bonus received under such contract as ordinary income, not subject to depletion. Accordingly, the taxpayer shall recompute his tax liability for the taxable year in which such bonus was received. The recomputation shall be made in the form of an amended return where necessary.

(e) *Other rules for application of section.*—(1) Amounts paid by the lessee for timber or the acquisition of timber cutting rights, whether designated as such or as a rental, royalty, or bonus, shall be treated as the cost of timber and constitute part of the lessee's depletable basis of the timber, irrespective of the treatment accorded such payments in the hands of the lessor.

(2) The provisions of section 631(b) apply only to an owner of timber. An owner of timber means any person who owns an interest in timber, including a sublessor and a holder of a contract to cut timber. Such owner of timber must have a right to cut timber for sale on his own account or for use in his trade or business in order to own an interest in timber within the meaning of section 631(b).

(3) For purposes of section 631(b) and this section, the term "timber" includes evergreen trees which are more than 6 years old at the time severed from their roots and are sold for ornamental purposes such as Christmas decorations. Tops and other parts of standing timber are not considered as evergreen trees within the meaning of section 631(b). The term "evergreen trees" is used in its commonly accepted sense and includes pine, spruce, fir, hemlock, cedar, and other coniferous trees.

§ 1.631–3 Gain or Loss Upon the Disposal of Coal With a Retained Economic Interest.—(a) *In general.*—(1) The provisions of section 631(c) apply to an owner who disposes of coal (including lignite) held for more than 6 months before such disposal under any form or type of contract whereby he retains an economic interest in such coal. The difference between the amount realized from disposal of such coal in any taxable year, and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272, shall be gain or loss upon the sale of such coal. See paragraph (b)(4) of this section for definition of "owner".

(2) In the case of such a disposal, the provisions of section 1231 apply and such coal shall be considered to be property used in the trade or business for the taxable year in which it is considered to have been sold, along with other property of the taxpayer used in the trade or business as defined in section 1231(b), regardless of whether such coal is property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Whether gain or loss resulting from the disposition of the coal which is considered to have been sold will be deemed to be gain or less resulting from a sale of a capital asset held for more than six months will depend upon the application of section 1231 to the taxpayer for the taxable year.

(b) *Rules for application of section.*—(1) For purposes of section 631(c) and this section, the date of disposal of such coal shall be deemed to be the date the coal is mined. If the coal has been held for more than 6 months on the date it is mined, it is immaterial that it had not been held for more than 6 months on the date of the contract. There shall be no allowance for percentage depletion provided in section 613 with respect to amounts which are considered to be realized from the sale of coal under section 631(c).

(2) The term "adjusted depletion basis" as used in section 631(c) and in this section means the basis for allowance of cost depletion provided in section 612 and the regulations thereunder. Such "adjusted depletion basis" shall include exploration or development expenditures treated as deferred expenses under section 615(b) or 616 (b), or corresponding provisions of prior income tax laws, and be reduced by adjustments under section 1016(a)(9) and (10), or corresponding provisions of prior income tax laws, relating to deductions of deferred expenses for exploration or development expenditures in the taxable year or any prior taxable years. The depletion unit of the coal disposed of shall be determined under the rules provided in the regulations under section 611 relating to cost depletion.

(3) (i) In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties (except rents and royalties paid by a lessee with respect to coal disposed of by the lessee as an "owner" under section 631 (c)) shall be determined without regard to the provisions of section 631(c). Thus, the amounts of rents and royalties paid or incurred by a lessee with respect to coal shall be excluded from the lessee's gross income from the property for the purpose of determining his percentage depletion without regard to the treatment of such rents or royalties in the hands of the recipient under this section. See section 613 and the regulations thereunder.

(ii) However, a lessee who is also a sublessor may dispose of coal as an "owner" under section 631(c). Rents and royalties paid with respect to coal disposed of by such a lessee under section 631(c) shall increase the adjusted depletion basis of the coal and are not otherwise deductible. For example, B is a sublessor of a coal lease; A is the lessor; and C is the sublessee. B pays A a royalty of 50 cents per ton. C pays B a royalty of 60 cents per ton. The amount realized by B under section 631(c) is 60 cents per ton and will be reduced by the adjusted depletion basis of 50 cents per ton, leaving a gain of 10 cents per ton taxable under section 631(c).

(4) (i) The provisions of this section apply only to an owner who has disposed of coal and retained an economic interest. For the purposes of section 631 (c) and this section, the word "owner" means any person who owns an economic interest in coal in place, including a sublessor thereof. A person who merely acquires an economic interest and has not disposed of coal under a contract retaining an economic interest does not qualify under section 631(c). A successor to the interest of a person who has disposed of coal under a contract by virtue of which he retained an economic interest in such coal is also entitled to the benefits of this section. Such sections shall not apply with respect to any income realized by any owner as co-adventurer, partner, or principal in the mining of such coal.

(ii) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A owns a tract of coal land in fee. A leases to B the right to mine all the coal in such tract in return for a royalty of 30 cents per ton. B subleases his right to mine coal in such tract to C, who agrees to pay A 30 cents per ton and to pay to B an additional royalty of 10 cents per ton. Section 631(c) applies to the royalties of both A and B, if the other requisites of such section have been met.

Example (2). Assume the same facts as in example (1) except that A dies leaving his royalty interest to D. D has an economic interest in the coal in place and qualifies for section 631(c) treatment with respect to his share of the royalties since he is a successor in title to A.

Example (3). Assume the same facts as in example (1) except that E agrees to pay a sum of money to C in return for 10 cents per ton on the coal mined by C. E has an economic interest since he must look solely to the extraction of the coal for the return of his investment. However, E has not made a disposal of coal under a contract wherein he retains an economic interest, and, therefore, does not qualify under section 631(c). E is entitled to depletion on his royalties.

(c) *Payments received in advance of mining.*—(1) Where the conditions of paragraph (a) of this section are met, amounts received or accrued prior to mining shall be treated under section 631(c) as received from the sale of coal if the contract of disposal provides that such amounts are to be applied as payment for coal subsequently mined. For example, advance royalty payments or minimum royalty payments received by an owner of coal qualify under such section where the contract of disposal grants the lessee the right to apply such royalties in payment of coal mined at a later time. Thus, if A acquires coal rights on January 1, and on January 30 enters into a contract of disposal providing that mining shall begin July 2, and mining actually begins no earlier, any advance payments which A receives qualify under section 631(c).

(2) However, if the right to mine coal under the contract expires, terminates, or is abandoned before the coal which has been paid for is mined, the taxpayer shall treat payments attributable to the unmined coal as ordinary income and not as received from the sale of coal under section 631(c). Accordingly, the taxpayer shall recompute his tax liability for the taxable year in which such payments were received. The recomputation shall be made in the form of an amended return where necessary.

(3) Bonuses received or accrued by an owner in connection with the grant of a contract of disposal shall be treated under section 631(c) as received from the sale of coal to the extent attributable to coal held for more than six months. The rules contained in § 1.631–2(d) relating to bonuses in the case of contracts for the disposal of timber shall be equally applicable in the case of bonuses received for the grant of a contract of disposal of coal under this section.

(d) *Nonapplication of section.*—Section 631(c) shall not affect the application of the provisions of subchapter G of chapter 1 of the Internal Revenue Code of 1954, relating to corporations used to avoid income tax on shareholders. For example, in applying the provisions of section 543(a)(8)(A), the amounts received from a

disposal of coal subject to section 631(c) shall be considered as mineral royalties. For purposes of determining whether certain deductions of the taxpayer constitute 15 percent or more of gross income under section 543(a)(8)(B), the deductions disallowed under section 272 shall be considered as allowable.

§ 1.632 STATUTORY PROVISIONS; SALE OF OIL OR GAS PROPERTIES.

SEC. 632. SALE OF OIL OR GAS PROPERTIES.

In the case of a bona fide sale of any oil or gas property, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration or discovery work done by the taxpayer, the portion of the surtax imposed by section 1 attributable to such sale shall not exceed 30 percent of the selling price of such property or interest.

§ 1.632–1 SURTAX ON SALE OF OIL OR GAS PROPERTIES.—(a) If the taxpayer, by prospecting and locating claims or by exploring or discovering undeveloped claims, has demonstrated the principal value of oil or gas property, which prior to his efforts had a relatively minor value, the portion of the surtax imposed by section 1 (see section 1(c)) attributable to a sale of such property, or of any interest of the taxpayer therein, shall not exceed 30 percent of the selling price of such property or such interest. Shares of stock in a corporation owning oil or gas property do not constitute an interest in such property. To determine the application of section 632 to a particular case, the taxpayer should first compute the surtax imposed by section 1 upon his entire taxable income, including the taxable income from any sale of such property or interest therein, without regard to section 632. The proportion of the surtax, so computed, indicated by the ratio which the taxpayer's taxable income from the sale of the property or interest therein, computed as prescribed in this section, bears to his total taxable income is the portion of the surtax attributable to such sale and, if it exceeds 30 percent of the selling price of such property or interest, such portion of the surtax shall be reduced to that amount.

(b) In determining the portion of the taxable income attributable to the sale of such oil or gas property or interest therein, the taxpayer shall allocate to the gross income derived from such sale, and to the gross income derived from all other sources, the expenses, losses, and other deductions properly appertaining thereto and shall apply any general expenses, losses, and deductions (which cannot properly be otherwise allocated) ratably to the gross income from all sources. The gross income derived from the sale of such oil or gas property or interest therein, less the deductions properly appertaining thereto and less its proportion of any general deductions, shall be the taxable income attributable to such sale. The taxpayer shall submit with his return a statement fully explaining the manner in which such expenses, losses, and deductions are allocated or apportioned.

O GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved December 16, 1957.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on Dec. 20, 1957 at 8:48 a. m., and published in the issue of the Federal Register for Dec. 21, 1957, 22 F. R. 10450.)

SUBCHAPTER C.—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

PART I.—DISTRIBUTIONS BY CORPORATIONS

Subpart A.—Effects on Recipients

SECTION 301.—DISTRIBUTIONS OF PROPERTY

26 CFR 1.301–1: Rules applicable with respect to distributions of money and other property. Rev. Rul. 58–1
(Also Section 316; 1.316–1.)

Where a corporation is formed to own and operate an apartment project for profit and its stockholders are allowed by the corporation to rent an apartment in the project at a lower rental than is charged the general public, the excess of the fair rental value of the apartment over the amount of rent paid by each stockholder as a tenant is treated, for Federal income tax purposes, as a distribution by the corporation under the provisions of section 301 of the Internal Revenue Code of 1954. The amount of such excess is includible in the gross income of each stockholder to the extent that it constitutes a dividend. The amount of the excess which constitutes a dividend is that part of such excess which is considered to have been derived from the corporation's earnings and profits to the extent provided by section 316 of the Code.

SECTION 302.—DISTRIBUTIONS IN REDEMPTION OF STOCK

26 CFR 1.302–3: Substantially disproportionate redemption.

Treatment of an amount received by an estate in redemption of stock of a corporation. See Rev. Rul. 58–111, below.

Subpart C.—Definitions; Constructive Ownership of Stock

SECTION 316.—DIVIDEND DEFINED

26 CFR 1.316–1: Dividends.

Excess of fair rental value of apartment occupied by a shareholder in the corporate owner over the amount of rent paid. See Rev. Rul. 58–1, above.

SECTION 318.—CONSTRUCTIVE OWNERSHIP OF STOCK

26 CFR 1.318–3: Estates, trusts, and options. Rev. Rul. 58–111
(Also Section 302, 1.302–3.)

In the event of a redemption of stock of a corporation where section 318(a) of the Internal Revenue Code of 1954 is applied to determine the constructive ownership of stock for the purposes of section

302 of the Code, the beneficiaries' proportionate interests in the stock owned by an estate should be determined as of the date of the redemption.

Advice has been requested whether, for the purposes of section 318(a) of the Internal Revenue Code of 1954, in determining the applicability of section 302(b)(2) of the Code in any specific redemption of stock, the proportionate interest of a beneficiary of an estate is to remain fixed in accordance with the terms of the will, or whether such interest is to be adjusted with each partial distribution of the property of the estate so as to reflect the beneficiary's interest in the remaining assets at a given date.

Section 318(a)(2) of the Code states simply that stock owned by an estate shall be considered as owned proportionally by its beneficiaries. Section 1.318-3(a) of the Income Tax Regulations states that a person will no longer be considered a beneficiary of an estate when all the property to which he is entitled has been received by him. Presumably, the other remaining beneficiaries, in such a case, are considered to own any stock owned by an estate in proportion to their interest in the remaining assets of the estate. The regulations do not discuss the possible effect of partial distributions to a beneficiary by an estate.

In determining the applicability of the provisions of section 302 of the Code in any specific redemption of stock, it is necessary first to determine the actual ownership of the stock at the time of the redemption. This includes taking into account any distributions of stock made by the executors of an estate to the beneficiaries of that estate. This fact, coupled with the recognition in the regulations of the principle that a person can cease to be a beneficiary even though the estate still continues to exist, indicates that a beneficiary's proportionate interest, for the purpose of sections 318 and 302 of the Code, is to be measured by his proportionate share of an estate's remaining assets at the date of the redemption. This rule may cause a continual fluctuation of proportionate interests in an estate where non-pro rata distributions are made by the executor. However, not to recognize these changes in proportionate interests of beneficiaries may result in highly unrealistic situations.

Accordingly, the Internal Revenue Service holds that in all cases the date of redemption is the date to be used in determining the beneficiaries' proportionate interests in an estate when section 318(a) of the Code is applied to determine the ownership of stock for the purpose of section 302(b)(2) of the Code.

PART II.—CORPORATE LIQUIDATIONS

Subpart A.—Effects on Recipients

SECTION 333.—ELECTION AS TO RECOGNITION OF GAIN IN CERTAIN LIQUIDATIONS

26 CFR 1.333-4: Treatment of gain. Rev. Rul. 58-92

Stock and securities, acquired by a domestic corporation upon its organization in July 1955 in a transaction to which section 351 of

the Internal Revenue Code of 1954 applies, and having a holding period (determined under section 1223(2) of the Code) commencing prior to December 31, 1953, are, nevertheless, upon their distribution in the liquidation of the corporation in 1956, considered to be stock and securities "acquired by the corporation after December 31, 1953," for purposes of section 333(e)(2) of the Code.

Advice has been requested whether certain stock and securities distributed in complete liquidation of a corporation in 1956 should be considered "stock or securities acquired by the corporation after December 31, 1953," within the meaning of section 333(e)(2) of the Internal Revenue Code of 1954.

The stock and securities in question had been acquired by the corporation upon its organization in July 1955 from its sole shareholder in a transaction to which section 351 of the Code applies. The basis of the stock and securities in the hands of the shareholder ($450x$ dollars) became their basis to the corporation under the provisions of section 362(a)(1) of the Code. The corporation's holding period for the stock and securities, determined under section 1223(2) of the Code, included the period commencing prior to December 31, 1953, during which the shareholder had held such stock and securities before their transfer to the corporation.

In 1956, the corporation adopted a plan of liquidation and distributed all of its property (including the stock and securities) to its sole shareholder within one calendar month in complete redemption of its outstanding capital stock. The shareholder made and filed a timely election to have the gain on the liquidation recognized in accordance with the provisions of section 333(e) of the Code. At the time of the liquidation, the stock and securities had a fair market value of $1,200x$ dollars.

Section 333 of the Code provides, in effect, that, under certain conditions, if the shareholders of a corporation so elect, gain is not recognized to them on the distribution of the corporation's property in kind on a liquidation. The shareholders are, however, taxed as though they had received a cash dividend equal to the earnings and profits of the corporation and, in addition, gain is recognized to the extent that cash, and stock or securities acquired after December 31, 1953 ("cut-off" date), exceed the earnings and profits of the corporation.

The question presented in the instant case is whether the stock and securities distributed in liquidation, though not acquired by the corporation until July 1955 upon its incorporation, can be regarded as having been acquired by the corporation prior to 1954, in view of the fact that the corporation's sole shareholder had owned them prior to that time and had transferred them to the corporation in a nontaxable transaction, with his basis and holding period going over to the corporation.

The predecessor statutes to section 333 of the Code were temporary relief statutes enacted from year to year and made effective for short periods of time. See section 112(b)(7) of the Revenue Act of 1938, 52 Stat. 447 at 485; section 120(a) of the Revenue Act of 1943, 58 Stat. 21 at 40, 26 U. S. C. 112(b) (adding section 112(b)(7) to the Internal Revenue Code of 1939); section 206(a) of the Revenue Act of 1950, 64 Stat. 906 at 931, 26 U. S. C. 112(b); section 316(a) of the Revenue Act of 1951, 65 Stat. 452 at 493, 26 U. S. C. 112(b); and section 101

of the Technical Changes Act of 1953, 67 Stat. 615, 26 U. S. C. 112, C. B. 1953–2, 485 (amending the 1939 Code). Each of the five predecessor statutes included a cut-off date in advance of, or at the time of, its effective date so that cash on hand at the time the statute was enacted could not be used to purchase stock and securities and thus avoid part of the tax resulting from a liquidation. All of such predecessor statutes appear to have been drawn for the benefit of corporations already in existence when they were enacted and were intended to facilitate the liquidation of established personal holding companies.

Section 333 is made a permanent part of the Internal Revenue Code of 1954 and specifies that the cut-off date shall be the last day of 1953 (a date before the 1954 Code became effective). It seems clear that under the statute any stock or securities purchased by a corporation after that date will be treated the same as cash.

The statute is not on its face restricted to purchases, but refers only to stock or securities "acquired." The Internal Revenue Service has held that, for purposes of section 333(e)(2) of the Code, the acquisition date of stock received in a nontaxable exchange pursuant to a plan of reorganization is not the date of the exchange, but is the date on which the stock surrendered in the exchange was acquired. See Rev. Rul. 56–171, C. B. 1956–1, 179. Likewise, for purposes of section 333(e)(2), the acquisition date of stock received in a distribution to which section 305(a) of the Code applies is the date on which was acquired the stock with respect to which the dividend stock was received. The receipt of new shares in such a nontaxable exchange or distribution is not regarded as an "acquisition" within the meaning of the statute, since such transactions are merely changes in the nature or form of stock already owned by the liquidating corporation.

However, the instant case involved the acquisition by a corporation of stock and securities in a section 351 exchange which took place after the cut-off date. The sole question presented, therefore, is whether such an acquisition is within the terms of the statute.

Congress provided that stock or securities acquired during the effective periods of the earlier statutes were to be treated like cash and it has now provided that stock or securities acquired while the 1954 Code is in effect are always to be treated like cash, since the new relief statute is always effective. Reading the word "acquired" without qualification, the statute thus states that stock or securities distributed in a section 333 liquidation are always equivalent to cash unless such stock or securities were owned by an existing corporation on December 31, 1953 (or were received, with respect to stock or securities owned on that date, in a nontaxable exchange pursuant to a plan of reorganization or as a nontaxable stock dividend). Consequently, if stock or securities are now transferred to a newly formed corporation in exchange for stock, the ultimate result on a liquidation will be that gain resulting from an appreciation in the value of such stock or securities will not be exempt from tax under section 333 of the Code. In effect, therefore, such stock or securities will be treated as if they had been purchased by the corporation with contributed cash, and the fact that the holding period for the stock or securities, determined under section 1223(2) of the Code, commenced prior to December 31, 1953, is immaterial.

In view of the foregoing, it is held that the stock and securities acquired by the corporation upon its incorporation in July 1955 were acquired by it after December 31, 1953, within the meaning and for the purposes of section 333(e)(2) of the Code.

SECTION 334.—BASIS OF PROPERTY RECEIVED IN LIQUIDATIONS

26 CFR 1.334–1: Basis of property received in liquidations. Rev. Rul. 58–79

> Corporation *D* had outstanding one class of common stock, of which 10 percent was owned by corporation *C* and 90 percent was owned by a number of persons having no interest in corporation *C*. Corporation *C* owned all of the outstanding stock of corporation *B*, and corporation *D* owned all of the outstanding stock of corporation *E*. In connection with its complete liquidation, corporation *D* sold all of the stock of *E* to *B* for cash at its fair market value. Immediately thereafter, *E* was completely liquidated and all of its assets were transferred to *B*. *Held*, the basis in *B's* hands of the assets acquired upon the liquidation of *E* was the same as the adjusted basis of the stock of *E*, pursuant to section 334(b)(2) of the Internal Revenue Code of 1954. In this instance, the adjusted basis of the stock of *E* in the hands of *B* was the cost of such stock.

Advice has been requested whether an acquisition of stock of a corporation under the circumstances described below constitutes a purchase of such stock within the meaning of section 334(b)(3) of the Internal Revenue Code of 1954.

Corporation *D* had outstanding one class of common stock, of which 10 percent was owned by corporation *C* and 90 percent was owned by a number of persons having no interest in, or relation to, corporation *C*. Corporation *C* owned all of the outstanding stock of corporation *B*, and corporation *D* owned all of the outstanding stock of corporation *E*. As part of a program to sell its assets and liquidate, corporation *D* sold all of the stock of corporation *E* (comprising about 10 percent in value of the total assets of *D*) to corporation *B* for cash at a price equal to the fair market value of the stock, but substantially in excess of the adjusted basis of the assets of *E* on the books of *E*. Immediately thereafter, corporation *E* transferred all of its assets to corporation *B* in complete liquidation (within the meaning of section 332(b) of the Internal Revenue Code of 1954). At issue is whether the acquisition of the *E* stock by corporation *B* constituted a purchase within the meaning of section 334(b)(3) so as to entitle corporation *B* to a stepped-up basis for the *E* assets under the provisions of section 334(b)(2).

Section 334(b)(3) of the Code provides in part as follows:

> (3) Purchase defined.—For purposes of paragraph (2)(B), the term "purchase" means any acquisition of stock, but only if—
>
> (A) the basis of the stock in the hands of the distributee is not determined (i) in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom acquired, . . .
>
> * * * * * * *

(C) the stock is not acquired from a person the ownership of whose stock would, under section 318(a), be attributed to the person acquiring such stock.

By reason of the fact that corporation *C* is a stockholder of corporation *D*, corporation *D* is deemed to own all of the stock of corporation *B* under the provisions of section 318(a)(2)(C)(ii) (applied without the 50 percent limitation). This would likewise be true were corporation *C* the owner of but a single share of stock of corporation *D*. Thus, the sale by *D* to *B* of the stock of corporation *E* is a transaction to which section 304(a)(1) applies although, because of section 302(b)(1), it clearly is not equivalent to a dividend. Under the provisions of section 304(a)(1), the stock of corporation *E* is treated as having been received by corporation *B* as a contribution to its capital. Section 1.304–2(a) of the Income Tax Regulations provides that the stock acquired shall have the same basis in the hands of the acquiring corporation as in the hands of the transferor. The question therefore arises whether the acquisition falls within the exception of section 334(b)(3)(A) and fails to qualify as a purchase under section 334(b)(3).

It is further provided in section 1.304–2(a) of the regulations that, in the case of an acquisition of stock coming under the provisions of section 304(a)(1), if section 302(a) applies, the acquiring corporation will be considered to have redeemed a portion of its stock having a basis equal to the basis in the hands of the transferor of the stock of the issuing corporation sold to the acquiring corporation. However, the transaction from the viewpoint of the transferor is treated the same as a sale under sections 1001 and 1002 (without regard to section 304). Therefore, it is the opinion of the Internal Revenue Service that consistent treatment compels the analogous conclusion that in such a case (particularly, where as here, the transferor has no actual stock interest in the acquiring corporation but only an indirect interest through a minority stockholder), the basis of the stock of the issuing corporation in the hands of the acquiring corporation will be its cost of such shares. However, shares acquired in a transaction governed by section 304(a)(1) will have the same basis in the hands of the acquiring corporation as in the hands of the transferor under section 1.304–2(a) of the regulations in the case of an acquisition to which section 302(d) applies. Consequently, the acquisition of the *E* stock by corporation *B* does not come within the exception of section 334(b)(3)(A).

The exception of section 334(b)(3)(B) by its terms cannot apply in this situation. Likewise, the exception of section 334(b)(3)(C) does not apply, because the provisions of section 318(a)(2)(C) are applied with the 50 percent limitation for this purpose. Since corporation *C* owned only 10 percent of the stock of corporation *D*, *D*'s ownership of the stock of corporation *E* was not attributable to Corporation *B*.

For the reasons stated above, it is held that the acquisition of the stock of corporation *E* by corporation *B* constituted a purchase within the meaning of section 334(b)(3) of the Code, and that the basis in the hands of corporation *B* of the assets received by it upon the liquidation of corporation *E* is the same as the adjusted basis of the stock of *E* with respect to which the distribution was made, under section

334(b)(2) of the Code. In this instance, the adjusted basis of the stock of E, in the hands of B, was the cost of such stock.

Subpart B.—Effects on Corporation

SECTION 337.—GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS

26 CFR 1.337–2: Sales or exchanges within the scope of section 337.

A sale of property by a corporation in liquidation, now determined to be a collapsible corporation. See Rev. Rul. 58–241, below.

Subpart C.—Collapsible Corporations; Foreign Personal Holding Companies

---

SECTION 341.—COLLAPSIBLE CORPORATIONS

26 CFR 1.341–2: Definitions. (Also Section 337; 1.337–1.) Rev. Rul. 58–241

Where a corporation, claiming the benefit of a nontaxable sale of of its property under section 337 of the Internal Revenue Code of 1954, is determined to be a collapsible corporation as defined in section 341(b) of the Code, the gain from the sale of its property is included in taxable income of the corporation. However, since the corporation has realized all of the taxable income from its property, the stockholders' gain upon liquidation would not constitute ordinary income within the purview of section 341 of such Code.

The Internal Revenue Service has been requested to explain the relationship of sections 337 and 341 of the Internal Revenue Code of 1954 in a corporate liquidation.

Section 341 of the Code relating to collapsible corporations provides, in part, as follows:

(a) TREATMENT OF GAIN TO SHAREHOLDERS.—Gain from—

(1) the sale or exchange of stock of a collapsible corporation,

(2) a distribution in partial or complete liquidation of a collapsible corporation, which distribution is treated under this part as in part or full payment in exchange for stock, and

(3) a distribution made by a collapsible corporation which, under section 301(c)(3)(A), is treated, to the extent it exceeds the basis of the stock, in the same manner as a gain from the sale or exchange of property,

to the extent that it would be considered (but for the provisions of this section) as gain from the sale or exchange of a capital asset held for more than 6 months shall, except as provided in subsection (d), be considered as gain from the sale or exchange of property which is not a capital asset.

(b) DEFINITIONS.—

(1) COLLAPSIBLE CORPORATION.—For purposes of this section, the term "collapsible corporation" means a corporation formed or availed of principally for the manufacture, construction, or production of property, for the purchase of property which (in the hands of the corporation) is property described in paragraph (3), or for the holding of stock in a corporation so formed or availed of, with a view to—

(A) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, before the realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the taxable income to be derived from such property, and

(B) the realization by such shareholders of gain attributable to such property.

Section 337 of such Code relating to gain or loss on sales or exchanges in connection with certain liquidations reads in part:

(a) GENERAL RULE.—If—
(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and
(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims.
then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

* * * * * * *

(c) LIMITATIONS.—
(1) COLLAPSIBLE CORPORATIONS AND LIQUIDATIONS TO WHICH SECTION 333 APPLIES.—This section shall not apply to any sale or exchange—
(A) made by a collapsible corporation (as defined in section 341(b)), or * * *.

Section 1.337-1 of the Income Tax Regulations states in part that sales or exchanges made by a collapsible corporation (as defined in section 341(b)) are excluded from the operation of section 337 by section 337(c). Accordingly, section 337 does not apply to any sale or exchange of property whenever the distribution of such property in partial or complete liquidation to the shareholders, in lieu of such sale or exchange, would have resulted in the taxation of the gain as ordinary income within the purview of section 341, but for the application of section 341(d) of the Code.

In effect, the foregoing provision of the regulations constitutes a test to be applied to determine whether a corporation may avail itself of the benefits of section 337 of the Code. Thus, if in lieu of selling all of its property the corporation had liquidated in kind and the gain on liquidation in kind would have been taxable as ordinary income to the stockholders pursuant to section 341, but without application of the limitation provisions of section 341(d), such corporation is a collapsible corporation within the definition of section 341(b) and cannot avail itself of the benefits of section 337.

If the corporation did in fact sell all of its property with a view to taking advantage of section 337 and, upon applying the test of the regulations set forth above, it was found that such corporation was a collapsible corporation, the corporation, not being able to avail itself of the benefits of section 337, would realize taxable income by reason of the sale of its property at a gain. Since the corporation would have realized all of the taxable income from its property, it would not meet the definition of section 341(b). Accordingly, the gain, if any, to the stockholders upon liquidation would not constitute ordinary income within the purview of section 341.

The reason for the limitation found in section 337(c)(1)(A) of the Code was to prevent the existence of a loophole through which a collapsible corporation could escape tax on the sale of its property, yet have the shareholders pay the tax on their liquidation gain at long-term capital gain rates. However, under section 112(a) of the Internal Revenue Code of 1939, the corporation could have sold its property and become liable for the corporate tax on the gain from the sale of such property. Therefore, had the corporation sold its property and realized all of the taxable income, the gain to the share-

holders would not have been taxable as ordinary income under section 117(m) of the 1939 Code.

The same rule applies under the 1954 Code. If on an "in-kind" liquidation the corporation would be considered a collapsible corporation under section 341, it can, by selling all its property, realize the taxable income from such property. In that way the gain to its shareholders would not be taxable to them as ordinary income under section 341.

Accordingly, since section 337 cannot be availed of by a collapsible corporation, as defined in section 341(b), the gain on the sale of the property would constitute taxable income to that corporation.

PART III.—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

Subpart B.—Effects on Shareholders and Security Holders

SECTION 355.—DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION

26 CFR 1.355–1: Distribution of stock and securities or controlled corporations. Rev. Rul. 58–54

> Where a corporation which operates a soft drink bottling and distributing business, transfers the portion of its assets applicable to its distributing operations at three locations to three new corporations in exchange for their capital stock, followed by a distribution of such stock to its stockholders, such distribution does not qualify as a tax-free distribution within the purview of section 355 of the Internal Revenue Code of 1954, since the activities in all the locations constitute an integral part of only one enterprise. Hence, the distribution of such stock in the three new corporations to the shareholders of the original corporation is treated as a dividend to the extent provided in sections 301(c) and 316 of the Code.

Advice has been requested as to the Federal income tax consequences of the transfer by a corporation of property to three new corporations in exchange for their stock and the distribution of such stock to its shareholders.

The corporation operates a soft drink bottling and distributing business. Its franchise for distribution covers four towns within the area of a certain State. Although the beverage was actually bottled in each of these localities for a number of year, all of the bottling has been done at the main plant in recent years. A warehouse for the storage and distribution of beverage has been maintained at each of the localities. Each of these branches has sold, rented, and serviced coolers in addition to selling and distributing the beverage. Gross sales of bottled beverage in the locality of the main plant have averaged 53 percent of the corporation's total sales in recent years, the remaining 47 percent of the sales being made in the three other localities. About 91 percent of the total assets of the corporation are attributable to the operation of the main plant and to the distribution facilities of the corporation in that locality.

The corporation desired to separate the properties used in the business according to the four localities. Accordingly, assets of the cor-

poration applicable to the operations of the three branches were transferred to three new corporations, one for each area served, in exchange for their capital stock. The stock of these three new corporations then was distributed to the shareholders of the original corporation on a pro rata basis.

Thereafter, the original corporation bottled and distributed such beverage for the territory in and around the main plant, while the three new corporations distributed the beverage in their respective areas. The original corporation supplies the new corporations with bottled beverage for a reasonable charge, since this work can be accomplished more economically at the main bottling plant.

Section 355 of the Internal Revenue Code of 1954 provides, in part, that if a corporation distributes to a shareholder solely stock of another corporation which it controls immediately before the distribution, then no gain or loss shall be recognized to such shareholder on the receipt of such stock.

The above section, however, is applicable only if the distributing corporation and each of the controlled corporations is engaged, immediately after the distribution, in the active conduct of an existing trade or business which has been in operation for at least five years. Section 355 does not apply to the division of a single business. See section 1.355–1(a) of the Income Tax Regulations.

In regard to the meaning of the term "active business," section 1.355–1(c) of the regulations states, in part, that a trade or business consists of a specific existing group of activities being carried on for the purpose of earning income or profit from only such group of activities, and the activities included in such group must include *every* operation which forms a part of, or a step in, the process of earning income or profit from such group.

Where a corporation is engaged in one particular trade or business, the manufacturing activities and the sales activities of that business do not constitute separate businesses. The manufacturing and selling operations constitute only an integrated business, as illustrated by example (11) of section 1.355–1(d) of the regulations. The operation of the same type of business in different states or localities is considered a separate business in each area only if they are independent of each other. See Rev. Rul. 56–344, C. B. 1956–2, 195.

In the instant case, the original corporation manufactured and sold only one product. All of the soft drink beverages were bottled at one location, *i. e.*, the main plant, although sold or distributed through warehouses and other distribution facilities located in four localities. There was one business, the manufacture and sale of one product within a certain area. Accordingly, the selling or distributing activities of the one business did not constitute a separate business or businesses despite some geographical differences in warehouse locations. They all formed part of one integrated business wherein the product was manufactured in one place, although distributed through several warehouse points. See Rev. Rul. 56–287, C. B. 1956–1, 186.

In view of the foregoing, it is held that the distribution of the stock of the three new corporations to the stockholders of the original corporation does not qualify as a transaction coming within the purview of section 355 of the Code. However, no gain or loss is recognized, under the provisions of section 351 of the Code, to the original

corporation upon the transfer of a part of its property to the three new corporations solely in exchange for all the stock in such corporations. The distribution of stock in the three new corporations to the shareholders of the original corporation constitutes a dividend to the recipients under the provisions of section 301(c) of the Code to the extent provided in section 316 thereof.

---

26 CFR 1.355–2: Limitations. Rev. Rul. 58–68

Where a parent corporation contributed to the capital of its subsidiary by cancelling the latter's indebtedness to the parent shortly before the distribution of the stock of this subsidiary to the parent's sole stockholder, and the distribution was followed by a statutory merger between the former subsidiary and a third corporation owned by the same stockholder and his wife, the transaction is considered as one which was used principally as a device for the distribution of the earnings and profits of the distributing corporation within the purview of section 355(a)(1)(B) of the Internal Revenue Code of 1954. Therefore, this distribution constituted the payment of a taxable dividend.

Advice has been requested relative to the status, for Federal income tax purposes, of a distribution by one corporation of the capital stock of a subsidiary and the subsequent merger of the former subsidiary with a third corporation.

Corporation *X*, operating an automobile dealership, owned all the stock of *Y* corporation which operated an automobile finance business. A certain stockholder owned all the stock of *X*, and he and his wife owned all the stock of *Z* corporation which was also engaged in the automobile finance business. *Y* owed its parent *X* for recent loans in an amount greater than *Y's* capital plus its surplus. The surplus of *X* was substantial.

Allegedly in order to eliminate duplication and increase borrowing capacity for possible expansion, the following plan was carried out:

1. (a) A contribution to capital was made by the parent *X* to the subsidiary *Y* through cancellation of the loans.

(b) The parent made a distribution to its sole stockholder of all of the capital stock of the subsidiary corporation without any surrender of stock by him.

2. Corporations *Y* and *Z* entered into a statutory merger pursuant to the corporation laws of their state, after which the two businesses were operated as one by *Y*, the surviving corporation. Both stockholders of *Z* received additional stock in *Y* in exchange for their stock in *Z*.

The Internal Revenue Service concludes that the transaction was used principally as a device for the distribution of the earnings and profits of the parent, because the distribution of the stock of the controlled corporation was immediately preceded by a very large contribution (through debt cancellation) to the capital of the subsidiary In addition the distribution was immediately succeeded by the effective disposition of the stock distributed in a merger negotiated prior to the distribution. See section 355(a)(1)(B) of the Internal Revenue Code of 1954. Moreover, the active business requirements of section 355(b) of the Code were not met, since the transaction was preceded by a contribution to *Y* corporation resulting in a more than

100 percent increase in its net worth. Thus, more than half of the net assets of *Y* at the time of the distribution were not owned by it in connection with its active conduct of its trade or business during the five-year period ending on the date of the distribution.

In view of the foregoing, it is held that, although no income resulted to *Y* corporation from the contribution by its parent, under section 118 of the Code, the distribution by *X* corporation of all of the capital stock of *Y* constituted payment of a taxable dividend as defined in section 316(a) of the Code, to the sole stockholder of *X*, to the extent of the fair market value of such stock. The basis to this sole stockholder of the stock of *Y* thus acquired is its fair market value when received. The subsequent merger constituted a nontaxable reorganization under sections 368(a)(1)(A), 1032, 361(a), and 354(a) of the Code.

---

26 CFR. 1.355–4: Active conduct of a trade or business. (Also Section 361; 1.361–1.) Rev. Rul. 58–164

Where a corporation, engaged primarily in the textile business but also operating rental property, transfers such real estate to a new corporation in exchange for its stock, followed by a distribution of the stock of the new controlled corporation to a single minority stockholder in exchange for part of her stock in the distributing corporation, such exchanges are nontaxable under the provisions of sections 361 and 355 of the Internal Revenue Code of 1954.

Advice has been requested as to the tax effect of a transaction involving a transfer by a corporation to a new corporation of rental property, followed by a distribution of the new corporation's stock to a minority stockholder in exchange for a portion of her stock.

Ten years before the transaction here involved, a corporation selling textile products as a commission merchant purchased a valuable eight-story loft building and the land on which it was situated. Five years before the transaction, the percentage of the entire property rented to others was 60 percent both on the basis of floor space and rental value. Two years before the transaction the portion leased to outsiders increased to 100 percent and, thereafter, the corporation never used the building in its own business. The building yielded a gross rental of $135,000 and its operation resulted in a substantial net rental.

For bona fide business reasons, the corporation organized a new corporation to which it transferred the land and building referred to above in exchange for all the stock of latter. The original corporation distributed all of this stock to the minority shareholder in exchange for part of the common stock of the distributing corporation which she owned. Both corporations continued their respective businesses and the instant shareholder did not intend to dispose of the stock which she received.

Under the facts in this case, the Internal Revenue Service holds that the rental business of the old corporation was an "active" business for the purposes of section 355(b)(1) of the Internal Revenue Code of 1954, and the business purposes were germane to such business. The fact that the distribution of the stock of the new controlled corporation was not pro rata did not preclude the application of section 355(a)(1)

of the Code. Consequently, the transfer of the land and building to the new corporation in exchange for the new corporation's stock constituted a reorganization under section 368(a)(1)(D) of the Code. Accordingly, no gain or loss is recognized to the transferor corporation under section 361(a), and no gain or loss is recognized, under the provisions of section 355(a)(1) of the Code, to the minority stockholder upon the exchange of part of her common stock in the distributing corporation for all the stock of the new controlled corporation.

SECTION 356.—RECEIPT OF ADDITIONAL CONSIDERATION

26 CFR 1.356–1: Receipt of additional consideration in connection with an exchange.

A guaranty fund returned to certain insurance underwriters pursuant to a plan of reorganization. See Rev. Rul. 58–218, below.

Subpart C.—Effects on Corporation

SECTION 361.—NONRECOGNITION OF GAIN OR LOSS TO CORPORATIONS

26 CFR 1.361–1: Nonrecognition of gain or loss to corporations.

A transfer by a corporation of real estate to new controlled corporation in exchange for its stock. See Rev. Rul. 58–164, page 184.

Subpart D.—Special Rule; Definitions

SECTION 368.—DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges. (Also Section 356; 1.356–1.) Rev. Rul. 58–218

An association of insurance underwriters, taxable as a corporation for Federal income tax purposes, contributed a certain amount in cash and other assets to a guaranty fund in accordance with the requirements of the insurance laws of a certain state preparatory to doing business. For valid business reasons, the underwriters converted the association into a stock insurance company by transferring all the assets of the association, except the cash and other assets in the guaranty fund, to a new corporation in exchange for capital stock of the new corporation. The cash and other assets in the guaranty fund were returned to the underwriters. *Held*, the transaction constitutes a reorganization under section 368(a)(1) of the Internal Revenue Code of 1954, resulting in the nonrecognition of gain or loss to the association or the new corporation. However, any gain realized by an underwriter upon receipt of the cash and

other assets from the guaranty fund and the stock of the new corporation (measured by the amount by which the original cash deposit required to be made to the guaranty fund and the fair market value of the stock of the new corporation exceeds the cost or other basis of his interest in the association) is recognized, but in an amount not in excess of the original cash deposit required to be made to the guaranty fund. To the extent of his ratable share of the earnings and profits of the association, such gain is taxable as a dividend, pursuant to section 356(a)(2) of the Code. The balance of such gain, if any, is treated as gain from the exchange of property.

Advice has been requested relative to the Federal income tax consequences attendant upon the conversion of an association of insurance underwriters into a stock insurance corporation under the circumstances described below.

A group of 20 insurance underwriters operated an association, duly licensed under the insurance laws of a certain state. The association filed income tax returns as an association taxable as a corporation. The statute under which the association was organized required each individual underwriter to deposit a certain minimum amount of cash in a guaranty fund prior to the association's commencing business, which fund was subject to the joint control of the attorney in fact for such underwriters and the state's board of insurance commissioners. In lieu of a cash deposit in the guaranty fund, the statute permitted the underwriters to deposit bonds, securities, or other property equal or greater in value to the amount of the cash deposit required. The cash or other assets so deposited could not be withdrawn, diverted or expended except with the approval of the board of insurance commissioners and except for the purposes provided by statute. The statute further provided that each underwriter was entitled to the interest or income accruing from the cash or other assets deposited in the guaranty fund, and that the appreciation or depreciation in value of the property deposited was for the account of the individual underwriter. With the approval of the board of insurance commissioners, any underwriter could withdraw the assets deposited in the guaranty fund and deposit others, equal or greater in value to the amount of the original cash deposit required. Each underwriter's stake in the enterprise and interest in the profits was determined by the amount of his deposit in the guaranty fund.

It has been held that the interest or dividend income from the securities in the guaranty fund is no includible in the taxable income of the association. *Liberty Lloyds* v. *United States*, United States District Court, Northern District of Texas, entered February 23, 1948. The statute provided that the solvency of the insurance underwriters should be determined by taking into account both funds accumulated during the progress of the business and the guaranty fund, and that a Lloyds should be considered solvent when the guaranty fund was unimpaired.

For reasons of business necessity and in order to meet local competition, the underwriters desired to convert the association into a stock insurance company. At that time, since the association's operations had been profitable, the assets in the hands of the association in addition to the guaranty fund were sufficient to constitute the minimum capital for an insurance corporation under the state's laws. Accordingly, a new corporation was organized by the underwriters

which acquired all of the assets of the association, except the cash and other assets in the guaranty fund and sufficient cash to pay the association's accrued ordinary expenses and income taxes, and assumed all of its liabilities. In exchange for the assets transferred to the new corporation, the underwriters received capital stock of the new corporation in proportion to their interests in the association and the cash and other assets in the guaranty fund were returned to them. Each underwriter received, in addition to stock of the new corporation, the same assets which he had originally contributed to the guaranty fund.

In view of the foregoing, the Internal Revenue Service holds as follows:

(1) The transfer to a new corporation by the association of all of its assets, except the cash and other assets in the guaranty fund and an amount of cash sufficient to pay its accrued ordinary expenses and income taxes, and the assumption by the new corporation of the liabilities of the association, in exchange solely for capital stock of the new corporation constitutes a reorganization within the meaning of section 368 (a) (1) of the Internal Revenue Code of 1954.

(2) Pursuant to sections 361(a) and 1032(a) of the Code, no gain or loss is recognized to either the association or the new corporation.

(3) Pursuant to section 362(b) of the Code, the basis of the assets which are acquired by the new corporation is the same as it was in the hands of the association.

(4) In accordance with the provisions of sections 354(a) and 356(a)(1) of the Code, the gain, if any, realized by each underwriter upon the exchange of his interest in the association for stock of the new corporation and his cash and asset deposit in the guaranty fund (measured by the amount by which the original cash deposit required to be made to the guaranty fund and the fair market value of the stock of the new corporation exceeds the cost or other basis of his interest in the association) is recognized, but in an amount not in excess of the original cash deposit required to be made to the guaranty fund. Pursuant to section 356(a)(2) of the Code, the gain, if any, so recognized is taxable as a dividend to each underwriter in an amount not in excess of his ratable share of the undistributed earnings and profits of the association accumulated after February 28, 1913. The remainder, if any, of the gain so recognized is taxable as gain from the exchange of property. Pursuant to section 356(c) of the Code, no loss is recognized to the underwriters on the exchange.

(5) Pursuant to section 358(a) of the Code, the basis of the stock of the new corporation in the hands of each underwriter is the same as the cost or other basis of the interest in the association exchanged, decreased by the amount of the original cash deposit required to be made to the guaranty fund and increased by the amount which was treated as a dividend and the amount of gain recognized to the underwriter on the exchange (not including any portion thereof treated as a dividend). The basis of the assets received from the guaranty fund is the same as it was in the hands of each underwriter prior to their deposit in the guaranty fund.

(6) Pursuant to section 381 of the Code, the earnings and profits, if any, of the association remaining after giving effect to the amount

of the distribution which is taxable as a dividend under section 356(a)(2), constitute earnings and profits of the new corporation.

---

26 CFR 1.368–2: Definition of terms. Rev. Rul. 58–93

A transaction, whereby a 79-percent owned subsidiary (1) transfers all of its assets to a new corporation in exchange for all of the stock of the latter and (2) immediately thereafter merges into its parent in pursuance of a plan of statutory merger, constitutes a reorganization within the meaning of sections 368(a)(1)(A) and 368(a)(2)(C) of the Internal Revenue Code of 1954.

Advice has been requested as to the tax effect, under section 368 of the Internal Revenue Code of 1954, of certain corporate transactions hereinafter described.

Corporation *Y*, a corporation organized under the laws of the State of *C*, was engaged in the small loan business in the State of *B*. Its outstanding capital stock consisted of $100x$ shares of common stock of one class, of which $79x$ shares were owned by Corporation *X* and $21x$ shares were owned by various individuals.

Inasmuch as the business of Corporation *Y* was carried on entirely within the State of *B*, there were business disadvantages in operating under a corporate charter issued by the State of *C*. Also, the existence of the large minority interest in Corporation *Y* had been a handicap to Corporation *X* in its efforts to raise additional capital through the sale of additional shares of its stock to the public. Therefore, Corporation *X* desired to eliminate the minority interest and continue the activities of Corporation *Y* through a wholly-owned subsidiary organized in the State of *B*.

For the above reasons, a plan of reorganization was adopted under which Corporation *Y* transferred all of its assets, subject to all of its liabilities, to new Corporation *Z* (organized under the laws of the State of *B*) in exchange for all of the capital stock of Corporation *Z*. Immediately thereafter, Corporation *Y* was merged into Corporation *X* in accordance with the applicable merger statutes of the State of *C* and the state of incorporation of Corporation *X*. Pursuant to the merger, the minority shareholders of Corporation *Y* exchanged their *Y* stock for stock of Corporation *X*. The assets of Corporation *Y* were transferred to Corporation *Z* prior to the statutory merger (rather than after) for the reason that Corporation *X* was not licensed to do a small loan business in the State of *B* and therefore could not directly receive the *Y* assets.

Section 368(a)(1)(A) of the Internal Revenue Code of 1954, relating to corporate reorganizations, defines a reorganization as "* * * a statutory merger or consolidation * * *." Section 368(a)(2)(C), containing special rules relating to the definition of the term "reorganization," provides in part:

(C) Transfers of Assets to Subsidiaries in Certain Paragraph (1)(A) and (1)(C) Cases.—A transaction otherwise qualifying under paragraph (1)(A) [statutory merger] or paragraph (1)(C) shall not be disqualified by reason of the fact that part or all of the assets which were acquired in the transaction are transferred to a corporation controlled by the corporation acquiring such assets.

Section 368(b) reads as follows:

(b) PARTY TO A REORGANIZATION.—For purposes of this part, the term "a party to a reorganization" includes—

(1) a corporation resulting from a reorganization, and

(2) both corporations, in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

In the case of a reorganization qualifying under paragraph (1)(C) of subsection (a), if the stock exchanged for the properties is stock of a corporation which is in control of the acquiring corporation, the term "a party to a reorganization" includes the corporation so controlling the acquiring corporation. In the case of a reorganization qualifying under paragraph (1)(A) or (1)(C) of subsection (a) by reason of paragraph (2)(C) of subsection (a), the term "a party to a reorganization" includes the corporation controlling the corporation to which the acquired assets are transferred.

Section 368(a)(2)(C) permits the transfer of assets acquired in a statutory merger to a subsidiary, which may be a new subsidiary. The statute speaks of assets "acquired" so that it seems clear that the transfer contemplated is ordinarily one which occurs *after* the merger or at the same time as the merger. In the instant case, the transfer to the new subsidiary was required to be made immediately *prior* to the merger in view of the fact that Corporation X was not permitted under local law to receive the assets for the purpose of conveying them to the new subsidiary after the merger. However, in either case the ultimate effect is practically the same, and it is not believed that the timing of the transfer of the assets to the new subsidiary (under the facts of the instant case) should disqualify the reorganization. It is therefore the position of the Internal Revenue Service that the transaction should be treated for Federal income tax purposes as though Corporation Y had been merged into Corporation X and thereafter Corporation X had transferred the Y assets to the new subsidiary, Corporation Z. See Revenue Ruling 57–278, C. B. 1957–1, 124, where a similar result was achieved in a case involving similar facts in a reorganization qualifying under section 368(a)(1)(C).

In view of the foregoing, it is held that the transaction in the instant case constitutes a reorganization under the provisions of sections 368(a)(1)(A) and 368(a)(2)(C) of the Internal Revenue Code of 1954. No gain or loss is recognized to Corporation X, Corporation Y, or Corporation Z as a result of the exchanges made pursuant to the plan of reorganization. As provided by section 354(a)(1) of the Code, no gain or loss is recognized to the minority shareholders of Corporation Y upon the exchange of their stock for stock of Corporation X. Under section 368, the basis of the Corporation X stock in the hands of the minority shareholders of Corporation Y is the same as the basis of the Corporation Y stock exchanged therefor and, under section 362(b), the basis of the assets of Corporation Y acquired by Corporation Z is the same in the hands of Corporation Z as it was in the hands of Corporation Y. In accordance with section 381(c)(2) of the Code, the earnings and profits of Corporation Y are deemed to have been received by Corporation Z as of the date on which the assets of Corporation Y were transferred to Corporation Z.

PART V.—CARRYOVERS

SECTION 382.—SPECIAL LIMITATIONS ON NET OPERATING LOSS CARRYOVERS

Rev. Rul. 58–9

A net operating loss carryover of an inactive corporation is not available as a net operating loss deduction for the taxable year in which the percentage ownership of its stock changed to the extent provided in section 382(a) of the Internal Revenue Code of 1954, and for subsequent taxable years, even though the corporation is reactivated in the same line of business as that originally conducted.

Advice has been requested whether a corporation, which had been inactive but was reactivated in its original line of business during a taxable year in which the percentage ownership of its stock changed to the extent provided in section 382(a) of the Internal Revenue Code of 1954, may avail itself of net operating loss carryovers from taxable years prior to such change in percentage ownership.

The taxpayer corporation, had been engaged in carrying on a general insurance business, but in 1955 ceased to do business because of adverse business factors which resulted in operating losses and in a substantial deficit in its earned surplus account. In 1956, the stockholders of the corporation sold all of the stock in the corporation to an individual engaged in the same type of business. The individual continued to operate his own insurance business, together with the acquired business under the taxpayer's corporate charter.

Section 382(a) of the Code provides, in part, that if one or more of the ten largest unrelated stockholders in a corporation own, at the end of the corporation's taxable year, a percentage of the total fair market value of the outstanding stock as a result of purchase or redemption which is at least 50 percentage points more than such person or persons owned at either the beginning of such taxable year or the prior taxable year, and if the corporation has not continued to carry on a trade or business substantially the same as that conducted before the change in percentage ownership of the fair market value of such stock, the net operating loss carryovers of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable years.

Since the corporation was not engaged in business but was inactive, the reactivation of the corporation after the change in the percentage ownership of the fair market value of its stock, whether or not in the same line of business as that originally conducted, did not put the corporation in a trade or business "substantially the same as that conducted before the change in percentage ownership of such stock," as provided in section 382(a) of the Code.

Accordingly, it is held that a net operating loss carryover of an inactive corporation is not available as a net operating loss deduction for the taxable year in which the percentage ownership of its stock changed to the extent provided in section 382(a) of the Code, and for subsequent taxable years, even though the corporation is reactivated in the same line of business as that originally conducted.

PART VI.—EFFECTIVE DATE OF SUBCHAPTER C

SECTION 392.—EFFECTIVE DATE OF PART II

26 CFR 1.392–1: Effective date of Part II of Subchapter C. T. D. 6286

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations under section 392(b) of the Internal Revenue Code of 1954 as amended.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

SECTION 1.392–1 of the Income Tax Regulations (26 CFR Part 1) is amended by striking paragraph (c) and inserting in lieu thereof the following:

(c) ELECTION.—(1) Except as provided in subparagraph (2) of this paragraph, any election provided in section 392(b) shall be made by attaching to the return of the liquidating corporation for the year in which falls the date of the final liquidating distribution, a statement indicating its election wth respect to section 392(b) or, in any case in which the final return of the corporation was filed on or before December 11, 1954, within 90 days after December 2, 1955, by filing such a statement with the proper district director of internal revenue for association with the final return.

(2) In any case in which the final return of a liquidating corporation was filed after December 11, 1954, and on or before December 2, 1955, any election provided in section 392(b) shall be made either by attaching to the return of such corporation for the year in which falls the date of the final liquidating distribution, a statement indicating its election with respect to section 392(b), or by filing such a statement on or before June 15, 1958, with the district director with whom such final return was filed.

(3) If a statement of election is not attached to the final return of a liquidating corporation or if such a statement is not filed with the proper district director within the time prescribed by this paragraph, the provisions of section 392(b) shall not be applicable.

Because this Treasury Decision liberalizes existing regulations and because it is desirable to inform interested taxpayers promptly of the change, it is found that it is unnecessary and impracticable to issue such Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U. S. 7805).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved March 12, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on March 12, 1958 at 12:01 P. M., and published in the issue of the Federal Register for March 13, 1958, 23 F. R. 1725.)

SUBCHAPTER D.—DEFERRED COMPENSATION, ETC.

Part I.—Pension, Profit-Sharing, Stock Bonus Plans, Etc.

SECTION 401.—QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS

26 CFR 1.401–4: Discrimination as to contributions or benefits. Rev. Rul. 58–151

The standards set forth in Part 5 (f) of Revenue Rulings 57–163, C. B. 1957–1, 128, at page 149, regarding the provisions in employees' pension, annuity, profit-sharing, and stock bonus plans granting early retirement benefits with the employer's consent, will not be applied retroactively to those plans which conformed to the rules and regulations existing at the time of the issuance of a favorable determination regarding their qualification. Such standards are also amplified as to prohibited discrimination.

Rev. Rul. 57–163, Part 5(f), C. B. 1957–1, 128, at page 149, modified.

Advice has been requested concerning the application of the provisions of Part 5(f) of Revenue Ruling 57–163, C. B. 1957–1, 128, at page 149, concerning the granting of early retirement benefits under an employees' pension, annuity, profit-sharing, or stock bonus plan with the employer's consent where a prior favorable determination letter had been issued as to the qualification of such plan under section 401(a) of the Internal Revenue Code of 1954 (or section 165(a) of the 1939 Code) and the plan had conformed to requirements existing at that time.

Prior to the publication of Part 5(f) of Revenue Ruling 57–163, *supra*, the conditions and limitations on benefits which could be paid to a participant in an employees' pension, annuity, profit-sharing, or stock bonus plan before attaining the normal retirement age were set forth in Part 5(f) of Revenue Ruling 33, C.B. 1953–1, 267, at pages 282–283, which stated in part: "Where the benefits payable upon such early retirement meet the above conditions they will be acceptable even if no benefits would be vested if the employee's service were terminated at the time for other reasons, *unless it appears from the facts in a particular case that the prohibited discrimination is likely to result because of the provisions for early retirement.*" (Italics added for emphasis.) Thus, where a plan contained a provision for early retirement, the factor controlling qualification under section 165(a) of the 1939 Code (section 401(a) of the 1954 Code) is "prohibited discrimination." Where it did not appear that such discrimination is likely to result, a favorable determination was made with respect to this issue.

In order to remove any element of uncertainty, an affirmative position was taken in Revenue Ruling 57–163, Part 5(f), *supra*, by holding that "Any reasonable optional early retirement age will generally be acceptable provided that, if the employer's consent is required, the value of the early retirement benefits does not exceed the value of the employee's vested benefits at that time." Thus, every employee with similar credits must be granted benefits of equal value. This does not mean, however, that when an employer consents to early retirement benefits for an employee all employees who except for such

consent satisfy the requirements for early retirement must also be granted immediate retirement benefits. The terms "vested benefits" and "immediate retirement benefits" are not synonymous. As pointed out in Part 5(j) of Revenue Ruling 57–163 *supra*, "Plans may include various modes of settlement for payment of benefits thereunder if under each mode of settlement the distribution has the same value as a distribution determined under any other mode of settlement provided for under the plan, and further, if upon retirement (or event calling for a distribution in a profit-sharing plan) each participant is entitled to a fully vested right in the amount which has been accumulated for his benefit." Thus, where early retirement is permitted for one employee, another employee with similar credits need not be accorded similar treatment, provided that his credits are vested so as to entitle him to a deferred annuity, based on such credits plus any additional credits he may subsequently earn, commencing at normal retirement age or at actual retirement after attaining such age.

In the case of plans that are limited to employees other than those enumerated in section 401(a)(4) of the Code (in whose favor discrimination should never exist), the early retirement of employees before they acquire vested rights equal to the value of the benefits which, under the plan, are payable at the early retirement date, will not be deemed to be contrary to the requirements of section 401(a)(4) of the Code, regarding nondiscrimination in contributions or benefits. Thus, for example, such early retirement provision may be acceptable in a plan in which coverage is limited only to the hourly-rated employees, or where, in a plan covering salaried as well as hourly-rated employees, such provision is applicable only to employees whose remuneration does not exceed the Social Security maximum compensation limit ($4,200 per annum currently).

Also, where set standards for early retirement are prescribed and are uniformly applied and consistently followed, they may be acceptable, as in the case of pensions payable because of disability. See Part 5(k) of Revenue Ruling 57–163, *supra*. An example in this category would be a plan under which early retirement benefits are payable to all employees separated from service incident to a discontinuance of business operations at a particular locality, regardless of the extent of their otherwise vested rights.

Accordingly, Part 5(f) of Revenue Ruling 57–163, *supra*, to the extent it states that optional early retirement with the employer's consent will generally be acceptable if the value of the early retirement benefits does not exceed the value of the employee's vested benefits at that time, is modified as stated above, but is reaffirmed in all other respects.

Under the authority of section 7805(b) of the 1954 Code, the effect of Revenue Ruling 57–163, *supra*, as reaffirmed by this ruling, will not be applied retroactively to those plans containing a provision for early retirement with the employer's consent which are not in conformance with the aforesaid standards, but with respect to which favorable determination letters as to qualification under section 401(a) of the 1954 Code (or section 165(a) of the 1939 Code) had been issued prior to the publication of Revenue Ruling 57–163, *supra*. Such favorable determination letters will continue in effect unless and until revoked.

SECTION 402.—TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST

26 CFR 1.402(a)-1: Taxability of beneficiary under a trust which meets the requirements of section 401(a). Rev. Rul. 58-94

An employee is deemed to have separated from the service of an employer where, under a plan of reorganization within the meaning of section 368(a)(1)(C) of the Internal Revenue Code of 1954, all the assets and liabilities of a corporation are transferred to another corporation which, in turn, transfers such assets and liabilities to a wholly owned subsidiary of the latter and the employees of the predecessor corporation become employees of the subsidiary. Therefore, a distribution, within one taxable year, of the total amount standing to the credit of the participants under the predecessor corporation's qualified employees' pension plan which is terminated by reason of the reorganization, may be considered a gain from the sale or exchange of a capital asset held for more than six months, to the extent that it exceeds the amount contributed by the employee.

Advice has been requested whether an employee is deemed to have separated from the service of his employer, within the meaning of section 402(a)(2) of the Internal Revenue Code of 1954, where, under a reorganization, the qualified employees' pension plan and trust are terminated and all the assets and liabilities of the employer company are transferred to a corporation which then transfers such assets and liabilities to a wholly owned subsidiary of the latter and the employees of the predecessor company become employees of the subsidiary corporation.

The *M* company entered into an agreement and plan of reorganization with the *P* corporation and the *S* corporation whereby all the assets and liabilities of the *M* company were transferred to the *P* corporation in exchange for common stock of the *P* corporation. After acquiring these assets and liabilities, the *P* corporation then transferred them to the *S* corporation in exchange for shares of common stock of the *S* corporation. The *S* corporation is a wholly owned subsidiary of the *P* corporation. The reorganization was one within the meaning of section 368(a)(1)(C) of the Code wherein the term "reorganization" is defined, in part, as meaning the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in the control of the acquiring corporation), of substantially all of the property of another corporation. The places of business formerly operated by the *M* company were then operated by the *S* corporation and virtually all the employees of *M* company became employees of the *S* corporation. The *M* company continued in existence after the effective date of the transfer of its assets only for purposes of liquidation.

The employees' pension plan and trust established by the *M* company, which have been held to qualify under section 401(a) and the trust to be exempt under section 501(a) of the Code, were terminated. A distribution of the total amount standing to the credit of each employee of *M* company was made in one taxable year to each such employee.

Distributions from a qualified employees' trust are taxable in accordance with section 402(a) of the Code. Paragraph (1) of such section provides, in part, that amounts actually distributed or made available shall be taxable in the year in which distributed or made available, under section 72 of the Code except that section 72(e)(3) shall not apply. Section 402(a)(2) of the Code provides that if the total distributions payable under a qualified trust, with respect to any employee, are paid to the distributee within one taxable year of the distributee on account of the employee's death or other separation from the service, or on account of the employee's death after separation from the service, the amount of such distribution, to the extent exceeding the amounts contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than six months.

Unlike section 165(b) of the Internal Revenue Code of 1939, which was silent as to any distinction, section 402 of the 1954 Code differentiates between distributions on account of a "separation from the service" of an employer and distributions as a result of "the complete termination of" the plan of an employer, at least where the employer is a corporation. Distributions on account of "separation from the service" of an employer which otherwise meet the tests of section 402(a)(2) are given long-term capital gain treatment thereunder, but under section 402(e) distributions resulting from the complete termination of a stock bonus, pension, or profit-sharing plan of a corporation, if the termination of the plan is incident to the complete liquidation of the corporation, whether or not such liquidation is incident to a reorganization as defined in section 368(a) of the Code, are to be considered as distributions on account of separation from service only if made after December 31, 1953, and before January 1, 1955, and only if the liquidation occurs before August 16, 1954.

It is clearly brought out by the legislative history of section 402 of the 1954 Code that the phrase "separation from the service" in section 402(a)(2) of the Code as finally enacted does not extend to distributions resulting from the liquidation or reorganization of a corporate employer, which do not involve a substantial change in the make-up of employees, except as section 402(e) of the Code requires such distributions to be considered on account of separation from service for the limited period to which that subsection is applicable. Section 402(e), in substantially its present form, was added to the proposed legislation in the Senate as a partial substitute for similar provisions contained in section 402(a)(2) and (3)(B)(ii) of the House bill, which were eliminated in the Senate. Those provisions of the House bill would have extended long-term capital gain treatment prospectively to distributions by reason of the termination of a plan "as a result of the complete termination of the business of the employer," which was defined in section 402(a)(3)(B)(ii) to mean "in the case of an employer which is a corporation, the complete liquidation of such corporation whether or not such liquidation qualifies as a complete liquidation under section 336 and whether or not such liquidation is incident to a corporate acquisition of property, a statutory merger, or consolidation," which was treated as a cause of distribution distinct from separation from service. As was stated most clearly at page 54 of the report of the Senate Committee on Finance, the provisions of the

House bill regarding distributions resulting from the termination of a plan because of the complete liquidation of the business of a corporate employer had been intended to extend capital gain treatment to situations such as arise upon the merger of a firm with a pension plan with another firm without such a plan, with the result that the plan of the first corporation is terminated; but it was deemed necessary to eliminate, prospectively, any such extension of capital gain treatment "to eliminate the possibility that reorganizations which do not involve a substantial change in the make-up of employees might be arranged merely to take advantage of the capital gains provision." See section 402 of Senate print of H. R. 8300, 83d Cong., as referred to the Committee on Finance, March 23, 1954; print of H. R. 8300 dated July 2, 1954, with engrossed Senate amendments, pages 173-178, inclusive. See also H. R. Report No. 1337, 83d Cong., page A147; Senate Report No. 1622, 83d Cong., pages 54 and 289; and the H. R. Report, No. 2543, 83d Cong., pages 11, 41, and 42, as to Senate Amendment No. 83.

It is nevertheless the position of the Internal Revenue Service that Congress did not intend in section 402 to discriminate against the employees of a corporate employer by extending to them less favorable treatment than would be accorded under section 402(a)(2) in cases involving separation from the service of a noncorporate employer. The legislative history of section 402 discloses instead an attempt to deal, in the first instance favorably but in the ultimate outcome unfavorably, so far as concerns the prospective effect of the section, with a phase of the subject of separation from employment which is peculiar to the termination of plans of corporate employers by reason of corporate liquidations or reorganizations. This history makes it plain that a corporate liquidation or reorganization which brings about a change in employment relationship in no more than a formal or technical sense, and which does not involve a substantial change in the make-up of employees, is not enough to constitute a "separation from the service" under section 402(a)(2). Nothing in the language of section 402 or in its legislative history, however, suggests that a separation from the service of a corporate employer does not occur where a corporate liquidation or reorganization is not itself the cause of termination of the employer's plan but is merely incident to such a change in the ownership of the business as might occur in the case of a noncorporate employer. If, for example, the termination of a corporate employer's plan is incident to a sale of its stock to another corporation for cash, followed by the immediate merger of the employer corporation into the purchasing corporation, distributions to its employees under the plan may be on account of a separation from service, just as in the case of an individual or partnership employer which has sold its assets for cash, even though substantially all employees of the former business are re-employed by the purchaser. In that regard, see Rev. Rul. 58-95, page 21, this Bulletin.

The instant case does not involve the disposition of either the stock or the assets of the employer corporation for cash but the disposition of assets for stock of a corporation in control of the acquiring corporation in a section 368(a)(1)(C) reorganization. Factually, the case is similar to *Mary Miller et al* v. *Commissioner*, 22 T. C. 293, affirmed 226 Fed. (2d), 618, acquiescence page 5, but that case arose under section 165(b) of the 1939 Code and for the reasons stated above is

not considered controlling for purposes of section 402(a)(2) of the 1954 Code. Nevertheless, a separation from service would have occurred in the instant case within the meaning of section 402(a)(2) had the employer been an individual or partnership disposing of its assets for stock in a previously unrelated corporation, at least where the transferor or transferors were not in control of the transferee corporation immediately after its acquisition of the assets. There is as real a change in the ownership of the business in the instant case as if the employer had not been a corporation, and the fact that there is sufficient continuity of interest to allow the transaction to be treated as a tax-free reorganization under section 361(a) and 368(a)(1)(C) of the Code, so far as concerns the employer corporation and its stockholders, should not prevent viewing it as involving a separation from service for the purposes of section 402(a)(2) as to the affected employees.

Accordingly, it is held that an employee is deemed to have "separated from the service" of an employer, within the meaning of section 402(a)(2) of the 1954 Code where, under a reorganization, within the meaning of section 368(a)(1)(C) of the Code, all the assets and liabilities of a company are transferred to a corporation which then transfers such assets and liabilities to a wholly owned subsidiary of the latter, and the employees of the predecessor company become employees of the subsidiary. Therefore, a distribution, within one taxable year, of the total amount standing to the credit of the participants under the predecessor company's qualified employees' pension trust which is terminated by reason of the reorganization, may be considered a gain from the sale or exchange of a capital asset held for more than six months, to the extent that it exceeds the amount contributed by the employee.

Rev. Rul. 58–95

A "separation from the service" of a corporate employer occurs, within the intendment of section 402(a)(2) of the Internal Revenue Code of 1954, when the termination of its qualified employees' pension trust is incident to the acquisition of all of its stock by another corporation for cash, in a transaction amounting in substance to a purchase of assets for cash, even though shortly thereafter its employees are taken over by the controlling corporation upon the transfer of the assets of the subsidiary to the controlling corporation under a plan of complete liquidation within the meaning of section 332(b) of the Code. Therefore, a distribution, made in one taxable year of each distributee, of the total amount due such employees upon the termination of the trust, may be considered a gain from the sale or exchange of a capital asset held for more than six months, to the extent that it exceeds the amount contributed by the employee.

Advice has been requested whether a distribution under a qualified employees' pension trust, terminated on the occasion of the liquidation of a subsidiary company, with resultant transfer of all its assets to the controlling corporation, where the employees of the subsidiary become employees of the controlling corporation, may be considered to be made on account of the employees' "separation from the service" of the employer within the intendment of section 402(a)(2) of the Internal Revenue Code of 1954.

In March 1956, the *M* corporation purchased all outstanding shares of the stock of *O* company. The *O* company continued to operate, as

a wholly owned subsidiary of the *M* corporation, until July 1956, when, under a plan of complete liquidation theretofore adopted, all of the assets of the *O* company, exclusive of its franchise, were distributed to the *M* corporation, as its sole stockholder. The distribution of assets, subject to liabilities, resulted in the complete liquidation of the *O* company within the meaning of section 332(b) of the Code.

After the complete liquidation of the *O* company, the *M* corporation continued the same business at the place of business formerly used by the *O* company. The former employees of the *O* company were then taken over by the *M* corporation. The basis for the assets acquired by the *M* corporation was determined under the provisions of section 334(b)(2) of the Code, wherein it is provided, in part, that if property is received by a corporation in a distribution in complete liquidation of another corporation, within the meaning of section 332(b), and if the distribution is pursuant to a plan of liquidation adopted on or after June 22, 1954, and not more than two years after the date the stock of the distributing corporation possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock, was acquired by the distributee by purchase during a period of not more than 12 months, then the basis of the property in the hands of the distributee shall be the adjusted basis of the stock with respect to which the distribution was made.

Upon the liquidation of the *O* company, the employees' pension plan and trust, which it had established in 1943 and which have been held respectively to meet the requirements of section 401(a) of the Code and to be exempt under section 501(a), were terminated. A distribution, of the total amount due the employee participants under the trust, was made in one taxable year to each of the distributees.

Section 402(a)(1) of the Code provides, in part, that amounts actually distributed or made available under a qualified employees' trust shall be taxable in the year in which distributed or made available, under section 72 of the Code except that section 72(e)(3) shall not apply. Section 402(a)(2) provides that if the total distributions payable under a qualified trust, with respect to any employee, are paid to the distributee within one taxable year of the distributee on account of the employees' death or other separation from the service, or on account of the employees' death after separation from the service, the amount of such distribution, to the extent exceeding the amount contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than six months.

The facts of the instant case closely parallel those in the case of *Lester B. Martin et ux.* v. *Commissioner*, 26 T. C. 100, acquiescence page 5. There the entire capital stock of the employer corporation was acquired by another corporation for cash in September, 1948, and the purchasing corporation operated the employer corporation as a subsidiary through March, 1949, with the employer corporation's pension plan remaining in effect during that period of operation. On April 1, 1949, however, the subsidiary employer corporation was liquidated and all of its assets were transferred to the parent along with all of its employees. The pension plan of the former employer was thereupon terminated and terminal distributions were made to its

beneficiaries, which were held entitled to capital gain treatment under section 165(b) of the 1939 Code. The Tax Court, following its decision in *Mary Miller et al.* v. *Commissioner*, 22 T. C. 293, affirmed 226 Fed. (2d) 618, acquiescence page 5, held that the liquidation of the subsidiary itself resulted in a "separation from the service" of the liquidated corporation.

For the reasons stated in Rev. Rul. 58–94, page 194, it is the position of the Internal Revenue Service that the liquidation of a wholly-owned subsidiary corporation does not, in and of itself, effect a "separation from the service" of an employer within the meaning of section 402(a)(2) of the 1954 Code. The rationale of the *Martin* case is therefore not considered controlling for the purposes of section 402(a)(2). Nevertheless, it is considered that the same result might be reached on similar facts under section 402(a)(2) of the Code, provided the acquisition of stock of the liquidated corporation and the later liquidation may be regarded as an integrated transaction in substance involving the purchase of the assets of the former employer corporation. The rule is well established by court decisions that the acquisition of the assets of a corporation in a series of steps, involving an initial purchase of its stock and the later liquidation or merger of the acquired corporation into the acquiring corporation, may in substance constitute an acquisition of the assets for cash. See, for example, *Commissioner* v. *Ashland Oil and Refining Co.*, 99 Fed. (2d) 588, certiorari denied, 306 U. S. 661; *Kimbell-Diamond Milling Co.* v. *Commissioner*, 14 T. C. 74, affirmed 187 Fed. (2d) 718, certiorari denied 342 U. S. 827. In such cases there is a real, as distinguished from a purely formal or technical, change in the ownership of the business, and the fact that the necessary series of steps includes a corporate liquidation or reorganization does not preclude the result that a "separation from the service" of the former employer corporation has occurred.

As indicated above, section 334(b)(2) of the Code allows a corporation which has acquired at least 80 percent of all classes of stock of another corporation, including voting stock, within a period of 12 months, to take as its basis for assets acquired within two years thereafter in a section 332(b) liquidation the adjusted basis of the stock with respect to which the distribution was made. Section 334(b)(2) represents a special statutory extension, for basis purposes, of the rule of the *Ashland Oil and Refining Co.* and *The Kimbell-Diamond Milling Co.* line of decisions since its effect is similarly to treat the acquisition as an acquisition of assets rather than of stock in the first instance. Where section 334(b)(2) is applicable, the Service will ordinarily view the acquisition as of assets rather than stock for the purposes of section 402(a)(2) as well, in the interest of convenience in administration.

Accordingly, it is held that a "separation from the service" of a corporate employer occurs, within the intendment of section 402(a)(2) of the Internal Revenue Code of 1954, when the termination of its qualified employees' pension trust is incident to the acquisition of all of its stock by another corporation for cash, in a transaction amounting in substance to a purchase of assets for cash, even though shortly thereafter its employees are taken over by the controlling

corporation upon the transfer of the assets of the subsidiary to the controlling corporation under a plan of complete liquidation within the meaning of section 332(b) of the Code. Therefore, a distribution made in one taxable year of each distributee, of the total amount due such employees upon the termination of the trust, may be considered a gain from the sale or exchange of a capital asset held for more than six months, to the extent that it exceeds the amount contributed by the employee.

Rev. Rul. 58–96

Where, incident to a plan of complete liquidation, all the assets of a corporation are sold for cash and the trust forming part of the qualified employees' pension, profit-sharing, or stock bonus plan is terminated, distributions under the trust may be considered to be made on account of the employees' "separation from the service," within the meaning of section 402(a)(2) of the Internal Revenue Code of 1954, as to all separated employees, including those employees who incident to such sale of assets go over to the purchaser. If the distributions represent the total distributions payable and are made in one taxable year of the distributees, the amount of such distributions, to the extent exceeding the amount contributed by the employees, shall be considered gains from the sale or exchange of capital assets held for more than six months.

Advice has been requested whether a distribution from an employees' trust, described under section 401(a) of the Internal Revenue Code of 1954 and exempt from tax under section 501(a) of the Code, may be treated as a distribution on account of separation from the service within the meaning of section 402(a)(2) of the Code, where incident to a plan of complete liquidation the assets of the employing corporation are sold for cash and most of the employees go over to the purchasing corporation.

Incident to a plan of complete liquidation, a corporation sold all its corporate assets to another corporation for cash and ceased its business operations. Most of the employees of the liquidated corporation became employees of the purchasing corporation. None of the officers or directors of either corporation were officers or directors of the other corporation. Incident to the sale and by reason of the cessation of business, the qualified employees' pension and profit-sharing plans and trusts were terminated and a distribution made of the total amounts standing to the credit of the employee participants.

Section 402(a)(2) of the Code provides, in part that in the case of an employees' trust described in section 401(a) of the Code, which is exempt from tax under section 501(a) of the Code, if the total distributions payable with respect to any employee are paid to the distributee within one taxable year of the distributee on account of the employee's separation from the service, the amount of such distribution, to the extent exceeding the amounts contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than six months.

Accordingly, in line with the position of the Service as stated in Revenue Rulings 58–94 and 58–95, pp. 194 and 197, it is held that where, incident to a plan of complete liquidation, all the assets of a corporation are sold with resulting recognition of gain or loss under section 1002 of the Code, and the trust forming part of the qualified employees' pension, profit-sharing or stock bonus plan is terminated,

distributions under such trust may be considered to be made on account of the employees' "separation from the service," within the meaning of section 402(a)(2) of the Code, as to all separated employees, including those employees who, incident to the sale of assets, go over to the purchaser. If the distributions represent the total distributions payable and are made in one taxable year of the distributees, the amount of such distributions, to the extent exceeding the amounts contributed by the employees, shall be considered gains from the sale or exchange of capital assets held for more than six months.

Rev. Rul. 58–97

Where, incident to a plan of complete liquidation, the assets used in carrying on the business of one of two divisions of a corporation are sold to another corporation and the employees' qualified profit-sharing plan and trust are continued by the seller, a total distribution of the amount standing to the credit of those employees who go over to the purchasing corporation may be considered as a long-term capital gain under section 402(a)(2) of the Internal Revenue Code of 1954, to the extent that it exceeds the amount contributed by the employee.

Advice has been requested whether a distribution from a trust forming part of a qualified employees' profit-sharing plan may be considered as a distribution on account of separation from service within the meaning of section 402(a)(2) of the Internal Revenue Code of 1954 where, incident to a plan of complete liquidation, the assets used in carrying on the business of one of two divisions of a corporation are sold to another corporation, the profit-sharing plan and trust are continued in operation by the seller but a total distribution is made to those employees who go over to the purchasing corporation.

A corporation conducted two businesses by means of separate divisions. Incident to a plan of complete liquidation, the corporation sold the property and assets of one division to a separate company. Practically all of the employees of the division, the property and assets of which were sold, were taken over by the purchasing corporation. A total distribution was made of the amounts standing to the credit of the former employees of said division under the employees' profit-sharing trust established by the corporation. The trust has been held as qualifying under section 401(a) of the Code and to be exempt under section 501(a).

The selling corporation did not control, nor was it controlled by, the purchasing corporation. None of the persons who were stockholders of the selling corporation are officers or directors of the purchasing corporation and none of the stockholders of the latter are officers or directors of the selling corporation. The selling corporation will continue to exist under State law for the period required to pay its debt, wind up its affairs, and distribute the remaining assets. The profit-sharing trust will not be terminated but is intended to be continued by the successor to the selling corporation, when its liquidation has been completed.

Section 402(a)(2) of the Code provides, in part, that in the case of an employees' trust described in section 401(a), which is exempt from tax under section 501(a) of the Code, if the total distributions payable with respect to any employee are paid to the distributee

within one taxable year of the distributee on account of the employee's death or other separation from service, the amount of such distribution, to the extent exceeding the amounts contributed by the employee, shall be considered a long-term capital gain.

Accordingly, in line with the position of the Service as stated in Revenue Rulings 58–94 and 58–95, pp. 194 and 197, it is held that where, incident to a plan of complete liquidation, the assets used in carrying on the business of one of two divisions of a corporation are sold to another corporation and the employees' qualified profit-sharing plan and trust are continued in effect by the seller, a total distribution of the amount standing to the credit of those employees who go over to the purchasing corporation may be considered as having been made on account of separation from the service and, therefore, taxable as a long-term capital gain under section 402(a)(2) of the Code, to the extent that it exceeds the amount contributed by the employee.

Rev. Rul. 58–98

Two stockholder-employees owned the outstanding shares of stock of the *M* corporation and participated in the employee's profit-sharing trust established by the corporation. The trust has been held to meet the requirements of section 401(a) of the Internal Revenue Code of 1954 and to be exempt from tax under section 501(a) of the Code. The *M* corporation was liquidated and dissolved, and a successor partnership was formed to continue the business. The two former stockholder-employees of the *M* corporation are partners in the successor partnership and, as such, are no longer eligible to participate in the profit-sharing trust, which was continued by the partnership. See I. T. 3350, C. B. 1940–1, 64, and Rev. Rul. 57–163, C. B. 1957–1, 128. A lump sum distribtion was made of the total amounts standing to the credit of each of the two former stockholder-employees in the trust. *Held*, insofar as the two former stockholder-employees of the *M* corporation are concerned, there was a "separation from the service" of such corporation when they became partners within the purview of section 402(a)(2) of the Code. Accordingly, a single cash payment to each of the two former stockholder-employees of the total amount due them under the trust constitutes a long-term capital gain, to the extent that it exceeds the amount contributed by the employees.

Rev. Rul. 58–99

Where the employees of a subsidiary corporation were participants in the qualified employees' pension plan and trust established by the parent corporation and such subsidiary, and the subsidiary is separated from the parent corporation and continues as a separate taxable entity, a distribution from the employees' trust of the total amount standing to the credit of the employees of the subsidiary corporation cannot be considered as having been made on account of the employee's separation from the service within the meaning of section 402(a)(2) of the Internal Revenue Code of 1954 and is, therefore, taxable under the provisions of section 72 of the Code.

Advice has been requested relative to the taxability of a distribution from a trust forming part of the qualified employees' pension plan established by a parent corporation and its subsidiary when the

subsidiary corporation is separated from and severs all connections with the parent corporation and distribution is made to the employees of the subsidiary of the total amounts standing to their credit in the trust.

The employees of the *S* corporation, a subsidiary of the *P* corporation, were participants in the trust forming a part of the employees' noncontributory pension plan established by the two corporations. The plan and trust have been held to meet the requirements of section 401(a) of the Internal Revenue Code of 1954 and the trust to be exempt under section 501(a) of the Code. Control of the *S* corporation was obtained by other interests under which it continued to operate as a separate taxable entity. The plan was at that time discontinued as to the employees of the *S* corporation. The total amount standing to the credit of the *S* corporation employees in the trust established as a part of the pension plan was distributed in cash in a lump-sum to those employees.

Distributions from a qualified employee's trust are taxable in accordance with section 402(a) of the Code. Paragraph (1) thereof provides, in part, that amounts actually distributed or made available shall be taxable in the year in which distributed or made available, under section 72 of the Code except that section 72(e)(3) shall not apply. Section 402(a)(2) of the Code provides that if the total distributions payable under a qualified trust, with respect to any employee, are paid to the distributee within one taxable year of the distributee on account of the employee's death or other separation from the service, or on account of the employee's death after separation from the service, the amount of such distribution, to the extent exceeding the amounts contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than six months.

In the cases of *Edward Joseph Glinski, Jr.* v. *Commissioner*, 17 T. C. 562, the Tax Court of the United States, in sustaining the Commissioner's findings that a distribution under a qualified trust was taxable as ordinary income and not as long-term capital gain stated, in part, "Total distributions 'on account of the employee's separation from the service' means that the distributions were made on account of the employee's separation from the service of his employer." Also, in *Estate of Frank B. Fry* v. *Commissioner*, 19 T. C. 461, affirmed, 205 Fed. (2d) 517, it was held that where an employee received the distributions payable to him by reason of his participation in an employees' trust but the employee continued to render services and receive his regular salary, the distribution was taxable as ordinary income. Here the Court stated, in part, that "In order to obtain the benefits permitted under section 165(b) of the Internal Revenue Code (corresponding to section 402(a)(2) of the 1954 Code), the decedent must have been retired or severed his connection with his employer. * * * " (Parenthesis supplied.) See Rev. Rul. 56–214, C. B. 1956–1, 196.

From the foregoing it is seen that employees of the *S* corporation prior to its separation from the parent, *P* corporation, continued as employees of *S* corporation subsequent to the separation of the two companies. Thus, the distributions from the instant pension trust cannot be said to have been made "on account of the employee's separation from the service" of the employer, the *S* corporation.

Accordingly, it is held that where the employees of a subsidiary corporation were participants in the qualified employees' pension plan and trust established by the parent corporation and such subsidiary, and the subsidiary is separated from the parent corporation and continues as a separate taxable entity, a distribution from the employees' trust of the total amount standing to the credit of the employees of the subsidiary corporation cannot be considered as having been made on account of the employee's separation from the service within the meaning of section 402(a)(2) of the Code and is, therefore, taxable under the provisions of section 72 of the Code.

Rev. Rul. 58–230

Under an employees' profit-sharing plan and trust, where participants of a stated length of time are permitted to make a withdrawal of employer contributions and earnings thereon which have been credited to their accounts for at least two years, thereby incurring a suspension of participation for a specified period during which time no contributions are made by the employer on behalf of such employees, such suspension represents a substantial restriction or limitation, the amounts which are permitted to be withdrawn are not "made available" to the employees, and such employees will not be taxable until a withdrawal is actually made.

When a plan provides that a suspension of participation for six months will be incurred upon each withdrawal, the amount representing the difference between the amount actually withdrawn and the maximum amount permitted as a withdrawal is held to be made available to the participant making such partial withdrawal, even though the balance may later be withdrawn only by incurring another similar suspension of participation.

Advice has been requested whether a participant in an employees' profit-sharing plan is held to be in receipt of the total amount he could withdraw from the trust under the plan, in those cases where he actually withdraws only a portion of such amounts, whereupon the balance thereof is available only by incurring an additional suspension from the plan.

An employees' profit-sharing plan provides for employer contributions out of current or accumulated earnings or profits, pursuant to a definite formula, which are contributed monthly. The accumulated earnings and profits are substantial and, even if a loss were sustained for any year in any amount which can reasonably be anticipated, contributions could still be made out of such accumulated earnings or profits. The plan also provides that employees who have been participants for a stated length of time may make a withdrawal of the employer's contributions to the plan and earnings thereon, which have been credited to their accounts in the trust under the plan for at least two years as of the close of the preceding calendar year. When such a withdrawal is made, the participant incurs a six-months' suspension from participation under the plan, during which time no contributions are made by the employer on behalf of such employee. Withdrawals are permitted only once in every six months. A participant making a partial withdrawal of the total amount available for withdrawal is suspended for a period of six months after each such withdrawal and such suspension will not run concurrently with any other suspension incurred or required. The plan and trust have been held to meet the requirements of section

401(a) of the Internal Revenue Code of 1954 and the trust to be exempt under section 501(a) of the Code.

Section 402(a) of the Code provides that the amount actually distributed or made available to any distributee by an employees' trust described in section 401(a), which is exempt from tax under section 501(a), shall be taxable to him in the year in which so distributed or made available. Revenue Ruling 55–423, C. B. 1955–1, 41, holds that a participant's interest in an employees' trust described in section 401(a) of the Code and exempt under section 501(a) is not made available to him within the purview of section 402(a) of the Code where there are substantial conditions or restrictions on his right of withdrawal.

Section 1.451–2 of the Income Tax Regulations states that income, although not actually reduced to a taxpayer's possession, is constructively received by him in the taxable year during which it is credited to his account or set apart for him so that he may draw upon it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Accordingly, it is held that, under an employees' profit-sharing plan and trust, where participants of a stated length of time are permitted to make a withdrawal of employer contributions to the trust and earnings thereon, which have been credited to their accounts for at least two years, thereby incurring a suspension of participation for a specified period during which no contributions are made by the employer on behalf of such employees, such suspension represents a substantial restriction or limitation, the amounts which are permitted to be withdrawn are not "made available" to the employees, and such employees will not be taxable until a withdrawal is actually made.

It is further held, however, that the act of withdrawing a portion of the trust funds constitutes an exercise of dominion and control over the entire amount which could have been withdrawn at the same time without any additional penalty. Thus, as to the difference between the maximum amount permitted as a withdrawal and the amount actually withdrawn, there is no substantial restriction or limitation on the participant's right to receive the amount representing such difference, even though the balance may be later withdrawn only by incurring another similar suspension of participation. Accordingly, such difference is considered to be made available at the time of any withdrawal.

Taxability of total distribution payable in one taxable year on account of the separation from service of a nonresident alien residing in Canada. See Rev. Rul. 58–247, page 623.

Taxability of total distribution payable in one taxable year, with respect to an employee who is a nonresident alien residing in Australia, under an employees' exempt trust on account of the employee's death or other separation from service. See Rev. Rul. 58–248, page 621.

26 CFR 1.402(b)-1: Treatment of beneficiary of a trust not exempt under section 501(a). (Also Section 2503.) Rev. Rul. 58-307

Under a nonexempt, contributory pension or profit-sharing plan and trust, established by an employer for employees, where a participant's interest therein (exceeding his own contributions) does not become vested until he reaches age 60, and is thereafter paid or made available to him only at the uncontrolled discretion of the trustees, a relinquishment by a participant, age 60 or over, to the trustees of all his rights to the amount of the employer's contributions credited to his account before such account has been made available to him will not result in Federal income tax liability to the employee or to the trust.

However, his interest in the relinquished amount is vested to the degree that the transfer to the trustees of his rights thereto, for reallocation among remaining participants, constitutes a gift for the purposes of the Federal gift tax and the remaining participants under the plan are donees under the gift. Also, since the trustees have broad discretion in the allocation of amounts in the trust, the value of the gift to any one donee is not susceptible of determination and no exclusion is allowable with respect to the gift.

Advice has been requested relative to the Federal income and gift tax consequences arising out of the relinquishment by an employee of all his vested rights to the amount of the employer's contributions to an employees' nonexempt, contributory pension or profit-sharing plan which have been credited to his account in the trust forming part of the plan.

A corporate employer established a contributory trusteed profit-sharing plan for some of its employees. All contributions by participating employees, and the earnings thereon, are maintained in "A" accounts in the names of such employees. The contributions of the employer on behalf of such employees, and the earnings thereon, are credited to the names of the employees in a separate "B" account. The trust forming a part of the plan was never exempt from tax under section 165(a) of the Internal Revenue Code of 1939; neither has it been a qualified and exempt trust under sections 401(a) and 501(a), respectively, of the 1954 Code.

Amounts set apart for an employee under the plan in both accounts "A" and "B" are made available and paid to the employee or his beneficiaries by direction of the trustees in their uncontrolled discretion at any time, except that payment of any amount set apart for any employee begins not later than the first day of the month following the month of his actual retirement. Where a participant ceases to be an employee before attaining the age of 60, then and only then may the trustees, in their uncontrolled discretion, reallocate or transfer all or part of the "B" account of such participant to the then existing "B" accounts of remaining participating employees in proportion to the amount in each such account. The trustee may direct the disposition, then or later, or from time to time, of the remainder, if any, of the "B" account of the participating employee, either to him or to his beneficiaries.

An employee, who was more than 60 years of age and a participant under the plan, relinquished all rights to any claims in or arising out of the "B" account of the trust under the plan. The relinquishment operated in favor of no particular individual, but the amount so released to the trustees was to be reallocated and administered in accord-

ance with the terms of the plan and the powers and discretion vested in such trustees.

Section 402(b) of the 1954 Code, covering the taxability of a beneficiary of a nonexempt employees' trust, provides, in part, that the amount actually distributed or made available to any distributee by any such trust shall be taxable to him, in the year in which so distributed or made available, under section 72 except that section 72(e)(3) shall not apply.

Accordingly, it is held that although the employee participant is more than 60 years of age, inasmuch as the amount relinquished is not unqualifiedly made available to him or any other participating employee until such time as the employee actually retires or otherwise terminates his services, or until the trustees, in their uncontrolled discretion, take the necessary action to make it available, the relinquishment by the employee before that time of all his rights to all amounts in his "B" account does not result in an actual or constructive distribution within the meaning of section 402(b)of the Code and, therefore, does not create any Federal income tax liability to the employee or to the trust.

Section 86.2 of Regulations 108, pertaining to the Federal gift tax and made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, states in part that, with regard to "transfers reached," that the statute imposes a tax whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. Thus, for example, a taxable transfer may be effected by the declaration of a trust, the foregiving of a debt, the assignment of a judgment, the assignment of the benefits of a contract of insurance, or the transfer of cash, etc. Inasmuch as the tax also applies to gifts indirectly made, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax.

It is also held that, inasmuch as the employee participant is over 60 years of age, his interest in the "B" account is "vested" to the degree that his transfer of his rights in the account to the trustees constitutes a gift for purposes of the Federal gift tax and the remaining participants under the plan are donees under the gift. However, since the trustees under the plan have broad discretion in the allocation of such relinquished trust funds, the value of the gift to any one donee is not susceptible of determination and, therefore, no exclusion is allowable with respect to the gift. In this connection, see Revenue Ruling 55–303, C. B. 1955–1, 471.

SECTION 403.—TAXATION OF EMPLOYEE ANNUITIES

26 CFR 1.403(a)–2: Capital gains treatment for certain distributions.

Taxability of total distribution payable in one taxable year under a qualified annuity plan on account of the separation from service of a nonresident alien residing in Canada. See Rev. Rul. 58–247, page 623.

SECTION 404.—DEDUCTIONS FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN

26 CFR 1.404(a)–1: Contributions of an employer to an employee's trust or annuity plan and compensation under a deferred-payment plan; general rule.

Rev. Rul. 58–193

The estate of a sole proprietor may not, under the carryover provisions of section 404(a)(1) (C) or (D) of the Internal Revenue Code of 1954, claim a deduction for any part of a contribution made by the sole proprietor to a qualified and tax exempt employees pension trust with regard to past service credits, which had not been deducted by the sole proprietor, pursuant to section 404, prior to his death.

Advice has been requested whether the estate of a deceased sole proprietor may be entitled to a deduction, under the carryover provisions of section 404(a)(1) (C) or (D) of the Internal Revenue Code of 1954, for any amount of a contribution made by the sole proprietor to fund past service credits under a qualified and tax exempt employees' pension trust which had not been deducted pursuant to section 404(a)(1) of the Code by the individual prior to his death.

A trusteed past and future service retirement plan was established by a sole proprietor for the benefit of his employees. The employer fully funded, at the inception of the plan, the total past service cost thereunder. The employer subsequently died before being entitled to a deduction for the entire amount of the cost of past service credits and his estate claims a deduction or deductions, under the carryover provision of section 404(a)(1) (C) and (D) of the Code, for that part of the past service cost funded by the employer which has not been deducted by him pursuant to section 404(a)(1)(C) of the Code. The last will and testament of the employer provided that his business be continued by the executor and/or trustees.

Section 404(a)(1) of the Code provides for a deduction by an employer of contributions made to an employees' pension trust during a taxable year of the employer which ends within or with a taxable year of the trust for which the trust is exempt under section 501(a) of the Code. Under subparagraph (C) of section 404(a)(1), an employer is allowed a deduction for contributions to an employees' pension trust in an amount equal to the normal cost of the plan, plus, if past service credits are provided by the plan, an amount not in excess of ten percent of the cost which would be required to completely fund such credits as of the date they are included in the plan. Subparagraph (D) provides that any amount paid in a taxable year in excess of the amount deductible in such year under the foregoing limitations shall be deductible in succeeding taxable years in order of time to the extent of the difference between the amount paid and deductible in each such succeeding year and the maximum amount deductible for such year.

The provisions, including those relating to a carryover, of section 404(a)(1)(C) and (D) of the Code relate only, in the case of trusteed

pension plans, to deductions that may be claimed for taxable years of the employer ending with or within a taxable year of the trust for which the trust is exempt under section 501(a) of the Code. With an exception not here pertinent, the employer, that actually made the contribution for which the deduction is claimed, is the only one entitled to the deduction. Under sections 1014 and 641 of the Code, an individual and his estate are separate taxable entities for Federal income tax purposes. The only authority for a carryover deduction under section 404(a)(1)(C) or (D) by a taxable entity other than for the employer that made the contribution is section 381(c)(11) or (20) of the Code. However, section 381 of the Code relates only to carryovers in certain corporate acquisitions and affords no authority for a carryover deduction by an individual's estate for contributions made by an individual as an employer prior to his death. The purpose of the exemption provisions in the Code, governing transactions in corporate reorganizations, is to remove an impediment to a corporate readjustment and to prevent taxation of purely fictitious gains. Section 381 of the Code cannot be used as a basis for a carryover deduction by an individual estate for contributions made by an indivdual as an employer prior to his death.

Accordingly, it is held that even though an employees' pension trust is determined to be qualified and exempt from taxation, respectively, under sections 401(a) and 501(a) of the Code in the year established and in each subsequent year, if the sole proprietor involved fully funds the cost of past service credits under the plan in the first year and dies before a deduction is claimed pursuant to section 404(a)(1)(C) and (D) of the Code for all such past service cost, the estate will not be entitled under the Code to carryover deductions for the undeducted portion of such past service cost.

---

26 CFR 1.404(a)-6: Pension and annuity plans; limitations under section 404(a)(1)(C). Rev. Rul. 58-165

A parent corporation which established a noncontributory trusteed past service employees' retirement plan for all employees who were in the employment of the parent corporation on the effective date of the plan and trust may, within the limitations of section 404(a)(1)(C) of the Internal Revenue Code of 1954, deduct contributions to the trust under the plan to fund all past service benefits contemplated by the plan, including benefits with respect to services previously rendered to a subsidiary corporation by any present employee of the parent corporation.

Also, if a subsidiary corporation is liquidated and its assets, liabilities, and employees are transferred to the parent corporation, the parent corporation, as the complete successor to the subsidiary corporation, will be entitled to deductions, within the limitations of section 404(a)(1)(C) of the Code, for contributions to the trust under the plan to fund benefits for the transferred employees with respect to all covered services rendered by such employees to either the parent corporation or the subsidiary corporation or both, on or prior to the effective date of the plan and trust.

Advice has been requested whether contributions under a trusteed past service retirement plan, by a parent corporation to fund benefits provided by the plan, including benefits with respect to services rendered by present employees of the parent corporation to a wholly

owned subsidiary corporation, are deductible by the parent corporation under section 404(a)(1) of the Internal Revenue Code of 1954.

A corporation and its wholly owned subsidiary adopted a noncontributory trusteed past service retirement plan for the benefit of their respective employees who, on the effective date of the plan and trust, had more than five years of service and were more than 30 years old. Neither plan contains vesting provisions for termination of services prior to death or retirement. Services are rendered by the employees only to their present employer. Two separate trusts were established, a trust under the plan of the parent corporation and a trust under the plan of the subsidiary corporation. Some employees of the parent corporation, on the effective date of its plan, also had prior service with the subsidiary corporation, and some employees of the subsidiary on the effective date of the subsidiary's plan had previously served with the parent corporation. The plan of the parent corporation has been held to meet the requirements of section 401(a) of the Code and the trust to be exempt under section 501(a) of the Code. Contributions were made to its trust by the parent corporation to fund the cost of benefits for all its present covered employees, not only with respect to the services they had rendered the parent corporation but also with respect to services such employees had rendered the subsidiary corporation.

Contributions paid by an employer to or under an employees' pension plan are, within the limitations provided by section 404(a)(1) of the Code, deductible in the taxable year when paid, if paid into a pension trust exempt under section 501(a) of the Code. Subparagraph (A) of section 404(a)(1) limits the deduction to an amount not in excess of five percent of the compensation otherwise paid or accrued during the taxable year to covered employees, plus any excess over the amount allowable under subparagraph (A) necessary to provide, with respect to all employees under the trust, the remaining unfunded cost of past and current service credits distributed as a level amount or a level percentage of compensation over the remaining future service of each such employee.

In lieu of the amounts allowable under subparagraph (A) and (B) of section 404(a)(1) of the Code, a deduction is allowed under subparagraph (C) of an amount equal to the normal cost of the plan plus, with respect to past service or other supplementary pension credits provided by the plan, an amount not in excess of ten percent of the cost required to completely fund such credits as of the date they are included in the plan.

Thus, it is held that in the case of an employees' noncontributory trusteed past service retirement plan, which has been held to qualify under section 401(a) and the trust to be exempt under section 501(a) of the Code, the parent corporation establishing such plan and trust may, within the limitations of section 404(a)(1)(C) of the Code, deduct contributions to the trust to fund all past service benefits contemplated by the plan, including benefits with respect to service previously rendered by an employee to a subsidiary corporation where the plan of such subsidiary did not contain vesting provisions for termination of service prior to death or retirement, for all employees who were in the employment of the parent corporation on the effective

date of the plan and trust and were then eligible to become participants under the plan.

Also, if a subsidiary corporation is liquidated and its assets, liabilities, and employees are transferred to the parent corporation, the parent corporation, as the complete successor to the subsidiary corporation, will be entitled to deductions, within the limitations of section 404(a)(1)(C) of the Code, for contributions to the trust under the plan to fund benefits for the transferred employees with respect to all covered services rendered by such employees to either the parent corporation or the subsidiary corporation or both, whether such services were rendered on, after, or prior to the effective date of the plan and trust.

PART II.—MISCELLANEOUS PROVISIONS

SECTION 421.—EMPLOYEE STOCK OPTIONS

Basis of stock acquired by exercise of restricted stock options after death of the employee. See Public Law 85–320, page 628.

---

26 CFR 1.421–2: Restricted stock option. Rev. Rul. 58–308

> For purposes of determining whether a corporation possesses 50 percent or more of the total combined voting power of all classes of stock in another corporation and thus qualifies as a "parent corporation" within the meaning of section 421(d)(2) of the Code, that portion of the voting stock of such other corporation which is owned by its subsidiaries and which the subsidiaries are prohibited by state law from voting is to be disregarded.

Advice has been requested whether a corporation is considered as owning stock possessing more than 50 percent of the total combined voting power of the stock of another corporation, thereby qualifying as a parent corporation under section 421(d)(2) of the Internal Revenue Code of 1954, under the circumstances described below.

In the instant case, *M* corporation proposes to grant a restricted stock option to one of its employees for the purchase of stock in *Z* corporation. *Z* corporation owns 45 percent of the outstanding voting stock in *P* corporation and *P* corporation owns all of the stock of *M* corporation. Other subsidiaries or *P* corporation own 35 percent of *P*'s voting stock, but, by virtue of state law, these shares cannot be voted.

Section 421 of the Code provides for special treatment of certain stock options granted to employees of corporations. Such an option may be granted by the employer corporation to purchase its own stock or the stock of its parent or its subsidiary corporation.

Section 421(d) of the Code provides, in part, as follows:

> (2) PARENT CORPORATION.—The term "parent corporation" means any corporation (other than the employer corporation) in an unbroken chain of corporations ending with the employer corporation if, at the time of the granting of the option, each of the corporations other than the employer corporation owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

For purposes of determining whether a corporation possesses 50 percent or more of the total combined voting power of all classes of stock in another corporation and thus qualifies as a "parent corporation" within the meaning of section 421(d)(2) of the Code, that portion of the voting stock of such other corporation which is owned by its subsidiaries and which the subsidiaries are prohibited by state law from voting is to be disregarded.

In the instant case, although *Z* corporation owns only 45 percent of the outstanding voting stock of *P* corporation, under the circumstances it owns 45/65, or approximately 70 percent, of the voting stock of *P* corporation which may be voted. Accordingly, *Z* corporation is considered as owning stock possessing more than 50 percent of the total combined voting power of the stock of *P* corporation and thus qualifies as a parent corporation within the meaning of section 423(d)(2) of the Code.

Rev. Rul. 58–325

In determining stock ownership for the purposes of section 421(d)(1)(C) of the Internal Revenue Code of 1954, an optionee is considered to own proportionately the present interests of qualifying relatives in a trust holding shares of stock in the corporation by which he has been granted the option, and is considered not to own remainder or other remote interests of such relatives, whether vested or contingent.

Advice has been requested concerning the method to be used in determining whether a taxpayer owns more than ten percent of the total combined voting power of a corporation within the meaning of section 421(d)(1)(C) of the Internal Revenue Code of 1954. Particularly, advice is requested (1) whether it is proper to use the actuarial approach, as provided for in section 318 of the Code, in arriving at the number of shares considered owned proportionately by the beneficiaries of certain trusts, and (2) whether the remainder interests under all the trusts should be excluded.

The taxpayer was granted an option to purchase stock of the *M* corporation. He and his relatives who fall within the classes enumerated in section 421(d)(1)(C) of the Code do not together directly own stock possessing more than ten percent of the total combined voting power of the corporation. His brother and his brother's children and his sister and his sister's children, however, are beneficiaries of certain trusts which own such stock.

Two of the trusts, established by the mother of the optionee, fall within a general type in which ten percent of the trust income is distributed to a charitable trust for a period of ten years. During the ten-year period the remainder of the income is accumulated, added to the corpus of the trust estate, and reinvested as a part hereof. After the expiration of ten years, the trustees may, in their discretion, accumulate and reinvest one-third of the income, and the remainder of the income is to be distributed to a principal beneficiary during his life. After the death of the beneficiary the income is distributed to his children until the termination of the trust. If the principal beneficiary dies without children living, the corpus, upon termination of the trust, is distributed, *per stirpes* to the other surviving descendants of the donor.

The sister of the optionee established a trust, which owns stock in the *M* corporation, for her own benefit, from which she will receive all of the income for life. At her death the property held in trust will be equally divided for her children and held in trust until each reaches the age of 21. If the optionee's sister dies without surviving children, the property held in trust will be distributed in equal portions to her surviving brothers or sisters.

Section 421(d) of the Code provides, in part, as follows:

> (d) DEFINITIONS.—For purposes of this section—
>
> (1) RESTRICTED STOCK OPTION.—The term 'restricted stock option' means an option granted after February 26, 1945, to an individual, for any reason connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if—
>
> * * * * * * *
>
> (C) such individual, at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the employer corporation or of its parent or subsidiary corporation. * * * For the purposes of this subparagraph—
>
> (i) such individual shall be considered as owning the stock owned, directly or indirectly, or by or for his brothers and sisters (whether by whole or half blood), spouse, ancestors, and lineal descendents; and
>
> (ii) stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries; * * *.

In the instant case, the brother and sister of the optionee, who fall within the relationship provided in section 421(d)(1)(C) of the Code, are principal beneficiaries under one or more of the trusts. Their children are also beneficiaries under one or more of the trusts. The optionee, as well as his brother and his sister, has a contingent remainder interest in at least two of the three trusts.

Section 421 of the Code does not provide for an actuarial computation to be used in calculating the interest of a life beneficiary in a trust. Section 318(a)(2)(B) of the Code provides that the actuarial method should be used in connection with the attribution rules of that section, but section 421 of the Code is not a section that is mentioned in section 318(b), which specifically makes provision for the sections to which the rule shall apply.

In the case of *Steuben Securities Corporation* v. *Commissioner*, 1 T. C. 395, which was concerned with the stock ownership requirement of section 503(a)(1) of the Internal Revenue Code of 1939, the Tax Court of the United States found that the word "beneficiaries" appearing in that section referred to those persons who had present interests in the trust holding the shares and excluded those who had a remainder or other remote interest, whether vested or contingent. The court stressed the present actual enjoyment as the controlling factor in determining who is the beneficiary of the trust.

In accordance with the *Steuben* case, none of the stock of either of the two trusts established by the optionee's mother can be attributed to either the brother or the sister for the year in which the option was granted, since one-tenth of the income thereof was being devoted to the charitable foundation and the remaining nine-tenths was being

accumulated. All of the stock held by the trust established by the taxpayer's sister must be attributed to her since she is the life beneficiary of all of the income of the trust.

Accordingly, it is held that, in determining stock ownership for the purposes of section 421(d)(1)(C) of the Code, an optionee is considered to own proportionately the present interests of qualifying relatives in a trust holding shares of stock in the corporation by which he has been granted the option, and is considered not to own remainder or other remote interests of such relatives, whether vested or contingent.

No opinion is expressed, in a situation where the trust instrument provides that the income will be accumulated and distributed at some future date to a definitely named beneficiary, as to whether such beneficiary has a present interest in the income of the trust.

---

26 CFR 1.421–3: Exercise of restricted stock option. Rev. Rul. 58–324

An optionee under a restricted stock option plan qualifies for the income tax treatment provided by section 421 of the Internal Revenue Code of 1954, where he exercised his option while employed by a corporation which became a subsidiary of the corporation which had previously granted him the option.

Advice has been requested whether, in view of the definition of a "subsidiary corporation" contained in section 421(d)(3) of the Internal Revenue Code of 1954, an optionee will qualify for the income tax treatment provided by section 421 of the Code if he accepts employment in a corporation which became a subsidiary of the parent corporation after he had been granted the option.

A corporation engaged in the manufacture of a wide variety of products distributes such products through distributorships. When new distributorships are established or acquired and become subsidiaries of the parent, key employees of the parent corporation are given positions as presidents or chief operating officers of the subsidiaries, and the employees selected will normally be among those who previously had been granted the restrictive stock options.

Section 421(a) of the Code, which outlines the treatment to be accorded restricted stock options, provides that subsection (a) and subsection (b) shall not apply unless the individual at the time he exercises the restricted stock option is an employee of either the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary of such corporation issuing or assuming a stock option in a transaction to which subsection (g) is applicable, or the option is exercised by him within three months after the date he ceases to be an employee of such corporations.

Section 1.421–3(b)(1) of the Income Tax Regulations provides, in part, as follows:

Section 421 is applicable to the exercise of a restricted stock option only if at the time the individual exercises the option he is a bona fide employee of the corporation granting the option, or of a corporation which is at the time the option is exercised a parent or subsidiary of such corporation, unless the

old option has been assumed or a new option has been issued in its place under section 421(g).

Accordingly, it is held that an optionee under a restricted stock option plan, who exercised his option while employed by a corporation which became a subsidiary of the corporation which had previously granted him the option, qualifies for the income tax treatment provided by section 421 of the Internal Revenue Code of 1954.

SUBCHAPTER E.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

PART I.—ACCOUNTING PERIODS

SECTION 441.—PERIOD FOR COMPUTATION OF TAXABLE INCOME

26 CFR 1.441–1(c): Annual accounting period. Rev. Rul. 58–256

Where a taxpayer has regularly maintained its books and records on a calendar year basis, but erroneously filed its Federal income tax returns on a fiscal year basis, the prior consent of the Commissioner is not required in order for the taxpayer to file its Federal income tax returns on a calendar year basis, the basis upon which its books and records have been regularly kept. See section 441(c) of the Internal Revenue Code of 1954 and section 1.441–1 of the Income Tax Regulations. Compare *Atlas Oil and Refining Corporation* v. *Commissioner*, 17 T. C. 733, acquiescence, C. B. 1952–1, 1, wherein it was held that since the taxpayer's books of account were closed at the end of each calendar year, its Federal income tax liability should have been determined on a calendar year basis, the basis upon which its books were kept, rather than on a fiscal year basis, the basis on which its returns were filed. The above rule is equally applicable where a taxpayer regularly maintains its books and records on the basis of a fiscal year, but erroneously filed its Federal income tax returns on the basis of a calendar year.

PART II.—METHODS OF ACCOUNTING

Subpart A.—Methods of Accounting in General

SECTION 446.—GENERAL RULE FOR METHODS OF ACCOUNTING

26 CFR 1.446: Statutory provisions; general rule for methods of accounting. T. D. 6282[1]
(Also Sections 451, 454, 461; 1.451, 1.454, 1.461.)

[1] 22 F. R. 10686.

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953.

Regulations prescribed under sections 446, 451, 454, and 461 of the Internal Revenue Code of 1954.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On December 21, 1956, notice of proposed rule making regarding the regulations under sections 446, 451, 454, and 461 of the Internal Revenue Code of 1954, was published in the Federal Register (21 F. R. 10275). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, such regulations are hereby prescribed subject to the changes set forth hereinafter. These regulations are applicable to taxable years beginning after December 31, 1953, and ending after August 16, 1954. Section 1.461–1(c) of the regulations hereby adopted supersedes paragraph 9 of T. D. 6118, approved December 30, 1954 (19 F. R. 9896; 26 CFR, Parts 1 to 169 (1956 Rev.), par. 9, p. 8) [C. B. 1955–1, 698].

TABLE OF CONTENTS

METHODS OF ACCOUNTING

Methods of Accounting in General

Section
1.446 Statutory provisions; general rule for methods of accounting.
1.446–1 General rule for methods of accounting.

Taxable Year for Which Items of Gross Income Included

1.451 Statutory provisions; general rule for taxable year of inclusion.
1.451–1 General rule for taxable year of inclusion.
1.451–2 Constructive receipt of income.
1.451–3 Long-term contracts.
1.451–4 Accounting for redemption of trading stamps and coupons.
1.454 Statutory provisions; obligations issued at discount.
1.454–1 Obligations issued at discount.

Taxable Year for Which Deductions Taken

1.461 Statutory provisions; general rule for taxable year of deduction.
1.461–1 General rule for taxable year of deduction.

AUTHORITY: §§ 1.446 through 1.451–4, and 1.454 through 1.461–1, issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

METHODS OF ACCOUNTING

Methods of Accounting in General

§ 1.446 STATUTORY PROVISIONS; GENERAL RULE FOR METHODS OF ACCOUNTING.

SEC. 446. GENERAL RULE FOR METHODS OF ACCOUNTING.

(a) GENERAL RULE.—Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

(b) EXCEPTIONS.—If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect

income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income.

(c) PERMISSIBLE METHODS.—Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting—

(1) The cash receipts and disbursements method;

(2) An accrual method;

(3) Any other method permitted by this chapter; or

(4) Any combination of the foregoing methods permitted under regulations prescribed by the Secretary or his delegate.

(d) TAXPAYER ENGAGED IN MORE THAN ONE BUSINESS.—A taxpayer engaged in more than one trade or business may, in computing taxable income, use a different method of accounting for each trade or business.

(e) REQUIREMENT RESPECTING CHANGE OF ACCOUNTING METHOD.—Except as otherwise expressly provided in this chapter, a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books shall, before computing his taxable income under the new method, secure the consent of the Secretary or his delegate.

§ 1.446–1 GENERAL RULE FOR METHODS OF ACCOUNTING.—(a) *General rule.*—(1) Section 446(a) provides that taxable income shall be computed under the method of accounting on the basis of which a taxpayer regularly computes his income in keeping his books. The term "method of accounting" includes not only the over-all method of accounting of the taxpayer but also the accounting treatment of any item. Examples of such over-all methods are the cash receipts and disbursements method, an accrual method, combinations of such methods, and combinations of the foregoing with various methods provided for the accounting treatment of special items. These methods of accounting for special items include the accounting treatment prescribed for research and experimental expenditures, soil and water conservation expenditures, depreciation, net operating losses, etc. Except for deviations permitted or required by such special accounting treatment, taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. For requirement respecting the adoption or change of accounting method, see section 446(e) and paragraph (e) of this section.

(2) It is recognized that no uniform method of accounting can be prescribed for all taxpayers. Each taxpayer shall adopt such forms and systems as are, in his judgment, best suited to his needs. However, no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income. A method of accounting which reflects the consistent application of generally accepted accounting principles in a particular trade or business in accordance with accepted conditions or practices in that trade or business will ordinarily be regarded as clearly reflecting income, provided all items of gross income and expense are treated consistently from year to year.

(3) Items of gross income and expenditures which are elements in the computation of taxable income need not be in the form of cash. It is sufficient that such items can be valued in terms of money. For general rules relating to the taxable year for inclusion of income and for taking deductions, see sections 451 and 461, and the regulations thereunder.

(4) Each taxpayer is required to make a return of his taxable income for each taxable year and must maintain such accounting records as will enable him to file a correct return. See section 6001 and the regulations thereunder. Accounting records include the taxpayer's regular books of account and such other records and data as may be necessary to support the entries on his books of account and on his return as, for example, a reconciliation of any differences between such books and his return. The following are among the essential features that must be considered in maintaining such records:

(i) In all cases in which the production, purchase, or sale of merchandise of any kind is an income-producing factor, merchandise on hand (including finished goods, work in process, raw materials, and supplies) at the beginning and end of the year shall be taken into account in computing the taxable income of the year. (For rules relating to computation of inventories, see sections 471 and 472, and the regulations thereunder.)

(ii) Expenditures made during the year shall be properly classified as between capital and expense. For example, expenditures for such items as plant and equipment, which have a useful life extending substantially beyond the taxable year, shall be charged to a capital account and not to an expense account.

(iii) In any case in which there is allowable with respect to an asset a deduction for depreciation, amortization, or depletion, any expenditures (other than ordinary repairs) made to restore the asset or prolong its useful life shall be added to the asset account or charged against the appropriate reserve.

(b) *Exceptions.*—(1) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation of taxable income shall be made in a manner which, in the opinion of the Commissioner, does clearly reflect income.

(2) A taxpayer whose sole source of income is wages need not keep formal books in order to have an accounting method. Tax returns, copies thereof, or other records may be sufficient to establish the use of the method of accounting used in the preparation of the taxpayer's income tax returns.

(c) *Permissible methods.*—(1) *In general.*—Subject to the provisions of paragraphs (a) and (b) of this section, a taxpayer may compute his taxable income under the following methods of accounting:

(i) *Cash receipts and disbursements method.*—Generally, under the cash receipts and disbursements method in the computation of taxable income, all items which constitute gross income (whether in the form of cash, property, or services) are to be included for the taxable year in which actually or constructively received. Expenditures are to be deducted for the taxable year in which actually made. For rules relating to constructive receipt, see § 1.451–2. For treatment of an expenditure attributable to more than one taxable year, see section 461(a) and § 1.461–1(a)(1).

(ii) *Accrual method.*—Generally, under an accrual method, income is to be included for the taxable year when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Under such a

method, deductions are allowable for the taxable year in which all the events have occurred which establish the fact of the liability giving rise to such deduction and the amount thereof can be determined with reasonable accuracy. The method used by the taxpayer in determining when income is to be accounted for will be acceptable if it accords with generally recognized and accepted income tax accounting principles and is consistently used by the taxpayer from year to year. For example, a taxpayer engaged in a manufacturing business may account for sales of his product when the goods are shipped, when the product is delivered or accepted, or when title to the goods passes to the customer, whether or not billed, depending upon the method regularly employed in keeping his books. Likewise, the extent to which indirect costs shall be included in computing cost of goods sold depends upon the method used by the taxpayer in treating such items in keeping his books.

(iii) *Other permissible methods.*—Special methods of accounting are described elsewhere in chapter 1 of the Internal Revenue Code and the regulations thereunder. For example, see the following sections and the regulations thereunder: Sections 61 and 162, relating to the crop method of accounting; section 453, relating to the installment method; section 451, relating to the long-term contract methods. In addition, special methods of accounting for particular items of income and expense are provided under other sections of chapter 1. For example, see section 174, relating to research and experimental expenditures, and section 175, relating to soil and water conservation expenditures.

(iv) *Combinations of the foregoing methods.*—(*a*) In accordance with the following rules, any combination of the foregoing methods of accounting will be permitted in connection with a trade or business if such combination clearly reflects income and is consistently used. Where a combination of methods of accounting includes any special methods, such as those referred to in subdivision (iii) of this subparagraph, the taxpayer must comply with the requirements relating to such special methods. A taxpayer using an accrual method of accounting with respect to purchases and sales may use the cash method in computing all other items of income and expense. However, a taxpayer who uses the cash method of accounting in computing gross income from his trade or business shall use the cash method in computing expenses of such trade or business. Similarly, a taxpayer who uses an accrual method of accounting in computing business expenses shall use an accrual method in computing items affecting gross income from his trade or business.

(*b*) A taxpayer using one method of accounting in computing items of income and deductions of his trade or business may compute other items of income and deductions not connected with his trade or business under a different method of accounting.

(2) *Special rules.*—(i) In any case in which it is necessary to use an inventory the accrual method of accounting must be used with regard to purchases and sales unless otherwise authorized under subdivision (ii) of this subparagraph.

(ii) No method of accounting will be regarded as clearly reflecting income unless all items of gross profit and deductions are treated with consistency from year to year. The Commissioner may authorize a

taxpayer to adopt or change to a method of accounting permitted by this chapter although the method is not specifically described in the Income Tax Regulations if, in the opinion of the Commissioner, income is clearly reflected by the use of such method. Further, the Commissioner may authorize a taxpayer to continue the use of a method of accounting consistently used by the taxpayer, even though not specifically authorized by the Income Tax Regulations, if, in the opinion of the Commissioner, income is clearly reflected by the use of such method. See section 446(a) and paragraph (a) of this section, which require that taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books, and section 446(e) and paragraph (e) of this section, which require the prior approval of the Commissioner in the case of changes in accounting method.

(d) *Taxpayer engaged in more than one business.*—(1) Where a taxpayer has two or more separate and distinct trades or businesses, a different method of accounting may be used for each trade or business, provided the method used for each trade or business clearly reflects the income of that particular trade or business. For example, a taxpayer may account for the operations of a personal service business on the cash receipts and disbursements method and of a manufacturing business on an accrual method, provided such businesses are separate and distinct and the methods used for each clearly reflect income. The method first used in accounting for business income and deductions in connection with each trade or business, as evidenced in the taxpayer's income tax return in which such income or deductions are first reported, must be consistently followed thereafter.

(2) No trade or business will be considered separate and distinct for purposes of this paragraph unless a complete and separable set of books and records is kept for such trade or business.

(3) If, by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses of the taxpayer (for example, through inventory adjustments, sales, purchases, or expenses) so that income of the taxpayer is not clearly reflected, the trades or businesses of the taxpayer will not be considered to be separate and distinct.

(e) *Requirement respecting the adoption or change of accounting method.*—(1) A taxpayer filing his first return may adopt any permissible method of accounting in computing taxable income for the taxable year covered by such return. See section 446(c) and paragraph (c) of this section for permissible methods. Moreover, a taxpayer may adopt any permissible method of accounting in connection with each separate and distinct trade or business, the income from which is reported for the first time. See section 446(d) and paragraph (d) of this section. See also section 446(a) and paragraph (a) of this section.

(2)(i) Except as otherwise expressly provided in chapter 1 of the Internal Revenue Code of 1954 and the regulations thereunder, a taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. A change in the method of accounting includes a change in the overall method of accounting for gross income or deductions, or a change

in the treatment of a material item. Consent must be secured whether or not a taxpayer regards the method from which he desires to change to be proper. Thus, a taxpayer may not compute his taxable income under a method of accounting different from that previously used by him unless such consent is secured.

(ii) Examples of changes requiring consent are: A change from the cash receipts and disbursements method to an accrual method, or vice versa; a change involving the method or basis used in the valuation of inventories (see sections 471 and 472 and the regulations thereunder); a change from the cash or accrual method ot a long-term contract method, or vice versa (see § 1.451–3); a change involving the adoption, use, or discontinuance of any other specialized method of computing taxable income, such as the crop method; or a change in the treatmnet of any other items of income or expense, where material.

(3) In order to secure the Commissioner's consent to a change of a taxpayer's method of accounting, the taxpayer must file an application by letter with the Commissioner of Internal Revenue, Washington 25, D. C., within 90 days after the beginning of the taxable year in which it is desired to make the change. The application shall be accompanied by a statement specifying the nature of the taxpayer's business, his present method of accounting, the method to which he desires to change, the taxable year in which the change is to be effected, the classes of items which would be treated differently under the new method, and all amounts which would be duplicated or omitted as a result of the proposed change. The Commissioner may require such other information as may be necessary in order to determine whether the proposed change will be permitted. Permission to change a taxpayer's method of accounting will not be granted unless the taxpayer and the Commissioner agree to the terms, conditions, and adjustments under which the change will be effected. See section 481 and regulations thereunder, relating to certain adjustments required by such changes, section 472 and the regulations thereunder, relating to changes to and from the last-in, first-out method of inventorying goods, and section 453 and the regulations thereunder, relating to certain adjustments required by a change from an accrual method to the installment method.

Taxable Year for Which Items of Gross Income Included

§ 1.451 STATUTORY PROVISIONS; GENERAL RULE FOR TAXABLE YEAR OF INCLUSION.

SEC. 451 GENERAL RULE FOR TAXABLE YEAR OF INCLUSION.

(a) GENERAL RULE.—The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

(b) SPECIAL RULE IN CASE OF DEATH.—In the case of the death of a taxpayer whose taxable income is computed under an accrual method of accounting, any amount accrued only by reason of the death of the taxpayer shall not be included in computing taxable income for the period in which falls the date of the taxpayer's death.

§ 1.451–1 GENERAL RULE FOR TAXABLE YEAR OF INCLUSION.—(a) *General rule.*—Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or construc-

tively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Therefore, under such a method of accounting if, in the case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. Under the cash receipts and disbursements method of accounting, such an amount is includible in gross income when actually or constructively received. Where an amount of income is properly accrued on the basis of a reasonable estimate and the the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which such determination is made. To the extent that income is attributable to the recovery of bad debts for accounts charged off in prior years, it is includible in the year of recovery in accordance with the taxpayer's method of accounting, regardless of the date when the amounts were charged off. For treatment of bad debts and bad debt recoveries, see sections 166 and 111 and the regulations thereunder. For rules relating to the treatment of amounts received in crop shares, see section 61 and the regulations thereunder. For the year in which a partner must include his distributive share of partnership income, see section 706(a) and § 1.706–1(a). If a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, he should, if within the period of limitation, file an amended return and pay any additional tax due. Similarly, if a taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom.

(b) *Special rule in case of death.*—(1) A taxpayer's taxable year ends on the date of his death. See section 443(a)(2) and § 1.443–1(a)(2). In computing taxable income for such year, there shall be included only amounts properly includible under the method of accounting used by the taxpayer. However, if the taxpayer used an accrual method of accounting, amounts accrued only by reason of his death shall not be included in computing taxable income for such year. If the taxpayer uses no regular accounting method, only amounts actually or constructively received during such year shall be included. (For rules relating to the inclusion of partnership income in the return of a decedent partner, see subchapter K of chapter 1 of the Internal Revenue Code of 1954 and the regulations thereunder.)

(2) If the decedent owned an installment obligation the income from which was taxable to him under section 453, no income is required to be reported in the return of the decedent by reason of the transmission at death of such obligation. See section 453(d)(3). For the treatment of installment obligations, acquired by the decedent's estate or by any person by bequest, devise, or inheritance from the decedent, see section 691(a)(4) and the regulations thereunder.

§ 1.451–2 Constructive Receipt of Income.—(a) *General rule.*—Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is

credited to his account or set apart for him so that he may draw upon it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. Thus, if a corporation 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.

(b) *Examples of constructive receipt.*—Interest coupons which have matured and are payable but which have not been cashed are constructively received in the taxable year during which the coupons mature, unless it can be shown that there are no funds available for payment of the interest during such year. Dividends on corporate stock are constructively received when unqualifiedly made subject to the demand of the shareholder. However, if a dividend is declared payable on December 31 and the corporation followed its usual practice of paying the dividends by checks mailed so that the shareholders would not receive them until January of the following year, such dividends are not considered to have been constructively received until January. Interest on savings bank deposits is income to the depositor when credited on the books of the bank, even though the bank has a rule, seldom or never enforced, that it may require a certain number of days' notice before withdrawals are permitted. Generally, the amount of dividends or interested credited to shareholders of organizations such as building and loan associations or cooperative banks, is income to the shareholders for the taxable year when credited. However, if the amount of such dividends or interest is not available for the shareholders' free and unrestricted use at the time credited, such amount is not constructively received and does not constitute income to the shareholder until the taxable year in which the amount is available. Accordingly, if the amount of dividends or interest is accumulated and is not available to the shareholder until the maturity of a share, the crediting thereof to the shareholder's account does not constitute constructive receipt. However, in such a case the total amount credited is income to the shareholder in the year of maturity.

§ 1.451–3 LONG-TERM CONTRACTS. — (a) *Definition.*—The term "long-term contracts" means building, installation, or construction contracts covering a period in excess of one year from the date of execution of the contract to the date on which the contract is finally completed and accepted.

(b) *Methods.*—Income from long-term contracts (as defined in paragraph (a) of this section), determined in a manner consistent with the nature and terms of the contract, may be included in gross income in accordance with one of the following methods, provided such method clearly reflects income:

(1) *Percentage of completion method.*—Gross income derived from long-term contracts may be reported according to the percentage of completion method. Under this method, the portion of the gross contract price which corresponds to the percentage of the entire contract which has been completed during the taxable year shall be included in gross income for such taxable year. There shall then be deducted all expenditures made during the taxable year in connection with the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable year for use in such contract.

Certificates of architects or engineers showing the percentage of completion of each contract during the taxable year shall be available at the principal place of business of the taxpayer for inspection in connection with an examination of the income tax return.

(2) *Completed contract method.*—Gross income derived from long-term contracts may be reported for the taxable year in which the contract is finally completed and accepted. Under this method, there shall be deducted from gross income for such year all expenses which are properly allocable to the contract, taking into account any material and supplies charged to the contract but remaining on hand at the time of completion.

(c) *In general.*—Long-term contract methods of accounting apply only to the accounting for income and expenses attributable to long-term contracts. Other income and expense items, such as investment income or expenses not attributable to such contracts, shall be accounted for under a proper method of accounting. See section 446(c) and § 1.446–1(c). A taxpayer may change to or from a long-term contract method of accounting only with the consent of the Commissioner. See section 446(e) and § 1.446–1(e). When a taxpayer reports income under a long-term contract method, a statement to that effect shall be attached to his income tax return.

§ 1.451–4 Accounting for Redemption of Trading Stamps and Coupons.—(a) If a taxpayer issues trading stamps or premium coupons with sales, which stamps or coupons are redeemable in merchandise or cash, he should, in computing the income from such sales, subtract only the amount 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 of trading stamps or premium coupons engaged in similar businesses. The taxpayer shall file a statement showing with respect to each of the five preceding years, or such number of these years as stamps or coupons have been issued by him, the following:

(1) The total issue of stamps or coupons during each year;

(2) The total stamps or coupons redeemed in each year; and

(3) Such other information as is necessary to establish the correctness of the amount subtracted from sales in each of such years.

(b) Upon examination of the return, the amount subtracted in respect of such coupons will be adjusted if, in the opinion of the Commissioner, such amount is incorrectly computed.

§ 1.454 Statutory Provisions; Obligations Issued at Discount.

SEC. 454. OBLIGATIONS ISSUED AT DISCOUNT.

(a) Noninterest-Bearing Obligations Issued at a Discount.—If, in the case of a taxpayer owning any non-interest-bearing obligation issued at a discount and redeemable for fixed amounts increasing at stated intervals or owning an obligation described in paragraph (2) of subsection (c), the increase in the redemption price of such obligation occurring in the taxable year does not (under the method of accounting used in computing his taxable income) constitute income to him in such year, such taxpayer may, at his election made in his return for any taxable year, treat such increase as income received in such txable year. If any such election is made with respect to any such obligation, it shall apply also to all such obligations owned by the taxpayer at the beginning of the first taxable year to which it

applies and to all such obligations thereafter acquired by him and shall be binding for all subsequent taxable years, unless on application by the taxpayer the Secretary or his delegate permits him, subject to such conditions as the Secretary or his delegate deems necessary, to change to a different method. In the case of any such obligations owned by the taxpayer at the beginning of the first taxable year to which his election applies, the increase in the redemption price of such obligations occurring between the date of acquisition (or, in the case of an obligation described in paragraph (2) of subsection (c), the date of acquisition of the series E bond involved) and the first day of such taxable year shall also be treated as income received in such taxable year.

(b) SHORT-TERM OBLIGATIONS ISSUED ON DISCOUNT BASIS.—In the case of any obligation—

(1) Of the United States; or

(2) Of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia,

which is issued on a discount basis and payable without interest at a fixed maturity date not exceeding 1 year from the date of issue, the amount of discount at which such obligation is originally sold shall not be considered to accrue until the date on which such obligation is paid at maturity, sold, or otherwise disposed of.

(c) MATURED UNITED STATES SAVINGS BONDS.—In the case of a taxpayer who—

(1) Holds a series E United States savings bond at the date of maturity, and

(2) Pursuant to regulations prescribed under the Second Liberty Bond Act retains his investment in the maturity value of such series E bond in an obligation, other than a current income obligation, which matures not more than 10 years from the date of maturity of such series E bond,

the increase in redemption value (to the extent not previously includible in gross income) in excess of the amount paid for such series E bond shall be includible in gross income in the taxable year in which the obligation is finally redeemed or in the taxable year of final maturity, whichever is earlier. This subsection shall not apply to a corporation, and shall not apply in the case of any taxable year for which the taxpayer's taxable income is computed under an accrual method of accounting or for which an election made by the taxpayer under subsection (a) applies.

§ 1.454–1 OBLIGATIONS ISSUED AT DISCOUNT.—(a) *Non-interest-bearing obligations issued at discount.*—(1) If a taxpayer—

(i) Owns any non-interest-bearing obligation issued at a discount and redeemable for fixed amounts increasing at stated intervals, or

(ii) Retains his investment in the maturity value of a series E United States savings bond, in the manner described in section 454(c)(2), and

if the increase in redemption price of such obligation, described in subdivision (i) or (ii) of this subparagraph, occurring in the taxable year does not constitute income for such year under the method of accounting used in computing his taxable income, then the taxpayer may, at his election, treat the increase as constituting income for the year in which such increase occurs, rather than for the year in which the obligation is disposed of, redeemed, paid at maturity, or converted into a current income obligation of the United States (such as a bond of series G or K). Any such election must be made in the taxpayer's return and may be made for any taxable year. If an election is made with respect to any such obligation, it shall apply also to all other obligations of the type described in this paragraph

owned by the taxpayer at the beginning of the first taxable year to which the election applies and to those thereafter acquired by him, and shall be binding for the taxable year for which the return is filed and for all subsequent taxable years, unless the Commissioner permits the taxpayer to change to a different method of reporting income from such obligations. See section 446(e) and § 1.446–1(e), relating to requirement respecting a change of accounting method. Although the election once made is binding upon the taxpayer, it does not apply to a transferee of the taxpayer.

(2) In any case in which an election is made under section 454, the amount which accrues in any taxable year to which the election applies is measured by the actual increase in the redemption price occurring in that year. This amount does not accrue ratably between the dates on which the redemption price changes. For example, if two dates on which the redemption price increases (February 1 and August 1) fall within a taxable year and if the redemption price increases in the amount of 50 cents on each such date, the amount accruing in that year would be $1.00 ($0.50 on February 1 and $0.50 on August 1). If the taxpayer owns a non-interest-bearing obligation of the character described in subparagraph (1) of this paragraph acquired prior to the first taxable year to which his election applies, he must also include in gross income for such first taxable year the increase in the redemption price of such obligation occurring between the date of acquisition of the obligation (or the series E bond involved in the case of a matured United States savings bond), and the first day of such first taxable year.

(3) The provisions of this paragraph are illustrated by the following example:

Example.—Throughout the calendar year 1954, a taxpayer who computes his taxable income under the cash receipts and disbursements method holds series E United States savings bonds having a maturity value of $5,000 and a redemption value at the beginning of the year 1954 of $4,050 and at the end of the year 1954 of $4,150. He purchased the bonds on January 1, 1949, for $3,750, and holds no other obligation of the type described in this section. If the taxpayer exercises the election in his return for the calendar year 1954, he is required to include $400 in taxable income with respect to such bonds. Of this amount, $300 represents the increase in the redemption price before 1954 and $100 represents the increase in the redemption price in 1954. The increases in redemption value occurring in subsequent taxable years are includible in gross income for such taxable years.

(b) *Short-term obligations issued on a discount basis.*—In the case of obligations of the United States or any of its possessions, or of a State, or Territory, or any political subdivision thereof, or of the District of Columbia, issued on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, the amount of discount at which such obligation originally sold does not accrue until the date on which such obligation is redeemed, sold, or otherwise disposed of. This rule applies regardless of the method of accounting used by the taxpayer. For examples illustrating rules for computation of income from sale or other disposition of certain obligations of the type

described in this paragraph, see section 1221 and the regulations thereunder.

(c) *Matured United States savings bonds.*—If a taxpayer (other than a corporation) holds a series E United States savings bond at the date of maturity, and under the regulations prescribed under the Second Liberty Bond Act retains his investment in the maturity value of such series E bond in an obligation, other than a current income obligation, which matures not more than 10 years from the date of maturity of such series E bond, the increase in redemption value not previously includible in gross income in excess of the amount paid for such series E bond shall be includible in gross income in the taxable year in which the obligation is finally redeemed or in the taxable year of final maturity, whichever is earlier. The provisions of section 454(c) and of this paragraph shall not apply in the case of any taxable year for which the taxpayer's taxable income is computed under an accrual method of accounting or for a taxable year for which an election made by the taxpayer under section 454(a) and paragraph (a) of this section applies.

Taxable Year for Which Deductions Taken

§ 1.461 STATUTORY PROVISIONS; GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION.

SEC. 461. GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION.

(a) GENERAL RULE.—The amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

(b) SPECIAL RULE IN CASE OF DEATH.—In the case of the death of a taxpayer whose taxable income is computed under an accrual method of accounting, any amount accrued as a deduction or credit only by reason of the death of the taxpayer shall not be allowed in computing taxable income for the period in which falls the date of the taxpayer's death.

(c) ACCRUAL OF REAL PROPERTY TAXES.—

(1) IN GENERAL.—If the taxable income is computed under an accrual method of accounting, then, at the election of the taxpayer, any real property tax which is related to a definite period of time shall be accrued ratably over that period.

(2) SPECIAL RULES.—Paragraph (1) shall not apply to any real property tax, to the extent that such tax was allowable as a deduction under the Internal Revenue Code of 1939 for a taxable year which began before January 1, 1954. In the case of any real property tax which would, but for this subsection, be allowable as a deduction for the first taxable year of the taxpayer which begins after December 31, 1953, then, to the extent that such tax is related to any period before the first day of such first taxable year, the tax shall be allowable as a deduction for such first taxable year.

(3) WHEN ELECTION MAY BE MADE.—

(A) WITHOUT CONSENT.—A taxpayer may, without the consent of the Secretary or his delegate, make an election under this subsection for his first taxable year which begins after December 31, 1953, and ends after the date of enactment of this title in which the taxpayer incurs real property taxes. Such an election shall be made not later than the time prescribed by law for filing the return for such year (including extensions thereof).

(B) WITH CONSENT.—A taxpayer may, with the consent of the Secretary or his delegate, make an election under this subsection at any time.

§ 1.461–1 GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION.—(a) *General rule.*—(1) *Taxpayer using cash receipts and disbursements method.*—Under the cash receipts and disbursements method of ac-

counting, amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid. Further, a taxpayer using this method may also be entitled to certain deductions in the computation of taxable income which do not involve cash disbursements during the taxable year, such as the deductions for depreciation, depletion, and losses under sections 167, 611, and 165, respectively. If an expenditure results in the creation of an asset having a useful life which extends substantially beyond the close of the taxable year, such an expenditure may not be deductible, or may be deductible only in part, for the taxable year in which made. An example is an expenditure for the construction of improvements by the lessee on leased property where the estimated life of the improvements is in excess of the remaining period of the lease. In such a case, in lieu of the allowance for depreciation provided by section 167, the basis shall be amortized ratably over the remaining period of the lease. See section 263 and the regulations thereunder for rules relating to capital expenditures.

(2) *Taxpayer using an accrual method.*—Under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount thereof can be determined with reasonable accuracy. However, any expenditure which results in the creation of an asset having a useful life which extends substantially beyond the close of the taxable year may not be deductible, or may be deductible only in part, for the taxable year in which incurred. While no accrual shall be made in any case in which all of the events have not occurred which fix the liability, the fact that the exact amount of the liability which has been incurred cannot be determined will not prevent the accrual within the taxable year of such part thereof as can be computed with reasonable accuracy. For example, A renders services to B during the taxable year for which A claims $10,000. B admits the liability to A for $5,000 but contests the remainder. B may accrue only $5,000 as an expense for the taxable year in which the services were rendered. Where a deduction is properly accrued on the basis of a computation made with reasonable accuracy and the exact amount is subsequently determined in a later taxable year, the difference, if any, between such amounts shall be taken into account for the later taxable year in which such determination is made.

(3) *Other factors which determine when deductions may be taken.*—(i) Each year's return should be complete in itself, and taxpayers shall ascertain the facts necessary to make a correct return. The expenses, liabilities, or loss of one year cannot be used to reduce the income of a subsequent year. A taxpayer may not take advantage in a return for a subsequent year of his failure to claim deductions in a prior taxable year in which such deductions should have been properly taken under his method of accounting. If a taxpayer ascertains that a deduction should have been claimed in a prior taxable year, he should, if within the period of limitation, file a claim for credit or refund of any overpayment of tax arising therefrom. Similarly, if a taxpayer ascertains that a deduction was improperly claimed in a prior taxable year, he should, if within the period of limitation, file an amended return and pay any additional tax due.

However, in a going business there are certain overlapping deductions. If these overlapping items do not materially distort income, they may be included in the years in which the taxpayer consistently takes them into account.

(ii) Where there is a dispute and the entire liability is contested, judgments on account of damages for patent infringement, personal injuries or other causes, or other binding adjudications, including decisions of referees and boards of review under workmen's compensation laws, are deductions from gross income when the claim is finally adjudicated or is paid, depending upon the taxpayer's method of accounting. However, see subparagraph (2) of this paragraph.

(iii) For special rules relating to certain deductions, see the following sections and the regulations thereunder: Section 1481, relating to accounting for amounts repaid in connection with renegotiation of a government contract; section 1341, relating to the computation of tax where the taxpayer repays a substantial amount received under a claim of right in a prior taxable year; and section 165(e), relating to losses resulting from theft.

(4) *Deductions attributable to certain foreign income.*—In any case in which, owing to monetary, exchange, or other restrictions imposed by a foreign country, an amount otherwise constituting gross income for the taxable year from sources without the United States is not includible in gross income of the taxpayer for that year, the deductions and credits properly chargeable against the amount so restricted shall not be deductible in such year but shall be deductible proportionately in any subsequent taxable year in which such amount or portion thereof is includible in gross income. See § 1.905–1(b) for rules relating to credit for foreign income taxes when foreign income is subject to exchange controls.

(b) *Special rule in case of death.*—A taxpayer's taxable year ends on the date of his death. See section 443(a)(2) and § 1.443–1(a)(2). In computing taxable income for such year, there shall be deducted only amounts properly deductible under the method of accounting used by the taxpayer. However, if the taxpayer used an accrual method of accounting, no deduction shall be allowed for amounts accrued only by reason of his death. For rules relating to the inclusion of items of partnership deduction, loss, or credit in the return of a decedent partner, see subchapter K of chapter 1 of the Internal Revenue Code of 1954 and the regulations thereunder.

(c) *Accrual of real property taxes.*—(1) *In general.*—If the accrual of real property taxes is proper in connection with one of the methods of accounting described in section 446(c), any taxpayer using such a method of accounting may elect to accrue any real property tax, which is related to a definite period of time, ratably over that period in the manner described in this paragraph. For example, assume that such an election is made by a calendar-year taxpayer whose real property taxes, applicable to the period from July 1, 1955, to June 30, 1956, amount to $1,200. Under section 461(c), $600 of such taxes accrue in the calendar year 1955, and the balance accrues in 1956. For general rules relating to deductions for taxes, see section 164 and the regulations thereunder.

(2) *Special rules.*—(i) *Effective date.*—Section 461(c) and this paragraph do not apply to any real property tax allowable as a deduction under the Internal Revenue Code of 1939 for any taxable year beginning before January 1, 1954.

(ii) If real property taxes which relate to a period prior to the taxpayer's first taxable year beginning on or after January 1, 1954, would, but for section 461(c), be deductible in such first taxable year, the portion of such taxes which applies to the prior period is deductible in such first taxable year (in addition to the amount allowable under section 461(c)(1)).

(3) *When election may be made.*—(i) *Without consent.*—A taxpayer may elect to accrue real property taxes ratably in accordance with section 461(c) and this paragraph without the consent of the Commissioner for his first taxable year beginning after December 31, 1953, and ending after August 16, 1954, in which the taxpayer incurs real property taxes. Such election must be made not later than the time prescribed by law for filing the return for such year (including extensions thereof). An election may be made by the taxpayer for each separate trade or business (and for nonbusiness activities, if accounted for separately). Such an election shall apply to all real property taxes of the trade, business, or nonbusiness activity for which the election is made. The election shall be made in a statement submitted with the taxpayer's return for the first taxable year to which the election is applicable. The statement should set forth:

(*a*) The trades or businesses, or nonbusiness activity, to which the election is to apply, and the method of accounting used therein;

(*b*) The period of time to which the taxes are related; and

(*c*) The computation of the deduction for real property taxes for the first year of the election (or a summary of such computation).

(ii) *With consent.*—A taxpayer may elect with the consent of the Commissioner to accrue real property taxes ratably in accordance with section 461(c) and this paragraph. A written request for permission to make such an election shall be submitted to the Commissioner of Internal Revenue, Washington 25, D. C., within 90 days after the beginning of the taxable year to which the election is first applicable, or within 90 days after the date of the publication in the Federal Register of the regulations under section 461, whichever date is later. The request for permission shall state:

(*a*) The name and address of the taxpayer;

(*b*) The trades or businesses, or nonbusiness activity, to which the election is to apply, and the method of accounting used therein;

(*c*) The taxable year to which the election first applies;

(*d*) The period to which the real property taxes relate;

(*e*) The computation of the deduction for real property taxes for the first year of election (or a summary of such computation); and

(*f*) An adequate description of the manner in which all real property taxes were deducted in the year prior to the year of election.

(4) *Binding effect of election.*—An election to accrue real property taxes ratably under section 461(c) is binding upon the taxpayer unless the consent of the Commissioner is obtained under section 446 (e) and § 1.446–1(e) to change such method of deducting real property taxes. If the last day prescribed by law for filing a return for any taxable year (including extensions thereof) to which section 461(c) is applicable falls before the 90th day after the date the regulations under section 461 are published in the Federal Register, consent is hereby given for the taxpayer to revoke an election previously made to accrue real property taxes in the manner prescribed by section 461(c). If the taxpayer revokes his election under the preceding sentence, he must, on or before such 90th day, notify the district director for the district in which the return was filed of such revocation. For any taxable year for which such revocation is applicable, an amended return reflecting such revocation shall be filed on or before such 90th day.

(5) *Apportionment of taxes on real property between seller and purchaser.*—For apportionment of taxes on real property between seller and purchaser, see section 164(d) and the regulations thereunder.

(6) *Examples.*—The provisions of this paragraph are illustrated by the following examples:

Example (1).—A taxpayer on an accrual method reports his taxable income for the taxable year ending June 30. He elects to accrue real property taxes ratably for the taxable year ending June 30, 1955 (which is his first taxable year beginning on or after January 1, 1954). In the absence of an election under section 461(c), such taxes would accrue on January 1 of the calendar year to which they are related. The real property taxes are $1,200 for 1954; $1,600 for 1955; and $1,800 for 1956. Deductions for such taxes for the fiscal years ending June 30, 1955, and June 30, 1956, are computed as follows:

Fiscal year ending June 30, 1955:	
July through December 1954	None [1]
January through June (6/12 of $1,600)	$800
Deduction for fiscal year ending June 30, 1955	$800
Fiscal year ending June 30, 1956:	
July through December 1955 (6/12 of $1,600)	$800
January through June 1956 (6/12 of $1,800)	900
Deduction for fiscal year ending June 30, 1956	$1,700

[1] The taxes for 1954 were deductible in the fiscal year ending June 30, 1954, since such taxes accrued on January 1, 1954.

Example (2).—A calendar-year taxpayer on an accrual method elects to accrue real property taxes ratably for 1954. In the absence of an election under section 461(c), such taxes would accrue on July 1 and are assessed for the 12-month period beginning on that date. The real property taxes assessed for the year ending June 30, 1954, are $1,200; $1,600 for the year ending June 30, 1955; and $1,800 for the

year ending June 30, 1956. Deductions for such taxes for the calendar years 1954 and 1955 are computed as follows:

Year ending December 31, 1954:

January through June 1954	None [1]
July through December 1954 (6/12 of $1,600)	$800
Deduction for year ending December 31, 1954	$800

Year ending December 31, 1955:

January through June 1955 (6/12 of $1,600)	$800
July through December 1955 (6/12 of $1,800)	900
Deduction for year ending December 31, 1955	$1,700

[1] The entire tax of $1,200 for the year ended June 30, 1954, was deductible in the return for 1953, since such tax accrued on July 1, 1953.

Example (3).—A calendar-year taxpayer on an accrual method elects to accrue real property taxes ratably for 1954. In the absence of an election under section 461(c), such taxes, which relate to the calendar year 1954, are accruable on December 1 of the preceding calendar year. No deduction for real property taxes is allowable for the taxable year 1954 since such taxes accrued in the taxable year 1953 under section 23(c) of the Internal Revenue Code of 1939.

Example (4).—A taxpayer on an accrual method reports his taxable income for the taxable year ending March 31. He elects to accrue real property taxes ratably for the taxable year ending March 31, 1955. In the absence of an election under section 461 (c), such taxes are accruable on June 1 of the calendar year to which they relate. The real property taxes are $1,200 for 1954; $1,600 for 1955; and $1,800 for 1956. Deductions for such taxes for the taxable years ending March 31, 1955, and March 31, 1956, are computed as follows:

Fiscal year ending March 31, 1955:

April through December 1954 (9/12 of $1,200)	$900
January through March 1955 (3/12 of $1,600)	400
Taxes accrued ratably in fiscal year ending March 31, 1955	$1,300
Tax relating to period January through March 1954, paid in June 1954, and not deductible in prior taxable years (3/12 of $1,200)	300
Deduction for fiscal year ending March 31, 1955	$1,600

Fiscal year ending March 31, 1956:

April through December 1955 (9/12 of $1,600)	$1,200
January through March 1956 (3/12 of $1,800)	450
Deduction for fiscal year ending March 31, 1956	$1,650

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved December 19, 1957.

FRED C. SCRIBNER, Jr.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on Dec. 24, 1957, at 8:48 a. m., and published in the issue of the Federal Register for Dec. 25, 1957, 22 F. R. 10686.)

Subpart B.—Taxable Year for Which Items of Gross Income Included

SECTION 451.—GENERAL RULE FOR TAXABLE YEAR OF INCLUSION

26 CFR 1.451: Statutory provisions; general rule for taxable year of inclusion.

Regulations under the Internal Revenue Code of 1954. See T. D. 6292, page 476.

---

26 CFR 1.451–1: General rules for taxable year of inclusion. (Also Sections 74, 1301; 1.74–1.) Rev. Rul. 58–101

The fair market value of a house received as a prize by an individual taking part in a contest is includible in the gross income of such individual for the year in which legal title is transferred or the benefits and burdens of ownership are received, whichever occurs first.

The Internal Revenue Service has been requested to advise whether the fair market value of a house received by a taxpayer as a prize for taking part in a contest, but subject to the conditions and restrictions described below, should be included in gross income for the year in which title to the property was transferred, or the benefits and burdens of ownership received; or, whether the prize should be considered as having been earned over a longer period. Advice is also requested as to the applicability to the transaction of section 1301 or 1302 of the Internal Revenue Code of 1954 relating to income attributable to several taxable years.

In the instant case, a taxpayer submitted an entry in a twenty-five word essay contest conducted by a sponsor in 1954. In 1955 it was publicly announced that the taxpayer had won a house which would be built for him, subject to certain conditions and restrictions contained in an agreement entered into between him and the sponsor. The agreement provided that the taxpayer would do all the work and pay all expenses incurred in connection with the selection of a lot upon which the house would be built and would permit the sponsor and its advertising agency to publicize the house in any manner they considered desirable. The agreement also provided that the taxpayer would live in the house for a period of six months and that he would not disclose the winning entry, nor publicize it, without prior approval of the sponsor. In addition the agreement contained a clause which provided that the taxpayer would return the house and deliver the title thereto to the sponsor should he fail to comply with any of the conditions set forth in the agreement. The house was completed in 1956 and the six months' occupancy period provided for in the agreement extended into 1957. Title to the property was received some time in 1956. In order to protect himself against any future suit by the sponsor, or anyone who might purchase the home, the taxpayer had the agreement with the sponsor recorded as a public document and made a part of the abstract of the property. Certain title insurance companies refused to insure title to the property unless the taxpayer would agree to post bond for the value of the property.

On the basis of these facts, it is held that the fair market value of the house constitutes gross income to the taxpayer, under the provisions of section 74 of the Code. Such income is includible in the taxpayer's gross income for the year in which title to the property was transferred to him or the year in which the taxpayer took possession of the completed home, whichever occurred first (in this case, both occurred in 1956), regardless of the fact that subsequent events may require him to reconvey title to the sponsor. Loss of title because of failure to comply with conditions subsequent would constitute a separate transaction for Federal income tax purposes.

The efforts expended by the taxpayer which resulted in his winning the prize do not constitute "an employment," the compensation from which would, under section 1301 of the Code, be attributable to several years. There was no "arrangement" within the meaning of section 1301(b) between the taxpayer and the sponsor at the time he submitted his essay in the contest. See Revenue Ruling 55–642, C. B. 1955–2, 302. Such an "arrangement" did not come into existence until the time of the announcement of the taxpayer as the winner, when the conditions to the awarding of the prize were agreed to. Therefore, the subsequent activities of the taxpayer in finding a lot suitable to the sponsor and in holding himself subject to publicity claims of the sponsor would constitute "personal services * * * to effect a particular result," *i. e.*, the furtherance of a particular advertising scheme of the sponsor. However, since the elapsed time between the date of announcement of the winner of the contest and the expiration of the six-month occupancy requirement amounted to less than 36 months, section 1301 is not applicable in the instant case.

Since the taxpayer's efforts did not culminate in an "invention" or "artistic work," section 1302 of the 1954 Code is not applicable.

Lump sum payment received by an employee for cancellation of employment contract. See Rev. Rul. 58–301, page 23.

---

26 CFR 1.451–2: Constructive receipt of income. Rev. Rul. 58–162

> The proceeds from the sale of wheat by a farmer using the cash receipts and disbursements method of accounting, under a bona fide arms-length contract calling for payment in the taxable year following that in which the wheat was delivered to the purchaser, are includible in his gross income for the taxable year in which payment is received.

Advice has been requested regarding the taxable year of inclusion in gross income of the selling price of grain under the circumstances described below.

Over a period of several years, the taxpayer, a farmer using the cash receipts and disbursements method of accounting and reporting on a calendar year basis, sold his wheat to the operator of a commercial grain elevator in one year, under contracts calling for payment during the following year. In some years the wheat was in storage in the elevator at the time the contract was entered into; in others it was delivered to the elevator on the day the contract was signed. But in all

of the years concerned the contract price agreed to was the market price as of the day the contract was signed; and in each case the contract form read in part as follows: "In consideration of the above agreement of the Owner to sell this grain, it is agreed between the Owner and the Purchaser that the Owner is to receive payment for this grain on January ——, 19—." Thus, under this contract the taxpayer and the purchaser agreed that the taxpayer was not entitled to the payment for the wheat until some date in January of a subsequent taxable year.

Section 1.451–2(a) of the Income Tax Regulations provides, in part, as follows:

> Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account or set apart for him so that he may draw upon it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Where the taxpayer (seller) has the right to the proceeds of a sale of grain upon delivery, the courts have held that any delay in payment due only to the seller's own volition puts the seller in constructive receipt of income. See *Mary J. Hineman, Executrix, Estate of J. A. Hineman* v. *Commissioner*, 99 Fed. Supp., 582; and *J. B. Banek* v. *Kasper*, District Court of the United States for the District of South Dakota, decided October 19, 1954. In similar situations where the taxpayer had control of the payment at the time payment was due, the courts have found that the income was constructively received at that time. See *Frank W. Kunze* v. *Commissioner*, 19 T. C. 29, affirmed per curiam, 203 Fed. (2d) 957. However, where a contract for the sale of wheat was a bona fide arm's-length transaction and the seller had no legal right to demand and receive payment for his wheat until the year following the contract of sale and delivery, income from the sale was held not to have been constructively received in the year in which the contract was executed. See *J. D. Amend, et ux*, v. *Commissioner*, 13 T. C. 178, acquiescence C. B. 1950–1, 1; and *Wilfred Weathers, et ux.*, v. *Commissioner*, Tax Court Memorandum Opinion, entered March 25, 1953.

In the instant case, the transactions entered into between the taxpayer and the grain elevator operator, as evidenced by the written contracts, were bona fide arm's-length transactions and the taxpayer did not have an unqualified right to receive payment for the wheat in the years in which the contracts were executed and the wheat was delivered.

Accordingly, it is held that the proceeds from the sale of wheat by a farmer, using the cash receipts and disbursements method of accounting, under a bona fide arm's-length contract calling for payment in the taxable year following that in which the wheat was delivered to the purchaser, are includible in his gross income for the taxable year in which payment is received.

SECTION 453.—INSTALLMENT METHOD

(Also Section 167; 26 CFR 1.167(a)–1.) Rev. Rul. 58–281

Revenue Ruling 56–498, C. B. 1956–2, 300, holds that the profit derived from a lease-purchase agreement, entered into pursuant to the

Post Office Department Property Act of 1954, Title II of Public Law 519, 83d Congress, Second Session, constitutes profit on the sale of real property, taxable as ordinary income which may be reported on the installment method, provided the sale otherwise qualifies for such treatment. That portion of each monthly installment which represents interest on the unpaid purchase price is to be separately treated since it represents ordinary interest income. The above holdings are equally applicable to the profit derived under an "Agreement to Finance, Construct, and Sell" (General Services Administration, Form 1276, revised July 1956, under which the taxpayer finances and constructs the building), and an "Agreement to Finance Construction, and Sell" (General Services Administration, Form 1274, revised July 1956, under which the taxpayer finances the construction of the building), entered into pursuant to the Public Buildings Purchase Contract Act of 1954, Title I, Public Law 519, 83d Congress, Second Session, 68 Stat. 518, 40 U. S. C. 356. The above holdings are not applicable under an "Agreement to Construct" (General Services Administration, Form 1275, revised July 1956), entered into pursuant to the Act, since, under such an agreement, the taxpayer will reflect profit from the performance of a construction contract as ordinary income in the same manner as he would reflect income on any other construction contract he would perform. A taxpayer may not claim depreciation on a building which has been made the subject of any of the agreements mentioned above.

SECTION 454.—OBLIGATIONS ISSUED AT DISCOUNT

(Also Section 676; 26 CFR 1.676(a)-1.) Rev. Rul. 58-2

An individual taxpayer established a personal trust over which he had power of revocation. The corpus of the trust was composed of Series E United States savings bonds which the taxpayer (grantor) had held for various numbers of years as the sole owner. It is assumed for the purposes of this ruling that the transfer of the bonds to the trust, concerning which there are some restrictions, was in conformity with the regulations governing savings bonds. The interest on the bonds had accumulated in the form of increment in value, none of which was reported in the taxpayer's individual income tax return in past years under the option available to owners of such bonds under section 454(a) of the Internal Revenue Code of 1954. Section 454(c) provides, in pertinent part, that the increase in redemption value in excess of the amount paid for a Series E bond shall be includible in gross income in the taxable year in which the obligation is finally redeemed or in the taxable year of final maturity, whichever is earlier. Under the provisions of section 676 of the Code, the taxpayer (grantor) is considered as the owner of the bonds. *Held*, since the taxpayer did not realize the benefit of the interest (increment in value) at the time of the transfer to the trust, he is not required to include in his Federal income tax return the amount thereof that had accumulated to the date of transfer. See, generally, I. T. 3011, C. B. XV-2, 132 (1936), and I. T. 3097,

C. B. 1937–2, 219. Compare Revenue Ruling 55–278, C. B. 1955–1, 471.

---

26 CFR 1.454: Statutory provisions; obligations issued at discount.

Regulations under the Internal Revenue Code of 1954. See T. D. 6282, page 215.

Subpart C.—Taxable Year for Which Deductions Taken

SECTION 461.—GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION

Rev. Rul. 58–18

A taxpayer, employing the accrual method of accounting and on a calendar year basis, adopted in 1954 a plan whereby its salaried employees who were on its payroll on December 31, 1954, and who had completed more than six months of service on that date would be entitled to vacation with pay in 1955 according to certain prescribed rules. Provisions were made in the plan for unused vacation payments to eligible employees who after December 31, 1954 and before taking a vacation were laid off, discharged, or retired, or who resigned, entered military service, or were deceased. No cash payments would be made in lieu of vacations to employees remaining on the payroll. The employees were notified of the plan in December 1954, and were also notified that the plan would remain in effect for years subsequent to 1955 unless revised before the beginning of each subsequent year. The plan is not based upon union contracts. On the facts, it constitutes a unilateral contract, offered to and accepted by the employees by meeting employment requirements. Salaried employees who were on the payroll on December 31, 1954, and who had completed more than six months of service on that date, therefore, had a vested right in their 1954 vacation pay. The liability of the corporation therefor as of December 31, 1954, was clearly established, and the amount of the liability to each individual employee was capable of being computed with reasonable accuracy. *Held*, the fact that there is no written contract for the payment of vacation pay to specified employees of the corporation does not, in and of itself, prevent the accrual and deduction for Federal income tax purposes of the amount of such liability for the taxable year in which such liability is established. No distinction is to be made between vacation plans based on a written contract and such plans based on a unilateral contract which provides the employee with a vested right to the unused vacation pay; which plan or policy is communicated to the employees involved before the beginning of the vacation year; and which plan meets the requirements of Revenue Ruling 54–608, C. B. 1954–2, 8.

26 CFR 1.461: Statutory provisions; general rule for taxable year of deduction.

Regulations under the Internal Revenue Code of 1954. See T. D. 6282, page 215.

Subpart D.—Inventories

SECTION 471.—GENERAL RULE FOR INVENTORIES

(Also Part II, Section 22(c); Regulations 118, Section 39.22(c)-2.) Rev. Rul. 58-181

A taxpayer who, in accordance with accepted accounting practice, uses depreciation as part of inventory costs in determining gross income (Revenue Ruling 141, C. B. 1953-2, 101) must also treat as part of inventory costs that portion of amortization of emergency facilities, computed under section 168 of the Internal Revenue Code of 1954 (Section 124A of the 1939 Code), which is equal to depreciation on the facilities that would have been included in inventory costs had the facilities not been subject to amortization under section 168 of the Code. Any amortization in excess of depreciation constitutes a current allowable deduction from gross income. Such procedure permits income to be clearly reflected in accordance with the method of accounting consistently employed by the taxpayer and in accordance with accepted accounting practice.

SECTION 472.—LAST-IN, FIRST-OUT INVENTORIES

Rev. Rul. 58-282

Price indexes for January 1958, published by the Bureau of Labor Statistics on March 6, 1958, for use by department stores employing the retail inventory and last-in, first-out inventory methods.

The following price indexes for January 1958, published by the Bureau of Labor Statistics on March 6, 1958, for use by department stores employing the retail inventory and last-in, first-out inventory methods, are accepted by the Internal Revenue Service pursuant to Treasury Decision 5605, C. B. 1948-1, 16, and Mimeograph 6244, C. B. 1948-1, 21, for appropriate application to inventories for taxable years of 12 months ended December 31, 1957, and January 31, 1958.

Indexes are given on a national basis for the store total, for 20 major groups of departments, and for two special group combinations. The store total includes all departments in the store, both those listed in the groups and those not specifically listed, except for candy, foods, liquor, tobacco, and paints and wall paper. Contract departments are also excluded.

Bureau of Labor Statistics, Department Store Inventory Price Indexes, by Department Groups

[January 1941=100]

	Department group	Jan. 1957	Jan. 1958	Percent change from January 1957 to January 1958
I	Piece goods	199.4	200.1	+0.4
II	Domestics and draperies	194.2	194.7	+0.3
III	Women's and children's shoes	233.6	240.0	+2.7
IV	Men's and boys' shoes	288.3	231.1	+1.2
V	Infants' wear	174.5	175.7	+0.7
VI	Women's underwear	172.3	175.2	+1.7
VII	Women's and girls' hosiery	163.1	160.6	−1.5
VIII	Women's and girls' accessories	175.4	177.8	+1.4
IX	Women's outerwear and girls' wear	180.4	181.3	+0.5
X	Men's clothing	211.2	213.7	+1.2
XI	Men's furnishings	199.9	199.6	−0.2
XII	Boys' clothing and furnishings	205.9	206.1	+0.1
XIII	Jewelry	168.9	173.3	+2.6
XIV	Notions	162.1	166.1	+2.5
XV	Toilet articles and drugs	178.6	184.0	+3.0
XVI	Furniture and bedding	218.1	219.7	+0.7
XVII	Floor covering	192.0	195.7	+1.9
XVIII	Housewares	213.9	224.9	+5.1
XIX	Major appliances	141.7	135.8	−4.2
XX	Radios and television sets	138.8	135.9	−2.1
Total: Groups I–XV		192.0	194.1	+1.1
Total: Groups XVI–XX		193.1	195.9	+1.5
Store total		192.3	194.6	+1.2

SUBCHAPTER F.—EXEMPT ORGANIZATIONS

Part I.—General Rule

SECTION 501.—EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

Rev. Rul. 58–143

Criteria or tests to be used in determining whether the payment of death, sick, accident, and other benefits to individual members of a labor union will affect the qualification of the union for exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as a labor organization described in section 501(c)(5) of the Code.

Advice has been requested whether the exempt status of a labor union, which has been held to be exempt from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as a labor organization described in section 501(c)(5) of the Code, will be affected by the payment of death, sick, accident, and other benefits to its members.

Subsection (a) of section 501 of the Code provides for an exemption from Federal income tax for certain organizations which are listed under subsection (c). Among these organizations, considered as

exempt, paragraph (5) of subsection (c) lists "Labor, agricultural, or horticultural organizations." The organizations contemplated by section 501(c)(5) are those which have no net earnings inuring to the benefit of any member and 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.

The concept of a labor organization, insofar as its objectives set forth above are concerned, implies that it must be for the betterment of conditions of its members as a group, in relation to employment, rather than improvement of conditions of individual members. In carrying out such objectives, its activities must, therefore, be primarily directed toward the improvement of conditions of the members in representing them in matters of wages, hours of labor, working conditions, and economic benefits.

Generally, sick, death, accident, and similar benefits are for the improvement of economic conditions of individual members rather than the members as a group. This is substantiated by the fact that provision is made separately in section 501(c)(9) of the Code for exemption of employee beneficiary associations formed for the purpose of paying certain benefits to members. However, it is recognized that, in effectively carrying out its purposes, a labor union may, under certain circumstances, give direct financial assistance of an incidental nature to members without loss of exemption. Strike benefits for example, come within this category. Certain other benefits may also be provided by a union as long as such activities remain incidental to the principal purposes, without regard to whether they are the type contemplated by section 501(c)(9) of the Code.

The Internal Revenue Service takes the position that the operation of an established system for the payment of sick, death, accident, and other benefits, which members are entitled to receive as a matter of right in consideration of the payment of assessments, has no customary relation to the purposes of a labor union within the contemplation of section 501(c)(5) of the Code. Such activities are for the economic benefit of members in their individual capacity. Where, however, the benefits are so indefinite that the members, individually, may not be said to have a substantial economic benefit, and where the amount of the funds used to provide these benefits is not so great as to imply a major purpose, the benefits are considered merely incidental and will not of themselves prevent exemption.

Where members of a labor union desire to receive benefits as a matter of right through an established system under which they make contributions for such purposes, or where the amount of the funds used to provide indefinite benefits is so great as to imply a major purpose of the union, a formal trust arrangement or other form of organization should be set up as a separate entity, apart from the labor union, through which the benefits are paid, inasmuch as the operation of such a system by their labor organization will cause a withdrawal of its exempt status.

Rev. Rul. 58–194

A corporation organized for the purpose of operating a book and supply store and a cafeteria and restaurant on the campus

of a State university primarily for the convenience of its student body and the members of its faculty, no part of the earnings of which inures to the benefit of any private shareholder or individual, may be considered to be operated exclusively for educational purposes and may qualify for exemption from Federal income tax under the provisions of section 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(3).

I. T. 2636, C. B. XI-2, 102 (1932), revoked.

Advice has been requested whether a corporation organized for the purposes hereinafter set forth will be exempt from Federal income tax.

The corporation was organized, without capital stock, to conduct a general book and supply store, dealing in books, magazines, stationery, student supplies, emblems, and sporting goods, and to operate a cafeteria and restaurant on the campus of a State university for the convenience of its student body and the members of its faculty. It was authorized to receive and disburse such funds as may be collected in accordance with the laws of the State and with the approval of the State Director of Education.

The corporation's activities are conducted on the campus of the university in buildings owned by the State and for which a nominal rental is paid. It is controlled by a board of directors composed of the president of the university, three elected faculty members and three elected student members. Membership in the corporation consists of all regular employees of the university and students who have purchased a membership for a nominal fee. The bylaws of the corporation provide that none of the profits or assets of the corporation shall ever be distributed to the members but shall be used solely for the benefit of the students and faculty of the university.

The facilities of the corporation are available to members as well as to non-members in order that all students at the university are afforded an opportunity to obtain their academic supplies without undue inconvenience. However, non-members are required to pay a small service charge on book store purchases. The services of the corporation are used almost exclusively by persons connected with the university.

Paragraph 3 of section 501(c) of the Internal Revenue Code of 1954, which describes certain organizations exempt from tax under section 501(a), provides in part that corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, 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, shall be exempt from Federal taxation. In order to be exempt under this provision of law, an organization must be organized and operated exclusively for one or more of the specified purposes.

In the instant case the corporation was organized for the purpose of furthering the educational program of the university through the medium of operating facilities for the convenience of the student body of the university and the members of its faculty. Any profits of the corporation are to be used solely for the benefit of the students and faculty of the university. Since the corporation is controlled by and serves almost exclusively the members of the faculty and student

body and since it is performing functions for their benefit and convenience and in furtherance of the educational program of the university, it is for all intents and purposes an integral part of the university. Therefore, it is apparent that it is a corporation organized and operated exclusively for educational purposes within the meaning of section 501(c)(3) of the Internal Revenue Code of 1954.

In view of the foregoing, since the instant corporation is organized for the purpose of operating a book and supply store and a cafeteria and restaurant on the campus of a State university primarily for the convenience of its student body and the members of its faculty, and no part of its earnings inures to the benefit of any private shareholder or individual, it is held that it is operated exclusively for educational purposes and is exempt from Federal income tax under the provisions of section 501 of the Internal Revenue Code of 1954 as an organization described in section 501(c)(3). However, an organization is not exempt from tax merely because it is not organized and operated for profit. In order to establish its exemption, it is necessary that every organization claiming exemption file an appropriate application form with the District Director of Internal Revenue for the internal revenue district in which is located the principal place of business or principal office of the organization. An organization claiming exemption under section 501(c)(3) shall file its application on Form 1023, Exemption Application. See section 39.101–1 of Regulations 118 made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, C. B. 1954–2, 47.

I. T. 2636, C. B. XI–2, 102 (1932), holding that a corporation conducting a students' store on the campus of a university, no part of the net earnings of which inure to the benefit of any private shareholder or individual, is not operated exclusively for religious, charitable, scientific, literary, or educational purposes is hereby revoked.

Rev. Rul. 58–224

An organization which operates a trade show as its sole or principal activity primarily for the purpose of rendering particular services to individual persons is not entitled to exemption from Federal income tax as an organization described as a business league in section 501(c)(6) of the Internal Revenue Code of 1954.

Advice has been requested whether an organization which is primarily engaged in the staging of an annual merchandise show, under the circumstances described below, is entitled to exemption from Federal income tax as a business league under the provisions of section 501(c)(6) of the Internal Revenue Code of 1954.

The instant organization is a nonprofit corporation without capital stock. It was organized by members of the trade and extension committee of the local chamber of commerce who are interested in the sale and distribution of gift and housewares merchandise. Each member of the merchandise show committee of the chamber is also a member of the organization. The bylaws provide that no dues or other charges of any nature shall be assessed against or collected from members. The general purpose of the organization is to promote the interest of trade and increase the facilities of commercial transactions,

particularly in connection with the display, distribution and sale of merchandise. However, its sole activity consists of the staging of an annual merchandise show under the sponsorship of the chamber of commerce. The show for the most part consists of exhibits by manufacturers. A few wholesalers have exhibits of such merchandise not otherwise represented. The association publishes a buyer's guide which it furnishes free to each exhibiter and retailer. The buyer's guide shows the name of each exhibitor, the type of merchandise on display, and the location of the exhibit, and stresses the economy and convenience of making all purchases of merchandise under one roof. Admittance is by reservation only and the general public is excluded from the show. Entertainment and the awarding of prizes serve as inducements for retailers to attend the show. A retailer may place his order at the show for merchandise to be shipped by the manufacturer or by the distributor specified. Receipts are derived from fees charged manufacturers and wholesalers for exhibit space and from the sale of banquet tickets. Expenditures are made for advertising, promotion, banquets, entertainment, rent of hotel space for exhibits, and other operating expenses.

Section 501(c)(6) of the Code exempts from Federal income tax "Business leagues, chambers of commerce, real-estate boards, 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."

Section 39.101 (7)-1 of Regulations 118, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47, holds that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit and that the activities of such an association should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

It is shown that the sole activity of the instant orgainzation is conducting an annual trade show. It is organized and operated for the most part by individuals who are salesmen and/or distributors. Its advertising appears to be directed toward potential retailers and to stress the advantages of making all purchases of merchandise under one roof. The income is derived principally from manufacturers and distributors, most of whom appear not to be members of the organization.

It is concluded that the activities of the instant organization substantially serve the exhibitors and retailers as a convenience and economy in the conduct of their businesses. In conducting the show, it provides direct advertising and publicity campaigns for distributors, eliminates substantial travel on the part of such distributors, and provides, primarily, selling opportunities for them, as well as opportunities for retailers to see all types of the merchandies in question under one roof. Therefore, it is the position of the Internal Revenue Service that the instant organization is rendering particular services for individual persons as distinguished from the improvement of business conditions generally.

Accordingly, it is held that the instant organization, which operates a trade show as its sole or principal activity and primarily for promoting the interest of individuals, is not entitled to exemption from Federal income tax as an organization described in section 501(c)(6) of the Internal Revenue Code of 1954. The conclusion reached herein represents the position of the Service as to the application of the law to the entire state of facts involved. The denial of exemption to the instant organization on the basis of the detailed statement of facts involved is not to be interpreted as implying that such an organization may qualify for exemption under section 501(c)(6) of the 1954 Code, if, on the contrary, it invites the public to its trade show and makes no sales of merchandise at the show. In such event, consideration would be given to the extent, if any, to which the organization is promoting the interests of individuals from the standpoint of its over-all activities.

Rev. Rul. 58–294

An association was organized and is being operated for the purpose of promoting uniform business, advertising and fair trade practices in connection with the manufacture and sale of a certain patented product. Membership in the association is limited to any person, firm, or corporation licensed to manufacture and sell the specified product. The association owns the controlling interest in the corporation which holds the basic patents on the particular product, grants licenses under the patents and sells to the members of the association the materials and equipment necessary in the manufacture of the product. In addition, the association acquired the rights, title and interest in certain supplementary patents on the product and provided for the payment for such patents by paying a stated amount for each unit sold by its licensees. *Held*, since the association is engaged in activities which are ordinarily carried on for profit and since it is engaged in furthering the business interests of the dealers in the particular patented product, rather than the improvement of business conditions of one or more lines of business, it does not qualify for exemption from Federal income tax as a business league under section 501(c)(6) of the Internal Revenue Code of 1954.

Taxability of an organization, including a trust, irrevocably dedicated to the perpetual care of a cemetery, burial lots, or mausoleum crypts. See Rev. Rul. 58–190, page 15.

PART II.—TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS

SECTION 512.—UNRELATED BUSINESS TAXABLE INCOME

Distributions from limited-partnership interest held by certain charitable trusts. See Public Law 85–367, page 633.

SUBCHAPTER G.—CORPORATIONS USED TO AVOID INCOME TAX ON SHAREHOLDERS
PART II.—PERSONAL HOLDING COMPANIES

SECTION 542.—DEFINITION OF PERSONAL HOLDING COMPANY: EXCEPTIONS

Rev. Rul. 58–309

Salaries paid by a finance company to employees who hold options to purchase common stock, but who are not currently shareholders within the meaning of section 542(c)(9) of the Internal Revenue Code of 1954, do not constitute compensation for personal services rendered by shareholders so as to prevent application of the exception from the personal holding company provisions.

Advice has been requested whether salaries paid by a finance company to employees who have no present stock interest in the corporation, but who hold options to purchase common stock, should be considered as deductions allowable under section 162 of the Internal Revenue Code of 1954, for the purpose of determining whether the corporation is exempt from personal holding company tax under section 542(c)(9) of the Code.

The taxpayer, a finance company, was organized prior to 1940. Its authorized issue of capital stock consists of $120x$ shares of preferred and $650x$ shares of common stock, of which, $117x$ shares of preferred and $328x$ shares of common stock are currently outstanding. Early in 1955 certain employees, who, at that time, owned no stock of the finance company, were granted options to acquire $200x$ shares of the company's common capital stock at $5x$ dollars per share. The options have not been exercised.

Section 542(c)(9) of the Code provides that the term "personal holding company" as defined in section 542(a) does not include a finance company which satisfies certain statutory requirements and whose deductions allowable under section 162 of the Code (relating to trade or business expenses), other than compensation for personal services rendered by shareholders (including members of the shareholder's family as described in section 544(a)(2)), constitute 15 percent or more of gross income.

The term "shareholders," as used in section 542(c)(9) of the Code to indicate those whose compensation for personal services cannot be a part of the minimum 15 percent expense deductions, does not include persons who merely have options to purchase stock, but the term would include compensated "members of the stockholder's family" as specified in section 542(c)(9) and described in section 544(a)(2). See *Helvering* v. *Southwest Consolidated Corporation*, 315 U. S. 194, Ct. D. 1544, C. B. 1942–1, 218. Since there are no questionable stockholding in this case, it is unnecessary to consider further the scope of the term "shareholders."

Therefore, it is concluded that the salaries paid to employees who hold options to purchase common stock, but who are not shareholders within the meaning of the statute, do not constitute compensation for

personal services rendered by shareholders so as to prevent application of the exception from the personal holding company provisions, under section 542(c)(9) of the Code.

SUBCHAPTER H.—BANKING INSTITUTIONS

PART II.—MUTUAL SAVINGS BANKS, ETC.

SECTION 593.—ADDITIONS TO RESERVE FOR BAD DEBTS

26 CFR 1.593–1: Additions to reserve for bad debts. Rev. Rul. 58–10

A deduction for an addition to a reserve for bad debts made by a mutual savings bank, or other institution of the type referred to in section 593 of the Internal Revenue Code of 1954, in its Federal income tax return for its fiscal year ended June 30, 1955, which deduction equaled its taxable income for that year before such deduction, may not be eliminated by a net operating loss carryback from a subsequent year in order that the amount previously credited to a bad debt reserve may be transferred tax-free to the institution's surplus account.

Advice has been requested whether a deduction for an addition to a reserve for bad debts made by a mutual savings bank in its income tax return for its fiscal year ended June 30, 1955, which deduction equaled its taxable income for that year before such deduction, may be eliminated by a net operating loss carryback from taxpayer's fiscal year ended June 30, 1956, in order that the amount previously credited to the bad debt reserve may be transferred tax-free to the bank's surplus account.

The instant mutual savings bank had a small net operating loss for its first taxable fiscal year, the year ended June 30, 1954, which it carried over and deducted as a net operating loss deduction in its income tax return for the fiscal year ended June 30, 1955. The resulting taxable income for that year, approximately $23x$ dollars, was deducted in its entirety as an addition to its reserve for bad debts, under section 593 of the Internal Revenue Code of 1954. Thus, its income tax return for that year disclosed a taxable income of zero. For the fiscal year ended June 30, 1956, taxpayer sustained a net operating loss of $24x$ dollars. In carrying back the fiscal year 1956 net operating loss to fiscal year 1955, taxpayer desires to apply the carryback to reduce the taxable income for fiscal year 1955 computed before the deduction for the addition to its bad debt reserve, so that it may transfer the amount previously credited to the bad debt reserve to its surplus account free of tax.

With respect to the mutual savings banks, domestic building and loan associations, and cooperative banks, referred to therein, section 593 of the Code provides, in part, as follows:

* * * the reasonable addition to a reserve for bad debts for any taxable year shall in no case be less than the amount determined by the taxpayer as the reasonable addition for such year; except that the amount determined by the taxpayer under this sentence shall not be greater than the lesser of—

(1) the amount of its taxable income for the taxable year computed without regard to this section, or

(2) the amount by which 12 percent of the total deposits or withdrawable amounts of its depositors at the close of such year exceeds the sum of its surplus, undivided profits, and reserves at the beginning of the taxable year.

Section 1.593–1(b) of Income Tax Regulations further provides that "the amount of its taxable income for the taxable year," computed without regard to section 593, is also to be computed without regard to any section of the Code providing for a deduction the amount of which is dependent upon the amount of taxable income (such as section 170 of the Code, relating to charitable, etc., contributions or gifts). While the effect of the foregoing sections of the Code and the regulations is to limit the amount of the deduction for an addition to a reserve for bad debts which the Commissioner of Internal Revenue may disallow, section 1.593–2 of the regulations authorizes the Commissioner to allow larger deductions for additions to a reserve for bad debts where circumstances in certain cases so warrant.

Before a taxpayer can carry back a net operating loss to a year in which it took its entire taxable income as a deduction under section 593 of the Code, it is necessary that taxable income first be created in that year by a reduction of the deduction taken as an addition to the reserve for bad debts. In the instant case, the taxpayer determined that its entire taxable income for the fiscal year 1955 was a reasonable addition to its reserve for bad debts. If the addition to the reserve was reasonable at that time, it does not become unreasonable because of subsequently occurring events such as a net operating loss in a subsequent year.

Accordingly, it is held that a deduction for an addition to a reserve for bad debts made by a mutual savings bank, or other institution of the type referred to in section 593 of the Code, in its Federal income tax return for its fiscal year ended June 30, 1955, which deduction equaled its taxable income for that year before such deduction, may not be eliminated by a net operating loss carryback from a subsequent year in order that the amount previously credited to the bad debt reserve may be transferred tax-free to the institution's surplus account.

SUBCHAPTER I.—NATURAL RESOURCES

PART I.—DEDUCTIONS

SECTION 613.—PERCENTAGE DEPLETION

Rev. Rul. 58–231

Intangible drilling and development costs incurred in drilling nonproductive wells in the development of the same producing deposit or reservoir must be deducted in computing taxable income from the producing "property" for the purposes of the limitation on percentage depletion. However, such costs incurred in an attempt to penetrate an entirely different and separate reservoir from the known producing zone need not be charged against the producing "property" if the election to aggregate under section 614(b) has not been exercised.

Advice has been requested in the following situations with respect to the treatment of intangible drilling and development costs in-

curred in drilling nonproductive oil or gas wells in determining taxable income for the purpose of limiting percentage depletion to 50 percent of the taxable income from the property.

1. Dry holes drilled prior to the completion of a productive well in the same taxable year.

2. Dry holes and noncommercial completions drilled within the accepted limits of the producing zone, *i. e.*, interior development wells.

3. Dry holes or noncommercial completions, drilled as "one location step-outs" and bottomed in the same zone from which production is obtained in interior wells.

4. Dry holes drilled as "exploratory step-outs" in the sense that they are located at a considerable distance from producing wells.

5. Wells drilled through the known producing horizon to test lower prospective zones and, having proven unsuccessful, such wells are backed-up and completed as producers in the known producing horizon.

The allowable deduction for percentage depletion in the case of gas and oil wells is 27½ percent of the gross income from the property, limited so as not to exceed 50 percent of the taxable income from the property. If the taxpayer has elected to deduct intangible drilling and development expenses, they must be deducted in determining taxable income from the property for purposes of the limitation on allowable percentage depletion. See Regulations 118, section 39.23(m)–1(g), made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47; *Helvering* v. *Wilshire Oil Co., Inc.*, 308 U. S. 90, Ct. D. 1424, C. B. 1939–2, 213; *F. H. E. Oil Co.* v. *Helvering*, 308 U. S. 104, Ct. D. 1423, C. B. 1939–2, 212.

Therefore, in the application of the provisions allowing percentage depletion, it is essential to establish what constitutes the "property" in the particular case. Section 614(a) of the Internal Revenue Code of 1954 defines "property" for the purpose of computing the depletion allowance as "each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land." See also G. C. M. 22106, C. B. 1941–1, 245; and G. C. M. 24094, C. B. 1944, 250. Thus, each separate interest of the taxpayer in each separate oil or gas deposit in each separate lease or tract of land must be considered "the property" for depletion purposes, unless the taxpayer has exercised a valid election under section 614 of the Code to form one aggregation of, and to treat as one property, any two or more of such interests which form part or all of an operating unit.

The advice given herein is based on the assumption that the taxpayer, in all five situations, has not elected to aggregate any separate deposits under section 614(b).

In each of the first four situations outlined above, the nonproductive wells were drilled in an effort to reach the same deposit or reservoir from which production has been obtained prior to the drilling of the nonproductive wells or during the same taxable year in which such wells were drilled. The cost of such dry holes was incurred in the development of the same producing deposit. Therefore such costs must be deducted in computing taxable income from the produc-

ing "property" for the purpose of the limitation on percentage depletion.

With respect to the fifth situtation, a different rule may be applicable to the cost of drilling a nonproductive well in an attempt to penetrate an entirely different and separate reservoir trap from the known producing deposit. The existence of multiple oil or gas deposits under a single tract or lease is a well recognized geological phenomenon. However, it is a question of fact to be determined by the circumstances in each instance whether the nonproducing well was actually drilled in an effort to penetrate a distinctly separate oil or gas accumulation or was drilled in the development of an already producing deposit. Where the facts clearly show the limits of a previously producing deposit or other circumstances clearly indicate that the nonproductive well could not have been drilled with the expectation of penetrating any previously producing deposit, the cost of such well is not allocable to any producing property and must not be deducted in determining taxable income from the producing property.

If a well is drilled through a known producing reservoir and the deeper well having proved nonproductive is backed up and completed as a producing well in the known producing sand, the portion of the total costs of the well reasonably allocable to the producing sand must be taken into consideration in computing taxable income from the producing property. However, the remaining portion of the costs of such well must be deducted independently of the producing property and considered as expenses allocable to the attempt to develop a separate and independent producing horizon.

If a nonproductive well is drilled through a known producing horizon in an unsuccessful attempt to reach a deeper sand and, under well-spacing regulations applicable to the particular locality, such well may not be backed up and completed in the producing zone, the entire cost of such well must be deducted independently of the producing property and need not be deducted in determining the taxable income from the producing property.

PART III.—SALES AND EXCHANGES

SECTION 631.—GAIN OR LOSS IN THE CASE OF TIMBER OR COAL

26 CFR 1.631: Statutory provisions; gain or loss in the case of timber or coal.

Regulations under the Internal Revenue Code of 1954. See T. D. 6281, page 159.

26 CFR 1.631-1: Election to consider cutting as sale or exchange. Rev. Rul. 58-295

(Also Part II, Section 117(k), Regulations 118, Section 39.117(k)-1.)

To be entitled to the benefits of section 631(a) of the Internal Revenue Code of 1954 as the holder of a "contract right to cut," a taxpayer must have acquired under such contract a proprietary interest in the timber which he cuts. Compare *Helga Carlen* v. *Commissioner*, 220 Fed. (2d) 338. Whether a taxpayer has a proprietary interest in timber cut by him depends upon the substance of the grant to him as determined in the light of all of the pertinent facts. Where a taxpayer is granted a contractual right to cut and remove all or a described part of the merchantable timber on a particular tract of land, he has a proprietary interest in the timber cut by him if at the time of the cutting he has an unrestricted right to sell the logs or to use them in his trade or business. If the circumstances are such that the grantor in fact takes for his own use or for sale on his own account substantially all of the logs cut, whether or not in the exercise of a right in the form of an option to purchase, the taxpayer-grantee will not be deemed to have an unrestricted right to sell the logs or to use them in his trade or business.

SECTION 632.—SALE OF OIL OR GAS PROPERTIES

26 CFR 1.632: Statutory provisions; sale of oil or gas properties.

Regulations under the Internal Revenue Code of 1954. See T. D. 6281, page 159.

SUBCHAPTER J.—ESTATES, TRUSTS, BENEFICIARIES, AND DECEDENTS

PART I.—ESTATES, TRUSTS, AND BENEFICIARIES

Subpart A.—General Rules for Taxation of Estates and Trusts

SECTION 642.—SPECIAL RULES FOR CREDITS AND DEDUCTIONS

Income of a trust which is used for the care, maintenance, and beautification of a mausoleum or family burial lot located in a community cemetary. See Rev. Rul. 58-190, page 15.

---

26 CFR 1.642(h)-1: Unused loss carryovers on termination of an estate or trust.

A taxpayer-beneficiary succeeding to farm property formerly held in trust. See Rev. Rul. 58-191, page 149.

---

26 CFR 1.642(h)-2: Excess deductions on termination of an estate or trust.

A taxpayer-beneficiary of a trust engaged in farming succeeding to farm property formerly held by the trust. See Rev. Rul. 58–191, page 149.

Subpart E.—Grantors and Others Treated as Substantial Owners

SECTION 671.—TRUST INCOME, DEDUCTIONS, AND CREDITS ATTRIBUTABLE TO GRANTORS AND OTHERS AS SUBSTANTIAL OWNERS

26 CFR 1.671–3: Attribution or inclusion of income, deductions, and credits against tax.

Commission for managing trust estate which is paid to a trustee in advance by the grantor-beneficiary. See Rev. Rul. 58–53, page 152.

SECTION 672.—DEFINITIONS AND RULES

26 CFR 1.672(c)–1: Related or subordinate party. — Rev. Rul. 58–19

For the purposes of sections 671 through 678 of the Internal Revenue Code of 1954, which provide the conditions under which grantors or others shall be considered as the substantial owners of any portion of a trust, the term "related or subordinate party," as defined in section 672(c) of the Code and section 1.672(c)–1 of the Income Tax Regulations, is held to include, among others, a brother and sister, whether by the whole or half blood.

SECTION 673.—REVERSIONARY INTERESTS

26 CFR 1.673(a)–1: Reversionary interests; income payable to beneficiaries other than certain charitable organizations. — Rev. Rul. 58–242
(Also Sections 677, 2503, 2512; 1.677(a)–1.)
(Also Part II, Section 1005, Regulations 108, Section 86.19(f).)

Federal income and gift tax treatment of an irrevocable, reversionary trust, the income of which is for the benefit of individuals other than the grantor, and which terminates more than ten years from the creation of the trust, or upon the earlier deaths of the beneficiaries.

Advice has been requested concerning the Federal income and gift tax treatment of an irrevocable, reversionary trust, the income of which is for the benefit of individuals other than the grantor and which terminates ten years and six months from the creation of the trust, or upon the earlier deaths of the beneficiaries.

On October 15, 1955, the taxpayer entered into a trust agreement with a bank and transferred to the trust a certain amount of cash. Under the agreement, the bank is the trustee of the trust. The in-

come beneficiary of the trust is the taxpayer's daughter during the daughter's lifetime, but in no event is the term of the trust to extend beyond April 15, 1966. In the event of the daughter's death during the term of the trust, the income of the trust becomes payable in equal shares to any surviving children of the grantor; and, if there are no surviving children of the grantor then living, the trust income is to be paid to the grantor's husband during his lifetime, but in no event beyond April 15, 1966. On termination of the trust, the trustee is to pay over the principal of the trust to the grantor, or to the grantor's estate in the event that the grantor is not living at that time. The trust agreement is irrevocable and is not subject to modification. Neither the grantor nor her husband has retained any administrative powers over the trust or the trust property. The period of the trust is therefore for ten years and six months, or until the earlier deaths of the beneficiaries.

Section 671 of the Internal Revenue Code of 1954 provides, in part, that the grantor of a trust shall include, in computing his taxable income and credits, those items of income, deduction, and credit against tax which are attributable to or included in any portion of a trust of which he is treated as the owner under the provisions of section 673 to 677, inclusive, of the Code.

Section 673(a) of the Code provides, in part, that a grantor, in general, is treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or income if, at the inception of the trust, the grantor's interest will or may reasonably be expected to take effect in possession or enjoyment within ten years commencing with the date of transfer of that portion of the trust. Section 1.673(a)-1(b) of the Income Tax Regulations provides, in part, that if the grantor's reversionary interest is to take effect on or after the death of an income beneficiary or upon the expiration of a specific term of years, whichever is earlier, the grantor is treated as the owner if the specific term of years is less than ten years (but not if the term is ten years or longer).

Even though the duration of the trust may be such that the grantor is not treated as the owner under section 673 of the Code, and therefore is not taxed on the "ordinary income" of the trust (*i. e.*, income for trust accounting purposes), he may nevertheless be treated as an owner under section 677(a)(2) of the Code if he has a reversionary interest in the corpus of the trust.

Section 677(a)(2) of the Code provides that if income is held or accumulated in any taxable year for future distribution to the grantor, the grantor shall be treated as an owner for that taxable year.

Under the law of the state in which the trust was created, capital gains realized by the trust must be added to the trust corpus. Since the principal of the trust is to be paid over by the trustee to the grantor on April 15, 1966, or upon the earlier deaths of the beneficiaries, any capital gains realized by the trust must be "held or accumulated for future distribution to the grantor." Under the provisions of section 677(a)(2) of the Code, the grantor is therefore considered as owner of the portion of the trust to which any capital gains are attributable.

Section 86.19(f) of Regulations 108, applicable to the gift tax provisions of the 1954 Code by authority of Treasury Decision 6091,

C. B. 1954–2, 47, provides, in part, that where a donor transfers property in trust or otherwise after December 31, 1951, and retains an interest therein, the value of the gift for Federal gift tax purposes is the value of the property transferred less the value of the donor's retained interest. Section 86.19(f) further provides that where the gift consists of the right to receive income during the life of one person only, or for a term certain, the donor's retained interest should be valued in accordance with Table I or II of that section. In several other situations, a special factor is necessary. See section 86.19(f)(5) for the circumstances under which a special factor is furnished by the Commissioner when required, as in the instant case.

Section 2503(b) of the Code provides, in part, that in the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1955 and subsequent calendar years, the first $3,000 of such gifts to such person shall not be included in the total amount of gifts made during such year for Federal gift tax purposes.

Accordingly, it is held that the ordinary income of the irrevocable trust described herein which is distributable to individual beneficiaries other than the grantor, the principal of which reverts to the grantor or to her estate after a period of more than ten years, or upon the earlier deaths of the beneficiaries, is taxable to such beneficiaries under subpart B or subpart C of part I of subchapter J of the Code. Where applicable state law requires that capital gains realized by the trust must be added to the trust corpus, and the grantor retains no right or power other than that of reversionary interest in the corpus, the grantor must include the capital gains in the computation of her taxable income for the taxable year in which they were realized by the trust under section 677 of subpart E of part I of subchapter J of the Code.

The value of the gift, for Federal gift tax purposes, is measured by the value of the property passing from the donor, minus the ascertainable value of the donor's retained interest in such property, actuarially computed. See section 86.19(f)(5) of Regulations 108. The donor's gift to the primary donee, consisting of the right to receive the income from the property for ten years and six months or until prior death, constitutes a gift of a present interest for purposes of the $3,000 gift tax exclusion provided by section 2503(b) of the Code.

SECTION 676.—POWER TO REVOKE

26 CFR 1.676–1: Power to revert title to portion property in grantor, general rule.

A personal trust transferred by the grantor, subject to power of revocation. See Rev. Rul. 58–2, page 236.

SECTION 677.—INCOME FOR BENEFIT OF GRANTOR

26 CFR 1.677(a)–1: Income for benefit of grantor.

Income from portion of a reversionary trust for benefit of individuals other than grantor which are accumulated for future distribution to grantor under applicable State law. See Rev. Rul. 58–242, page 251.

PART II.—INCOME IN RESPECT OF DECEDENTS

SECTION 691.—RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS

26 CFR 1.691(b)–1: Allowance of deductions and credit in respect of decedents. Rev. Rul. 58–69

Circumstances under which the executor or administrator of an estate may deduct real estate taxes paid by the estate on real property not subject to administration.

Advice has been requested relative to the circumstances under which an executor or administrator of an estate is entitled to deduct real estate taxes paid by the estate on real property not subject to administration.

The question as to the deductibility of real estate taxes arises in those cases where such taxes are a charge against the property at the date of death of the decedent and are paid by the executor or administrator of the estate.

Section 691(b) of the Internal Revenue Code of 1954 provides that the amount of any deduction specified in section 164 (relating to taxes) in respect of a decedent which is not properly allowable to the decedent in respect of the taxable period in which falls the date of his death, or a prior period, shall be allowed to the estate of the decedent for the taxable year in which paid, if the estate is liable to discharge the obligation.

It is well established that the allowance of a deduction for payment of taxes must be based upon liability for such taxes. If the real estate was not subject to the possession of the executor, that is, not subject to administration, then the executor is entitled to a deduction for the real estate taxes paid by the estate only to the extent that such taxes were a charge against the real estate at the date of death of the decedent.

If under the laws of the particular jurisdiction the executor is not required to pay the real estate taxes and has not taken over the property under court order, but pays the taxes, he would not be entitled to a deduction for the taxes. However, if the payment by the executor was in behalf of a beneficiary of the estate who was or would be entitled to income from the estate, then the deduction would be allowable under section 661 of the Code if the payment of the taxes was made by the executor in lieu of a direct payment to the beneficiary.

In view of the foregoing, it is held that in those jurisdictions which require the executor or administrator of the estate of a decedent to pay real estate taxes which, prior to death of the decedent, have become a charge against the real estate of the decedent, the tax so paid by the executor or administrator is allowable under the provisions of section 691(b)(1)(A) of the Code as a deduction on the fiduciary income tax return of the estate for the taxable year in which

paid. On the other hand, if the executor or administrator is not required to pay the taxes, but does so, then if the payment was in behalf of a beneficiary entitled to the income from the estate a deduction would be allowable under section 661 of the Code if made in lieu of a direct payment to the beneficiary.

SUBCHAPTER K.—PARTNERS AND PARTNERSHIPS

PART I.—DETERMINATION OF TAX LIABILITY

SECTION 704.—PARTNER'S DISTRIBUTIVE SHARE

26 CFR 1.704–1: Partner's distributive share. Rev. Rul. 58–243

> The fact that a husband and wife cannot legally be partners under state law does not necessarily prevent recognition of such a partnership for Federal income tax purposes. Conversely, the fact than an asserted husband and wife partnership would be valid under state law does not necessarily require recognition of such partnership for Federal income tax purposes.

Hereby modified are:

G. C. M. 450, C. B. V–2, 49 (1926) (Arkansas).
I. T. 1744 C. B. II–2, 179 (1923) (California).
S. M. 2964, C. B. IV–1, 171 (1925) (Colorado).
G. C. M. 433, C. B. V–2, 177 (1926) (Connecticut).
G. C. M. 3421, C. B. VII–1, 106 (1928) (District of Columbia).
G. C. M. 2448, C. B. VI–2, 69 (1927) (Florida).
S. M. 5042, C. B. V–1, 68 (1926) (Georgia).
I. T. 2321, C. B. V–2, 52 (1926) (Iowa).
I. T. 2240, C. B. IV–2, 60 (1925) (Kansas).
S. M. 4277, C. B. IV–2, 58 (1925) (Minnesota).
S. R. 6998, C. B. V–1, 268 (1926) (Nebraska).
G. C. M. 5761, C. B. VIII–1, 109 (1929) (New York).
G. C. M. 3034, C. B. VII–1, 104 (1928) (North Carolina).
I. T. 2022, C. B. III–1, 9 (1924) (Oregon).
S. M. 5411, C. B. V–1, 271 (1926) (Pennsylvania).
S. M. 3391, C. B. IV–1, 42 (1925) (South Carolina).
I. T. 1371, C. B. I–1, 208 (1922) (Maine).
S. R. 7199, C. B. V–1, 269 (1926) (Michigan).
S. R. 2863, C. B. IV–1, 174 (1925) (Texas).
S. M. 3917, C. B. IV–2, 189 (1925) (Vermont).

Advice has been requested whether the fact that a husband and wife partnership is invalid under state law would have any effect upon the recognition of the partnership for Federal income tax purposes.

In early published rulings, an attempt was made to distinguish between those states which permitted partnerships between a husband and wife and those which did not, for the purpose of recognizing or not recognizing them for Federal income tax purposes.

However, numerous court decisions have held that a bona fide partnership between a husband and wife would be recognized for Federal income tax purposes, despite provisions of state law to the contrary. See, for example, *Willis B. Anderson* v. *Commissioner*,

6 T. C. 956, acquiescence C. B. 1946–2, 1; *Francis A. Parker* v. *Commissioner*, 6 T. C. 974, acquiescence C. B. 1946–2, 4; *Felix Zukaitis* v. *Commissioner*, 3 T. C. 814, acquiescence C. B. 1944, 31; *R. E. Wing* v. *Commissioner*, 17 B. T. A. 1028, acquiescence C. B. IX–1, 59 (1930); *Alfred T. Wagner* v. *Commissioner*, 17 B. T. A. 1030, acquiescence C. B. IX–1, 56 (1930); and *Albert Kahn* v. *Commissioner*, 14 B. T. A. 125, acquiescence C. B. VIII–2, 27 (1929).

In *Commissioner* v. *Frances E. Tower*, 327 U. S. 280, Ct. D. 1670, C. B. 1946–1, 11, the Supreme Court of the United States stated in part:

> But Michigan cannot by its decisions and laws governing questions over which it has final say, also decide issues of Federal tax law and thus hamper the effective enforcement of a valid Federal tax levied against earned income.

While the Court was specifically concerned with the effect of Michigan law on Federal income tax matters, the principle stated is equally applicable to the law of other states. Further, in I. T. 3986, C. B. 1949–2, 108, it was also recognized that, even though a partnership is valid under state law, such "partnership" need not be recognized for Federal income tax purposes. Compare section 5 of Mimeograph 6767, C. B. 1952–1, 111, at 118, and section 1.704–1(e)(2) (viii) of the Income Tax Regulations relative to the effect of state law as to the disabilities of minor children.

Although prior rulings in this area have not been specifically revoked, they have clearly been overruled by the later court decisions. Accordingly, the fact that a husband and wife could not legally become partners under state law does not necessarily prevent the recognition of the partnership for Federal income tax purposes. Conversely, following the reasoning in the *Frances E. Tower* case, *supra*, the fact that an asserted husband and wife partnership would be valid under state law does not necessarily require recognition of such partnership for Federal income tax purposes.

To the extent the following rulings are contrary to the principle herein expressed, they are modified:

G. C. M. 450, C. B. V–2, 49 (1926) (Arkansas).
I. T. 1744, C. B. II–2, 179 (1923) (California).
S. M. 2964, C. B. IV–1, 171 (1925) (Colorado).
G. C. M. 433, C. B. V–2, 177 (1926) (Connecticut).
G. C. M. 3421, C. B. VII–1, 106 (1928) (District of Columbia).
G. C. M. 2448, C. B. VI–2, 69 (1927) (Florida).
S. M. 5042, C. B. V–1, 68 (1926) (Georgia).
I. T. 2321, C. B. V–2, 52 (1926) (Iowa).
I. T. 2240, C. B. IV–2, 60 (1925) (Kansas).
S. M. 4277, C. B. IV–2, 58 (1925) (Minnesota).
S. R. 6998, C. B. V–1, 268 (1926) (Nebraska).
G. C. M. 5761, C. B. VIII–1, 109 (1929) (New York).
G. C. M. 3034, C. B. VII–1, 104 (1928) (North Carolina).
I. T. 2022, C. B. III–1, 9 (1924) (Oregon).
S. M. 5411, C. B. V–1, 271 (1926) (Pennsylvania).
S. M. 3391, C. B. IV–1, 42 (1925) (South Carolina).
I. T. 1371, C. B. I–1, 208 (1922) (Maine).
S. R. 7199, C. B. V–1, 269 (1926) (Michigan).
S. R. 2863, C. B. IV–1, 174 (1925) (Texas).
S. M. 3917, C. B. IV–2, 189 (1925) (Vermont).

PART III.—DEFINITIONS

SECTION 761.—TERMS DEFINED

26 CFR 1.761–1: Terms defined. Rev. Rul. 58–132

Where an operator of oil and gas properties is required to file returns for many jointly owned organizations having many members in common, Form 1099, U. S. Information Return, filed for each individual, with a list attached to each Form 1099 showing thereon all of the organizations in which such individual is a member, will meet the requirements prescribed by section 1.761–1(a)(2)(v)(a)(2) of the Income Tax Regulations, provided that, at the time of filing Forms 1099, there is also submitted a Form 1096, U. S. Annual Information Returns, for each such organization whose members have availed themselves of the election under section 761 of the Internal Revenue Code of 1954.

Advice has been requested whether a literal compliance with section 1.761–1(a)(2)(v)(a)(2) of the Income Tax Regulations by a company engaged in the principal activity of operating oil and gas properties for various co-owners is necessary where many of the members in a large number of the organizations are the same individuals.

In the instant case, the company was engaged in the principal activity of operating oil and gas properties for various co-owners. Certain of the properties were considered to be covered by the definition of "partnership" under the provisions of section 761 of the Internal Revenue Code of 1954 and the partnerships were given the option to be excluded from the provisions of subchapter K of chapter 1 of the Code, relating to partners and parternerships. The operator caused to be filed the appropriate partnership returns in which elections were made on behalf of all the members to be excluded from the provisions of subchapter K of chapter 1 of the Code. Partnership returns were filed for 60 jointly owned organizations and each return contained a list of all of the members of the organization. Each organization listed approximately 75 members as an average, which resulted in a listing of approximately 4,500 persons. Many of the persons are members in more than one of the organizations. Consequently, there is a considerable amount of duplication.

Section 1.761–1(a)(2)(v) of the Income Tax Regulations provides, in part, as follows:

(a) An organization which elects under subdivision (iv)(a) of this subparagraph to be excluded from all of subchapter K shall file the following:

(1) For the first taxable year for which it wishes to be excluded: a partnership return, as provided in subdivision (iv)(a) of this subparagraph;

(2) For each subsequent taxable year for which it is excluded: Form 1096 for the organization and a Form 1099 for each person who was a member of the organization during any part of the calendar year. Form 1099 shall show the name and address of the organization (under "By Whom Paid"). In lieu of "Kind and Amount of Income paid", each Form 1099 shall state "Filed under section 761(a)" and the principal activity of the organization. Forms 1096 and 1099 shall be filed with the Commissioner of Internal Revenue, Midwest Service Center, Kansas City, Missouri.

The requirement for filing U. S. Information Return, Form 1099, as set forth in section 1.761–1(a)(2)(v) of the regulations, is for the purpose of informing the Internal Revenue Service annually of the membership of the unincorporated organizations which have elected to be excluded from all the provisions of subchapter K. Such forms

are not intended to be used in the same sense as information returns, Form 1099, required to be filed under other provisions of the Code.

Accordingly, it is held that where an operator of oil and gas properties is required to file returns for many jointly owned organizations which have the same membership, Form 1099, filed for each individual, with a list attached to each Form 1099 showing thereon all of the organizations in which such individual is a member, will meet the requirements prescribed by section 1.761–1(a)(2)(v)(a)(2) of the regulations, provided that at the time of filing Forms 1099, there is also submitted a U. S. Annual Information Return, Form 1096, for each such organization whose members have availed themselves of the election under section 761 of the Code.

The above ruling is applicable to any unincorporated organization described in subdivision (ii) or (iii) of section 1.761–1(a)(2) of the regulations.

A partnership created by an operating agreement involving a mineral lease. See Rev. Rul. 58–166, page 324.

SUBCHAPTER L.—INSURANCE COMPANIES

PART I.—LIFE INSURANCE COMPANIES

Subpart A.—1955 Formula

SECTION 802.—TAX IMPOSED

The 1955 formula for taxing the income of life insurance companies will also apply to taxable years beginning in 1957. See P. L. 85–345, page 632.

SECTION 803.—INCOME AND DEDUCTIONS

26 CFR 1.803–4: Taxable income and deductions. Rev. Rul. 58–225
(Also Part II, Section 201(c); Regulations 118, Section 39.201–7.)

> Interest collected in advance constitutes taxable income in the year received, even though the lender employs the accrual method of accounting and is required by state authorities to report only earned interest as income and to set up reserves for unearned interest.

Advice has been requested regarding the treatment of interest collected in advance by insurance companies on outstanding loans in cases where the companies are required by state authorities to report only earned interest as income and to set up reserves for unearned interest.

A life insurance company, employing the accrual method of accounting, made loans to policyholders on which interest was paid to the company annually in advance. The insurance commissioner of the state required the company to report, as income, the earned interest on outstanding loans and to set up a reserve for unearned

interest as of December 31st of each year. The specific question presented is whether the unearned interest received during a taxable year is includible in gross income for the year in which received.

In *North American Oil Consolidated* v. *David Burnet*, 286 U. S. 417, Ct. D. 499, C. B. XI–1, 293 (1932), it was held in part that "If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, * * *." The principle of the *North American Oil Consolidated* case is equally applicable to the facts in the instant case.

Accordingly, interest collected in advance constitutes taxable income in the year received, even though the lender employs the accrual method of accounting and is required by state authorities to report earned interest as income and to set up reserves for unearned interest.

Subpart B.—1942 Formula

SECTION 811.—TAX IMPOSED

The 1955 formula for taxing the income of life insurance companies will also apply to taxable years beginning in 1957. See P. L. 85–345, page 632.

SUBCHAPTER M.—REGULATED INVESTMENT COMPANIES

SECTION 852.—TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS

26 CFR 1.852–4: Method of taxation of policy holders of regulated investment companies.

Use of substitutes for Form 2439, Notice to Shareholder of Undistributed Long-term Capital Gains, see Rev. Proc. 58–2, page 684.

SUBCHAPTER N.—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

SECTION 861.—INCOME FROM SOURCES WITHIN THE UNITED STATES

26 CFR 1.861–8: Computation of taxable income from sources within the United States.

Exclusion of tax exempt interest in determining gross income from sources within the United States. See Rev. Rul. 58–310, page 262.

SECTION 863.—ITEMS NOT SPECIFIED IN SECTION 861 OR 862

Allocation of Western Hemisphere trade corporation deduction. See Rev. Rul. 58–56, page 335.

PART II.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

Subpart A.—Nonresident Alien Individuals

SECTION 871.—TAX ON NONRESIDENT ALIEN INDIVIDUALS

26 CFR 1.871–1: Taxation of aliens. Rev. Rul. 58–144

An alien individual serving in the Regular Army of the United States, who is present in the United States for a period of six months' military training, has the status of a nonresident alien engaged in trade or business within the United States and is liable for United States income tax on his taxable income from sources within the United States, including his compensation for services from the United States Army applicable to his stay in this country.

Advice has been requested as to the status for United States income tax purposes of a soldier, not a United States citizen, who was enlisted in the United States Army under the provisions of Public Law 597, [64 Stat. 316], and the treatment of compensation which he derived from the United States Army for a six months' training period in the United States.

Under section 4 of Public Law 597, *supra*, any alien enlisted or reenlisted in the United States Army, pursuant to the provisions of this Act, who subsequently enters the United States or an outlying possession thereof pursuant to military orders shall, if otherwise qualified for citizenship and after completion of five or more years of military service, if honorably discharged therefrom, be deemed to have been lawfully admitted to the United States for permanent residence within the meaning of section 324A of the Nationality Act of 1940, 54 Stat. 1137, 8 U. S. C. 907, as added by the Act of June 1, 1948, 62 Stat. 282, 8 U. S. C. 724(a), and now incorporated as section 329(a) of the Immigration and Nationality Act of June 27, 1952, 66 Stat. 250, 8 U. S. C. 1439.

The foregoing provisions of Public Law 597, *supra*, pertain to the status of the enlisted personnel in question for the purposes of the Immigration and Nationality Act, *supra*. They are not controlling as to the status of an individual for the United States income tax purposes.

An alien, whose stay in the United States is limited by immigration or other laws to a comparatively short period of time must be classified, for income tax purposes, as a nonresident alien. See G. C. M. 4236, C. B. VII-2, 131 (1928).

It is held that an alien individual serving in the Regular Army of the United States, who is present in the United States for a period of six months for military training, does not by reason of such stay therein become an alien resident of the United States. Accordingly, such an individual, unless residence in the United States has been otherwise established, is classified for United States income tax purposes as a nonresident alien engaged in trade or business within the United States and is liable for Federal income tax on his taxable income from sources within the United States, including his compensation for services from the United States Army which is applicable to his stay in this country.

26 CFR 1.871–7: Tax on nonresident alien individuals. Rev. Rul. 58–232

Gains from the sale or exchange of the capital assets of the estate of a deceased nonresident alien, not engaged in trade or business in the United States, are not subject to the tax imposed by section 871(a)(2) of the Internal Revenue Code of 1954, irrespective of the presence in the United States of the ancillary or domiciliary representative of such estate during the year in which such gains were realized.

Advice has been requested whether the gain, from the sale or exchange of the capital assets of a deceased nonresident alien's estate, is taxable to the extent provided in section 871(a)(2) of the Internal Revenue Code of 1954 where the ancillary and/or the domiciliary representative of such estate are present in the United States during the taxable year in which such gain is realized.

At the time of his death the decedent was a resident and citizen of a foreign country. His widow, also a citizen and resident of such foreign country, was appointed the domiciliary administratrix of her husband's estate. Neither the decedent nor his widow was engaged in trade or business in the United States. An ancillary administrator, a citizen and resident of the United States, was appointed by a state court to dispose of stock in several United States corporations held in the estate.

During the taxable year in which such stock was disposed of, the domiciliary administratrix was present in the United States for one period of over 90 days while the ancillary administrator was present during the year.

Section 871(a)(2) of the Code provides, in part, as follows:

> (2) CAPITAL GAINS OF ALIENS TEMPORARILY PRESENT IN THE UNITED STATES.—In the case of a nonresident alien individual not engaged in trade or business in the United States, there is hereby imposed for each taxable year, in addition to the tax imposed by paragraph (1)—
>
> (A) if he is present in the United States for a period or periods aggregating less than 90 days during such taxable year—a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from sales or exchanges of capital assets effected during his presence in the United States exceed his losses, allocable to sources within the United States, from such sales or exchanges effected during such presence; or
>
> (B) if he is present in the United States for a period or periods aggregating 90 days or more during such taxable year—a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from sales or exchanges of capital assets effected at any time during such year exceed his losses, allocable to sources within the United States, from such sales or exchanges effected at any time during such year.

The appointment of an ancillary administrator is merely one of several means by which parties interested in the decedent's estate secure recognition of rights under local law and an administration consonant therewith. Appointment of an ancillary administrator within the United States for the estate of a nonresident alien decedent subject to domiciliary administration in a foreign country does not create a new taxable entity which may be treated as a domestic estate.

Accordingly, it is held that gains from the sale or exchange of the capital assets of the estate of a deceased nonresident alien, not engaged

in trade or business in the United States, are not subject to the tax imposed by section 871(a)(2) of the Code, irrespective of the presence in the United States of the ancillary and/or the domiciliary representative of the estate during the year in which such gains were realized.

Taxability of a total distribution, payable in one taxable year of a nonresident alien distributee residing in Canada, from a qualified employees' trust, on account of separation from the service of an employee. See Rev. Rul. 58–247, page 623.

Taxability of total distribution payable in one taxable year, with respect to an employee who is a nonresident alien residing in Australia, under an employees' exempt trust on account of the employee's death or other separation from service. See Rev. Rul. 58–248, page 621.

---

26 CFR 1.871–8: Definition of engaging in trade or business within the United States.

Taxability of a purse won in an international horse race in the United States by a citizen and resident of France who owned and operated a horse racing stable for profit. See Rev. Rul. 58–63, page 624.

Subpart B.—Foreign Corporations

SECTION 882.—TAX ON RESIDENT FOREIGN CORPORATIONS

26 CFR 1.882–3: Deductions allowed foreign corporations. (Also Section 861; 1.861–8.) Rev. Rul. 58–310

In determining the ratable part of the United Kngdom tax, paid by British corporations (other than insurance companies, exclusive of life or mutual), allowable as a deduction in computing taxable income from sources within the United States, based upon the ratio of gross income from sources within the United States to the total gross income, dividends received from domestic corporations are includible in the numerator of the fraction. Tax exempt interest, however, is not so includable since it does not constitute gross income from sources within the United States and since no deduction is allowable for the amount of any item or part thereof allocable to a class or classes of exempt income.

Revenue Ruling 55–532, C. B. 1955–2, 592, clarified.

The Internal Revenue Service has been requested to clarify the provisions of Revenue Ruling 55–532, C. B. 1955–2, 592, with respect to the extent of its application to United Kingdom corporations, other than insurance companies, doing business in the United States, the principal point being whether, in the determination of United States gross income, tax exempt interest and 85 percent of the dividends received from domestic corporations are included.

Revenue Ruling 55–532 applied the established rule for determination of the ratable part of United Kingdom taxes paid by British insurance companies, other than life or mutual, doing business in the United States which is deductible for Federal income tax purposes. In computing the ratable amount to be allowed as a deduction in computing the net income from United States sources, it was held that the tax exempt interest and 85 percent of the dividends received from domestic corporations are excluded as part of gross income from sources within the United States but are included in total gross income from all sources. However, the position taken in the decisions of which Revenue Ruling 55–532 was based is not applicable to cases involving other than insurance companies, since that position was based in large part on the special prohibition of double deductions contained in section 204 (e) of the Internal Revenue Code of 1939, (section 832 (e) of the 1954 Code). See the *Third Scottish American Trust Co., Limited* v. *The United States*, 37 Fed. Supp. 279, Ct. D. 1525, C. B. 1941–2, 209; *London and Lancashire Inc., Co. Ltd.* v. *Commissioner*, 34 B. T. A. 295.

In determining the ratable part of the United Kingdom tax, paid by British corporations (other than insurance companies exclusive of life or mutual), allowable as a deduction in computing taxable income from sources within the United States, which under section 1.861–8(a) of the Income Tax Regulations under the 1954 Code is based upon the ratio of gross income from sources within the United States to the total gross income, dividends received from domestic corporations are includible in the numerator of the fraction. *Third Scottish American Trust Co., Ltd.*, v. *United States*, *supra*. Tax exempt interest, however, is not so includable since it does not constitute gross income from sources within the United States, and since no deduction is allowable for the amount of any item or part thereof allocable to a class or classes of exempt income. Waldorf Astor, 31 B. T. A. 1009. See section 1.861–8(d) of the regulations.

PART III.—INCOME FROM SOURCES WITHOUT THE UNITED STATES

Subpart A.—Foreign Tax Credit

SECTION 901.—TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES

(Also Section 903.) Rev. Rul. 58–3

Taxes imposed by the Federal Government of Mexico under the Mercantil Revenue Law of December 30, 1947, as amended, do not constitute income taxes within the meaning of section 901 or taxes in lieu of income taxes within the meaning of section 903 of the Internal Revenue Code of 1954 and are not allowable as a credit under section 901 of the Code.

Advice has been requested whether taxes imposed by the Federal Government of Mexico under the Mercantil Revenue Law of December 30, 1947, as amended, constitute income taxes within the meaning of section 901 or taxes in lieu of income taxes within the meaning of section

903 of the Internal Revenue Code of 1954 and are allowable as a credit under section 901 of the Code.

The translation of the Mercantil Revenue Law of Mexico, dated December 30, 1947, as amended, as submitted by the taxpayer, reads in part as follows:

ARTICLE 1.—The tax on mercantile revenue burdens the revenue obtained from the following sources, in the manner outlined in the following Articles:

I—From the alienation of property.
II—From the leasing of property.
III—From the rendering of services.
IV—From commissions and mercantile mediations.

ARTICLE 2.—"Revenue" is any amount in cash, in property, in services, in securities, in negotiable instruments, in book credits or in other form obtained by parties subject to this tax, as a result of operations taxed by this Law.

ARTICLE 3.—The tax shall be payable on the total revenue from operations taxed by this Law, at the moment such operation is effected, even though it be on an installment or credit plan, including the overprice, interest or any other benefit which increases such revenue.

ARTICLE 10.—The party liable for this tax is the individual or concern habitually receiving revenue from operations taxed by this law or which takes effect within Mexican Territory. [This article was added by Decree of December 27, 1954 in terms which showed applicability of the tax to sales transactions and which permitted the seller to pass on the tax to the buyer or user of the service by adding it to the purchase price or price of services rendered.]

ARTICLE 14.—The tax shall be payable at the rate of 18 per mil on the total amount of the taxable revenue.

The Mexican law taxes specified operations from which certain types of receipts are derived, and the liability for the tax arises at the time the operation subject to the tax takes place, whether or not income in the constitutional sense results. Although these receipts are made up at least in part of items which fall within the United States concept of taxable income, the tax apparently is imposed on the transactions rather than on the income derived therefrom. The mercantile tax law is separate and apart from the Mexican income tax law (the Ley del Impuesto sobre la Renta) which has been held by the Internal Revenue Service in several rulings to impose an income tax with respect to certain categories of income. I. T. 3787, C. B. 1946-1, 232; I. T. 3385, C. B. 1940-1, 103; I. T. 3683, C. B. 1944, 290. Payment of the mercantile tax does not relieve a taxpayer from payment of the income tax imposed by the Ley del Impuesto sobre la Renta.

Accordingly, it is held that taxes imposed by the Federal Government of Mexico under the Mercantil Revenue Law of December 30, 1947, as amended, do not constitute income taxes within the meaning of section 901 or taxes in lieu of income taxes within the meaning of section 903 of the Internal Revenue Code of 1954 and, consequently, are not allowable as a credit under section 901 of the Code.

SECTION 903.—CREDIT FOR TAXES IN LIEU OF INCOME, ETC., TAXES

Whether taxes imposed under the Mexican Mercantil Revenue Law of December 30, 1947, as amended, constitute taxes in lieu of income taxes. See Rev. Rul. 58-3, page 263.

SECTION 904.—LIMITATION ON CREDIT

Treatment of Western Hemisphere trade corporation deduction in computing the limitation of the foreign tax credit allowable. See Rev. Rul. 58–56, page 335.

SECTION 905.—APPLICABLE RULES

Rev. Rul. 58–244

Where a liability for additional Federal income tax arises out of a redetermination of the tax as the result of the receipt by the taxpayer of a refund of foreign tax for which credit was taken on his United States income tax return for a prior year, no interest may be assessed or collected on the additional amount due, pursuant to section 6601 of the Internal Revenue Code of 1954, for any period prior to the receipt of the refund of the foreign tax except to the extent that interest was paid by the foreign country on such refund for such period.

The Internal Revenue Service has been requested to clarify its position with respect to the assertion of interest on an assessment for additional Federal income tax resulting from an adjustment in the amount of the foreign tax credit, based upon a refund of foreign taxes, under the provisions of section 905 of the Internal Revenue Code of 1954.

The need for clarification has become evident in view of the misconstruction placed upon the interest provision of section 905(c) of the Code by numerous taxpayers. A typical example may be seen in the case of a taxpayer who received a refund of foreign taxes attributable to a prior year and for which credit under section 901 of the Code was claimed and allowed as of that year. The taxpayer made no report of this refund for the purpose of the recomputation under section 905 until two years later. The taxpayer contended that the total interest on the additional tax due was limited by section 905(c) of the Code to the amount of interest received from the foreign government.

Section 6601 of the Code provides in part that:

If any amount of tax imposed by this title * * * is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

Under the general rule outlined in section 6151 of the Code, the last date prescribed for payment of the tax with respect to which a return is required is "the time . . . fixed for filing the return."

Section 905(c), *supra*, like its predecessor, section 131(c) of the Internal Revenue Code of 1939 relates to refunds of foreign tax to taxpayers and the resulting redetermination of their United States tax liability. Under this section, the additional tax which arises as a result of the foreign tax refund must be paid on notice and demand by the Secretary of the Treasury or his delegate. But is is provided therein that:

No interest shall be assessed or collected on any amount of tax due on any redetermination by the Secretary or his delegate, resulting from a refund to the taxpayer for any period before the receipt of such refund, except to the extent interest was paid by the foreign country or possession of the United States on such refund for such period.

Accordingly, it is held, with respect to any additional tax due as redetermined pursuant to section 905(c) of the Code, that the interest imposed by section 6601 for the period prior to the date of the refund of the foreign tax may be assessed and collected only to the extent that interest was paid by the foreign country on such refund for such period, and that the interest imposed by section 6601 of the Code for the period from the date of such refund to the date of payment is collectible at the rate of six percent per annum.

---

26 CFR 1.905–1: When credit for taxes may be taken.
(Also Section 164; 1.164–1.)
(Also Part II, Sections 23(c), 131(d); Regulations 118, Sections 39.23(c)–1, 39.131(d)–1.)

Rev. Rul. 58–55

The "contested tax" doctrine, as expressed in *Dixie Pine Products Company* v. *Commissioner*, 320 U. S. 516, Ct. D. 1598, C. B. 1944, 509, does not apply to the accrual of foreign taxes for the purpose of the credit provided in section 901 of the Internal Revenue Code of 1954 and section 131 of the Internal Revenue Code of 1939. A foreign tax is accruable for the purpose of such credit for the taxable year to which it relates even though the taxpayer contests the liability therefor and such tax is not paid until a later year. Such accrual, however, cannot be made until the contested liability is finally determined.

Pursuant to the authority contained in section 7805(b) of the Internal Revenue Code of 1954, the principles stated herein will not, where adverse to the taxpayer, be applicable to taxes in respect of a taxable year ended prior to February 24, 1958.

Advice has been requested whether a taxpayer may consider a foreign tax accrued for the purpose of the foreign tax credit if the liability therefor is disputed and can not be reasonably fixed.

In *Dixie Pine Products Company* v. *Commissioner*, 320 U. S. 516, Ct. D. 1598, C. B. 1944, 509, the Supreme Court of the United States held that a taxpayer, employing the accrual method of accounting, could not accrue and deduct the amount of gasoline tax assessed against it by the State taxing authorities, so long as such taxes were contested by the taxpayer; and that the taxpayer may claim a deduction for such tax only for the taxable year in which the liability therefor is finally adjudicated.

However, in the case of *The Cuba Railroad Company* v. *United States*, 124 Fed. Supp. 182, the court held, so far as pertinent, that taxes paid to Cuba constituted a proper accrual for the purpose of the foreign tax credit for the year to which they relate irrespective of the fact that such taxes were contested and paid in a later year. Thus, the court rejected the "contested tax" doctrine in cases involving the accrual of a foreign tax under section 131(d) of the Internal Revenue Code of 1939, now section 905(a) of the Internal Revenue Code of 1954, for the purpose of the foreign tax credit.

Section 901(a) of the 1954 Code provides for the allowance of a credit against United States income tax, for taxes paid or accrued during the taxable year to a foreign country or to a possession of the United States, subject to the limitation of section 904 of the Code.

Section 905(a) of the 1954 Code provides that the credit for foreign taxes 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 possession of the United States accrued, subject to the adjustments prescribed in section 905(c) of the Code.

The basic purpose of the allowance of a foreign tax credit is to provide a credit against United States income tax on specific income from foreign sources for foreign taxes paid on such income and in this manner to substantially avoid double taxation on the income when earned. See H. R. Report No. 767, 65th Congress, Second Session, C. B. 1939–1 (Part 2), 86, at page 93. The alternative provisions of section 905(a) of the 1954 Code allowing a credit for foreign taxes when the tax accrued, irrespective of the accounting method used, demonstrate the special nature of such credit. The purpose of this provision of the Code was to allow a taxpayer, employing the cash method of accounting, to take the credit in the year in which the foreign tax accrued and thus offset the foreign tax against United States Federal income tax due. See H. R. Report No. 179, 68th Congress, First Session, C. B. 1939–1 (Part 2), 241, at page 257, and Senate Report No. 398, 68th Congress, First Session, C. B. 1939–1 (Part 2), 266, at page 284.

It is to be noted that the provisions are strictly statutory and do not relate to usual accounting practice. Section 905(c) of the 1954 Code and section 131(c) of the 1939 Code provide a separate and distinct method of correcting differences in taxes claimed as a credit and taxes finally paid. Under these provisions the Commissioner may call for additional taxes due by notice and demand without facing the bar of the ordinary statute of limitations. Similarly, section 6511(d)(3) of the 1954 Code, which provides a ten-year statutory period of limitations, with respect to refunds relating to the credit for foreign taxes, evidences Congressional intent of separate treatment of the foreign tax credit.

However, the accrual of foreign taxes, for the purpose of the foreign tax credit under section 901 of the 1954 Code and section 131 of the 1939 Code, must conform to the general rules laid down under section 461 of the 1954 Code or section 43 of the 1939 Code. Under such rules the accrual for the contested taxes cannot be made until the liability is finally determined, but, under the principles stated in *The Cuba Railroad Company* case, and in view of the special nature of the foreign tax credit as evidenced by its legislative history and concept, such accrual will relate back to the taxable year for which the foreign tax is in dispute.

Accordingly, in view of the statutory framework, the legislative history and the concept of the foreign tax credit, it is held that the "contested tax" doctrine as expressed in the *Dixie Pine Products Company* case is not applicable to the accrual of a foreign tax for the purpose of the credit under section 901 of the 1954 Code or section 131 of the 1939 Code. A foreign tax for the purpose of such credit is accruable for the taxable year to which it relates even though the taxpayer contests the liability therefor and such tax is not paid until a later year. Such accrual, however, cannot be made until the contested liability is finally determined.

The above-principles are not intended to affect the taxable year of the accrual of the deduction for foreign taxes under section 164 of the 1954 Code or section 23(c) of the 1939 Code, as distinguished from the accrual of credits for such taxes under section 905(a) of the 1954 Code or section 131(d) of the 1939 Code. The principles enunciated in the *Dixie Pine Products Company* case, *supra*, will continue to be applicable to the accrual of foreign taxes for the purposes of the deductions under section 164 of the 1954 Code or section 23(c) of the 1939 Code.

Since this Revenue Ruling modifies a prior position of the Internal Revenue Service on which taxpayers have relied in computing their foreign tax credit, pursuant to the authority contained in section 7805(b) of the Internal Revenue Code of 1954, the principles stated herein will not, where adverse to the taxpayer, be applicable to taxes in respect of a taxable year ended prior to February 24, 1958.

---

26 CFR 1.905–3: Redetermination of the tax when credit proves incorrect.

Redetermination of foreign tax credit upon receipt of refund of all or a part of such foreign tax. See Rev. Rul. 58–237, page 534.

SUBPART B.—EARNED INCOME OF CITIZENS OF UNITED STATES

SECTION 911.—EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES

26 CFR 1.911–1: Earned income from sources without the United States. Rev. Rul. 58–4

A citizen of the United States, employed on a vessel owned, or owned for the time being, by an agency of the United States and operated by the United States, is paid wages by a private shipping line as agent of the United States from funds provided specifically for that purpose by the United States. Such compensation constitutes an amount paid by the United States or an agency thereof within the meaning of section 911(a) of the Internal Revenue Code of 1954 and is not excludable from gross income under section 911(a)(2) of the Code even though the employee may be physically present in a foreign country or countries for 510 full days or more of an 18 consecutive month period to which such wages are attributable. Section 1(a) of the Clarification Act of March 24, 1943, 57 Stat. 45, 50 U. S. C. 1291(a), affords no basis for holding that such compensation is entitled to exemption from taxation under section 911(a)(2) of the Code.

Advice has been requested whether compensation received by a United States citizen, employed on a vessel owned, or owned for the time being, by the United States and paid from funds provided specifically for that purpose by the United States, is excludable from gross income under section 911(a)(2) of the Internal Revenue Code of 1954 or under section 1(a) of the Clarification Act of March 24, 1943, 57 Stat. 45, 50 U. S. C. 1291 (a), read in conjunction with that

section, when the services to which such compensation is attributable were performed under the circumstances described below.

From January 26, 1954, to July 24, 1955, inclusive, a total of 545 days, the taxpayer lived in Korea and was employed on a shuttle ship which sailed between Korea and Japan. During such period the taxpayer was not within the United States or any possession thereof. The United States, represented by the Maritime Administration, was owner, or owner for the time being, of the ship on which the taxpayer was employed. The ships are operated under a general arrangement whereby the United States, acting through the National Shipping Authority, Maritime Administration, enters into service agreements with various shipping lines for the operation of vessels of which the United States, represented by the Maritime Administration, is owner, or owner for the time being.

The instant agreement appointed a shipping line as general agent under the contract and defined the duties of the general agent. Among these duties was the procurement of a master who should be an agent and an employee of the United States. The general agent was required to procure and make available to the master, for engagement by him, the officers and men required by him to fill the complement of the vessel. This personnel was procured through usual channels and in accordance with the customary practices of commercial operators and upon the terms and conditions of the general agent's collective bargaining agreements, if any. All such personnel were paid by the general agent in the customary manner with funds provided by the United States for performing, procuring, or supplying services, and for paying all crew expenditures. Operating control of the ship was maintained by the United States through the ship's master.

The wages for the master and crew were paid out of a fund which was established by the Third Supplemental Appropriation Act (1951), 65 Stat. 52, 46 U. S. C. 1241a. That Act provides that the provisions of sections 1(a), 1(c), 3(c), and 4 of the Clarification Act of 1943, 57 Stat. 45, as amended, 50 U. S. C. 1291(a), (c), 1293(c), and 1294, amending and clarifying certain provisions of law relating to the functions of the War Shipping Administration, shall be applicable in connection with such operations and to seamen employed through general agents as employees of the United States, who may be employed in accordance with customary commercial practices in the maritime industry, notwithstanding the provisions of any law applicable in terms to the employment of persons by the United States.

Section 911 of the Internal Revenue Code of 1954 provides, in part, as follows:

> (a) GENERAL RULE.—The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:
>
> * * * * * * *
>
> (2) PRESENCE IN FOREIGN COUNTRY FOR 17 MONTHS.—In the case of an individual citizen of the United States, who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (except amounts paid by the United States or an agency thereof) if such amounts constitute earned income (as defined in subsection (b)) attributable to such period; * * *.

(b) DEFINITION OF EARNED INCOME.—For purposes of this section, the term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, * * *.

Section 1 (a) of the Clarification Act, as amended, *supra*, provides, in part, as follows:

Officers and members of crews (hereinafter referred to as "seamen") employed on United States or foreign flag vessels as employees of the United States through the War Shipping Administration shall, with respect to (1) laws administered by the Public Health Service and the Social Security Act, as amended by subsection (b) (2) and (3) of this section; (2) death, injuries, illness, maintenance and cure, loss of effects, detention, or repatriation, or claims arising therefrom not covered by the foregoing clause (1); and (3) collection of wages and bonuses and making of allotments, have all the rights, benefits, exemptions, privileges, and liabilities, under law applicable to citizens of the United States employed as seamen on privately owned and operated American vessels. * * *

If an individual travels over international waters from one place in a foreign country to a place in another foreign country and if such travel extends over a period of less than 24 hours and does not involve travel within the United States or any possession thereof, such individual shall not be deemed to have been outside a foreign country during the period of such travel for the purpose of determining whether he satisfies the minimum of 510 full days presence in a foreign country or countries. See Revenue Ruling 55–171, C. B. 1955–1, 80. The taxpayer may, therefore, satisfy the minimum requirement of 510 full days presence in a foreign country or countries even though his employment on the shuttle ship between Korea and Japan took him over international waters for part of the qualifying period. Such services were performed as an employee of the United States on a ship of which the United States was owner, or owner for the time being, and operator Cf. *Fink* v. *Shepard Steamship Co.*, 337 U. S. 810. Compensation for such services from funds provided by the United States constitutes an amount paid by the United States or an agency thereof within the meaning of section 911(a)(2) of the Code even though actual payment was made by a private shipping company acting as general agent of the United States.

Section 1(a) of the Clarification Act, *supra*, assures officers and members of crews employed on United States vessels as employees of the United States through the War Shipping Administration all the safeguards in collecting wages and bonuses and making allotments to which seamen employed on privately owned American vessels are entitled, but has no effect on the income tax liability which accrues to such seamen by reason of such earnings.

Accordingly, it is held that wages paid by a private shipping line as general agent of the United States, from funds provided for that purpose by the United States, to a citizen of the United States as compensation for services performed on a vessel owned, or owned for the time being, by an agency of the United States and operated by the United States, are not excludable from gross income under the provisions of section 911(a)(2) of the Code even though the employee may be physically present in a foreign country or countries for 510 full days or more of an 18 consecutive month period to which such wages are attributable. Section 1(a) of the Clarification Act of March 24, 1943, affords no basis for holding that such compensation is entitled to exemption from taxation under section 911(a)(2) of the Code.

Rev. Rul. 58–233

A taxpayer is employed by an American concern in a foreign country in the Mediterranean area. In traveling to this foreign country from the United States, the taxpayer was enroute more than 24 hours by airplane and, during the flight, passed over another foreign country. Less than 24 hours elapsed between the time the flight left the air space over the foreign country and the time of arrival in the foreign country in which the plane landed. Taxpayer inquires whether, in fulfilling the 510-full-day rule of presence in a foreign country or countries in order to come within the provisions of section 911(a)(2) of the Internal Revenue Code of 1954, his 510 days of presence in a foreign country or countries began on the day following the day his passport is stamped indicating entry into the foreign country in which he landed, or whether they began as of 12 o'clock midnight of the day in which his plane passed over a foreign country, even though he had not passed through customs in any foreign country prior to landing in the country of his destination. Section 1.911–1(b)(7) of the Income Tax Regulations provides that the term "foreign country" means territory under the sovereignty of a government other than that of the United States and includes the air space over such territory. Section 1.911–1(b)(10) of the regulations provides that, in computing 510 full days of presence in a foreign country or countries, if an individual travels over a route (a portion of which is not within any country) from one place in a foreign country to a place in another foreign country and if such travel not within any country extends over a period of less than 24 hours and does not involve travel within the United States or any possession thereof, such individual shall not be deemed outside a foreign country during the period of such travel. *Held*, if the aircraft in which the taxpayer traveled from the United States to the Mediterranean area passed over a foreign country before midnight of the day of his departure from the United States, the first day that may be counted in satisfaction of the 510-full-day requirement of section 911(a)(2) of the Code is the day following the day of his departure from the United States, since the taxpayer is considered to have been physically present in a foreign country when the aircraft in which he was traveling passed over such foreign country and since he is not deemed to have been outside a foreign country after passing over such foreign country. However, it will be incumbent upon the taxpayer to substantiate to the satisfaction of the Internal Revenue Service that he actually arrived in a foreign country prior to the day his passport was stamped.

Subpart C.—Western Hemisphere Trade Corporations

SECTION 921.—DEFINITION OF WESTERN HEMISPHERE TRADE CORPORATIONS

Corporations engaged in exploration activities in the Western Hemisphere outside the United States whose only sources of income is from dividends, interest, and capital gains. See Rev. Rul. 58–56, page 335.

SECTION 922.—SPECIAL DEDUCTION

Consolidated section 922 deduction where several subsidiary corporations engaged in exploration activities in the Western Hemisphere outside the United States have gross income only from dividends, interest, and capital gains. See Rev. Rul. 58–56, page 335.

SUBCHAPTER O.—GAIN OR LOSS ON DISPOSITION OF PROPERTY

PART II.—BASIS RULES OF GENERAL APPLICATION

SECTION 1012.—BASIS OF PROPERTY—COST

26 CFR 1. 1012–1 : Basis of property.

Basis of stock purchased by a corporation under the provisions of the Federal National Mortgage Association Charter Act, 12 U. S. C. 1716. See Rev. Rul. 58–41, page 86.

The treatment of the basis of property. See Rev. Rul. 58–130, page 121.

SECTION 1014.—BASIS OF PROPERTY ACQUIRED FROM A DECEDENT

26 CFR 1.1014–1 : Basis of property acquired from a decedent.

Basis of stock acquired by exercise of restricted stock options after death of the employee. See Public Law 85–320, page 628.

---

26 CFR 1.1014–6 : Special rule for adjustments to basis where property is acquired from a decedent prior to his death.

The basis of property, held as tenants by entirety, acquired by reason of the death of the husband. See Rev. Rul. 58–130, page 121.

SECTION 1016.—ADJUSTMENTS TO BASIS

26 CFR 1.1016–1 : Adjustments to basis; scope of section.

Adjustment for depreciation of property held as tenants by entirety. See Rev. Rul. 58–130, page 121.

PART III.—COMMON NONTAXABLE EXCHANGES

SECTION 1033.—INVOLUNTARY CONVERSIONS

26 CFR 1.1033(a)-2: Involuntary conversion where disposition of the converted property occured after December 31, 1950. Rev. Rul. 58-11

The sale by a corporation of its stock interest in another corporation pursuant to the order of a United States district court in an anti-trust action is not an involuntary conversion of such property as the result of its condemnation or threat or imminence thereof within section 1033 of the Internal Revenue Code of 1954. Further, if the proceeds from the sale are reinvested in similar shares of stocks in another company, there has not been a nontaxable exchange within the provisions of such section or within any provision of the income tax statute.

Advice has been requested whether the transaction described below constitutes an involuntary conversion of property within the meaning of section 1033 of the Internal Revenue Code of 1954.

M Corporation was ordered by a United States district court to dispose of its stock interest in *N* Corporation on the ground that *M* Corporation's ownership of such stock violated section 1 of the Sherman Anti-Trust Act, 26 Stat. 209, 15 U. S. C. 1–7. *M* Corporation sold its stock in *N* Corporation and immediately reinvested the proceeds from the sale in the stock of two of *N* Corporation's subsidiaries. It is the position of *M* Corporation that the forced sale of its stock in *N* Corporation was an involuntary conversion of such stock as a result of its condemnation within the meaning of section 1033; and since the proceeds from the sale were immediately reinvested in property related in use to that involuntarily converted, *M* Corporation contends that gain realized by it upon the sale comes within the nonrecognition provisions of section 1033.

Section 1033 provides for the nonrecognition of gain, under prescribed conditions, resulting from certain involuntary conversions of property into money or other property. For purposes of section 1033, an involuntary conversion is a transaction in which property has been compulsorily or involuntarily converted as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof. All involuntary conversions, then, are not covered by this section. Only those involuntary conversions which result from one of the specified causes are entitled to treatment under section 1033. See Rev. Rul. 57–314, C. B. 1957–2, 523, and cases cited therein.

Since *M* Corporation's stock interest in *N* Corporation was not destroyed, stolen, seized, requisitioned, or disposed of as the result of a threat or imminence of requisition, the involuntary conversion of such stock must have resulted from the stock's condemnation or threat or imminence thereof in order to bring the conversion within the scope of section 1033. The Service has taken the position that, as used in section 1033, the term "condemnation" refers to the process by which private property is taken for public use without the consent of the property owner but upon the award and payment of just

compensation. See Rev. Rul. 57–314, *supra.* A federal court's order to a corporation to divest itself of ownership of certain stock because such ownership is in violation of the Sherman Anti-Trust Act is not taking of the stock for public use. For this reason, a sale of the stock pursuant to such an order does not result from the stock's condemnation or from a threat or imminence of its condemnation within section 1033. In this connection, see Rev. Rul. 55–717, C. B. 1955–2, 298. Further, if the proceeds from the sale are reinvested in similar shares of stock in another company, there has not been a nontaxable exchange within the provisions of section 1033 or within any provision of the income tax statute.

Rev. Rul. 58–245

The taxpayer owned and operated unimproved property as a parking lot. During the taxable year, the property was condemned by the city in order to make way for the construction of a highway. The taxpayer, unable to procure a vacant lot in the vicinity, expended the condemnation award received on the purchase of property improved with a building, and immediately demolished such building, thus making the property suitable for use as a parking lot. *Held,* in view of the demolition of the building immediately upon purchase of the property, the acquired property constitutes replacement property for the purposes of section 1033 of the Internal Revenue Code of 1954, inasmuch as such property is suitable for the use for which the converted property was employed. The test to be applied, in determining whether there is a replacement, is the character of the service or use of the property. See Rev. Rul. 56–347, C. B. 1956–2, 517.

PART VIII.—WASH SALES OF STOCK OR SECURITIES

SECTION 1091.—LOSS FROM WASH SALES OF STOCK OR SECURITIES

26 CFR 1.1091–1: Losses from wash sales of stock or securities.

Certain United States Treasury 2½ percent bonds maturing September 15, 1972, when purchased by a taxpayer on June 17, 1953, were not substantially identical to United States Treasury 2½ percent bonds maturing December 15, 1972, when the latter were sold by the taxpayer on May 18, 1953. See Rev. Rul. 58–210, page 523.

Certain United States Treasury 2¼ percent bonds maturing December 15, 1962, when purchased by a taxpayer on June 24, 1953, were substantially identical to United States Treasury 2¼ percent bonds maturing June 15, 1962, when the latter were sold by the taxpayer on July 24, 1953. See Rev. Rul. 58–211, page 529.

PART III.—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1221.—CAPITAL ASSET DEFINED

26 CFR 1.1221–1: Meaning of terms. Rev. Rul. 58–40
(Also Section 61, 165; 1.61–1.)

Stocks, bonds or other securities, which are purchased pursuant to a contract performed in the regular course of business or are purchased solely for the purpose of obtaining inventory, under certain circumstances, do not constitute capital assets. Gain or loss resulting from the sale of such stocks, bonds or other securities constitutes ordinary gain or loss in some cases and, in other cases, is to be reflected in the cost of the goods acquired for the year in which the gain is realized or the loss sustained.

The above conclusions contemplate that the objectives for which the stocks, bonds or other securities are purchased are such as may be accomplished and the stocks, bonds or other securities disposed of within a relatively short period after their acquisition.

Advice has been requested as to the treatment, for Federal income tax purposes, of the gain or loss upon the sale of stock, bonds or other securities purchased under the circumstances in the three situations described below.

1. A taxpayer purchases capital stock of a corporation, representing a minority interest and not representing control of the corporation, solely for the purpose of enabling him to acquire inventory goods by the exercise of a right vested in the owner of the corporate stock to purchase a specific amount of such inventory within a specified time. After the acquisition of the inventory goods or the right to acquire such inventory goods, the corporate stock is forthwith sold.

2. A taxpayer, in accordance with the terms of a contract, purchases Government bonds which are placed in escrow in order to guarantee the faithful performance of a contract entered into in the normal course of the taxpayer's business. After the contract is fulfilled, the bonds are promptly sold.

3. A taxpayer, faced with a temporary shortage of inventory, purchases debentures of a supplier of such inventory. These debentures are issued to a limited number of distributors, including the taxpayer, as part of an arrangement under which a specific proportion of the supplier's production is allocated to each distributee. The taxpayer owns no other securities and purchases the debentures solely as a means of obtaining inventory. Shortly thereafter, the debentures become worthless.

Some guidance in the disposition of these cases is provided by the opinion in *Corn Products Refining Co.* v. *Commissioner*, 350 U. S. 46, Ct. Dec. 1787, C. B. 1955–2, 511, which states, in part:

* * * Congress intended that profits and losses arising from the every-day operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by section 117 applies to transactions and property which are not the normal source of business income. * * *

Accordingly, in the first situation described above, any gain or loss incurred in the sale of the corporate stock is deductible from or includible in the cost of the goods acquired by the taxpayer for the year in which the gain is realized or the loss sustained. See *Western Wine*

& Liquor Co. v. *Commissioner*, 18 T. C. 1090, acquiescence, page 6, this Bulletin, and *Charles A. Clark* v. *Commissioner*, 19 T. C. 48, acquiescence, page 7, this Bulletin.

In the second of the situations described above, the bonds, being closely related to the contract performed by the taxpayer in the regular course of his business, are not capital assets in his hands within the meaning of section 1221 of the Code. Therefore, any gain realized or loss sustained upon the sale of such bonds constitutes ordinary gain or loss, as the case may be, in the year they are sold.

Similarly, in the third of the situations described above, the particular function of the debentures there purchased precludes their treatment as capital assets. Section 165(g) of the Code relating to losses from worthless securities states in part:

> (1) GENERAL RULE.—If any security which is a capital asset becomes worthless during the taxable year, the loss resulting therefrom shall, for purposes of this subtitle, be treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset.
>
> (2) SECURITY DEFINED.—For purposes of this subsection, the term "security" means—
>
> (A) a share of stock in a corporation;
>
> (B) a right to subscribe for, or to receive, a share of stock in a corporation; or
>
> (C) a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form.

The debentures in this instance are securities within the meaning of section 165(g)(2)(C) of the Code. However, section 165(g)(1) of the Code applies only to a security "which is a capital asset." Since the debentures in this instance do not constitute capital assets the provisions of section 165(g) of the Code do not apply. Therefore, if such debentures become worthless or are sold at a loss, the loss incurred is deductible as an ordinary loss under section 165(a) of the Code. Conversely, any gain on the sale of such debentures would be included in gross income under section 61 of the Code and taxable as ordinary income.

The above conclusions contemplate that, in all three instances, the objectives for which the stock or securities are purchased are such as may be accomplished and the stock or securities disposed of within a relatively short time after their acquisition. Compare *Logan & Kanawha Coal Co.* v. *Commissioner*, 5 T. C. 1298. Also, compare *Gulftex Drug Co., Inc.* v. *Commissioner*, 29 T. C. No. 16, wherein it was held that where stock was purchased in order to obtain rights to purchase whiskey and, years after exercise of the rights, the stock was sold at a loss, a long-term capital loss resulted since the stock constituted a capital asset at the time of its sale.

See Revenue Ruling 58–41, page 86, this Bulletin, which holds that stock of the Federal National Mortgage Association, purchased by a taxpayer, such as a bank or trust company or any other private source dealing in mortgages, in order to enable the taxpayer to sell mortgages to the Association, constitutes a capital asset.

(Also Section 263.) Rev. Rul. 58–296

Payments received for agreements to retain ships under American registry procured for the purpose of enabling the payors to meet

the requirements of the Maritime Administration under the temporary policy in effect between August 16, 1954, and December 17, 1954, so as to be able to transfer like ships to foreign registry, constitute ordinary income and not capital gain. Such an agreement does not constitute a sale or exchange of property. The privilege passing under the agreement is a temporary privilege created and suspended by administrative action of a governmental agency and does not constitute property within the purview of section 1221 of the Internal Revenue Code of 1954.

Payments made for agreements of other shipowners to retain ships under American registry, so that like ships of the payors may be transferred to foreign registry, are payments increasing the value of such ships of the payor and, therefore constitute capital expenditures.

Stock of the Federal National Mortgage Association required to be purchased in conjunction with the sale of a mortgage to such Association. See Rev. Rul. 58-41, page 86.

PART IV.—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1231.—PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS

26 CFR 1.1231-1: Gains and losses from sale or exchange of certain property used in the trade or business. Rev. Rul. 58-133

> Real property purchased by a corporation specifically for use in its business, which it thereafter found to be unsuitable for its use and, more than six months after purchase, sold at a loss, constitutes "property used in the trade or business" within the meaning of section 1231(b)(1) of the Internal Revenue Code of 1954. The loss sustained on the sale of such property should therefore be treated, for Federal income tax purposes, in accordance with the provisions of section 1231(a) of the Code.

Advice has been requested whether a loss sustained by a corporation on the sale of real property which it had acquired for use in its trade or business, but found it could not use and later sold at a loss, constitutes an ordinary loss or a capital loss for Federal income tax purposes.

In April, 1956, a manufacturing corporation entered into an agreement to purchase a parcel of land and certain buildings thereon for the specific purpose of using the property in the operation of its business. The property appeared, at the time of the purchase agreement, to meet the requirements of the corporation. A substantial payment on the purchase price was made at the time the agreement was signed. The balance of the purchase price was to be paid in cash or certified funds in June, 1956 upon taking of title to the property.

Immediately after the execution of the agreement, but before the date designated for taking title, the corporation's engineers made a

study of the property and determined that, even after the expenditure of a large amount of money for alterations and changes in the buildings, the property would not lend itself to the expected and necessary economical operation of the corporation's business. Upon receiving this advice and information from its engineers, the corporation obtained a delay in the closing date of the transaction until October, 1956, and endeavored to sell the property to a third party. Since the corporation was unsuccessful in locating a purchaser before the closing date, the title to the property was conveyed to the corporation. The corporation continued to operate its business from a leased location and abandoned its original intention to use the acquired property in its business operation. In August, 1957, the entire property was sold by the corporation at a loss.

Section 1231(a) of the Internal Revenue Code of 1954 provides that if, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion of property used in the trade or business and capital assets held for more than six months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than six months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets.

Section 1231(b) of the Code provides, in part, as follows:

"(b) DEFINITION OF PROPERTY USED IN THE TRADE OR BUSINESS.—For purposes of this section—

(1) GENERAL RULE.—The term 'property used in the trade or business' means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not—

(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year,

(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, * * *"

In *Carter-Colton Cigar Company* v. *Commissioner*, 9 T. C. 219, acquiescence C. B. 1947–2, 1, a company purchased unimproved real estate with the intention of erecting a building thereon for use in its business. After plans and specifications were made, the original purpose was abandoned by the company and the property was sold at a loss. The court held that the property was "used in the trade or business" of the company, and loss sustained on its sale was an ordinary loss. The court stated in its opinion:

The acquisition of real estate for use at its principal place of business by a corporation is a proper business purpose and function, and the real estate so purchased, in our opinion, is devoted to and "used in" the business of the corporation during the planning and building stages preparatory to actual occupancy. Its character as "real property used * * * in trade or business" continues even after the planned use becomes impossible.

Accordingly, it is held that real property purchased by a corporation specifically for use in its business, which it thereafter found to be unsuitable for its use and, more than six months after purchase, sold at a loss, constitutes "property used in the trade or business" within the meaning of section 1231(b)(1) of the Code. The loss

sustained on the sale of such property should therefore be treated, for Federal income tax purposes, in accordance with the provisions of section 1231(a) of the Code.

Containers used by a taxpayer in which to ship his products. See Rev. Rul. 58–77, page 118.

SECTION 1234.—OPTIONS TO BUY OR SELL

26 CFR 1.1234–1: Options to buy or sell. Rev. Rul. 58–234
(Also Section 61.)
(Also Part II, Section 117(g)(2); Regulations 118, Section 39.117(g)–1.)

The amount (premium) received by the writer (issuer or optionor) for granting a "put" or "call" option, which is not exercised, constitutes ordinary income, for Federal income tax purposes, under section 61 of the Internal Revenue Code of 1954, to be included in his gross income only for the taxable year in which the failure to exercise the option becomes final.

Where a "put" option is exercised, the amount (premium) rereceived by the writer (issuer or optionor) for granting it constitutes an offset against the option price, which he paid for the securities involved upon its exercise, in determining the (net) cost basis to him of the securities that he purchased pursuant thereto, for subsequent gain or loss purposes.

Where a "call" option is exercised, the amount (premium) received by the writer (issuer or optionor) for granting it is includible by him, with the option price which he received for the securities involved upon its exercise, in the (total) amount realized by him for the securities that he sold pursuant thereto, for the purpose of determining his gain or loss on their sale. For such purpose, if the amount (premium) received for granting a "call" option is, under its terms, applicable, upon its exercise, on, to, or against the option price specified therein, such price thus adjusted (reduced) is considered the real option price.

On the sale by the option holder (optionee) of the stock involved in a "put" option, upon its exercise, the cost (premium) of the option to him should be offset against the option price, thereupon received or accrued, in computing the (net) amount realized by him for the stock that he sold pursuant thereto, for the purpose of determining his gain or loss on its sale.

The above holdings do not apply to amounts (sales proceeds) received by an option dealer from sales of "put" and "call" options which were written (issued or granted) by others and held by him for sale to his customers in the ordinary course of his business as such dealer, nor to amounts (commissions or fees) received by an option broker for selling "put" and "call" options for his principals as such broker.

I. T. 3835, C. B. 1947–1, 53, I. T. 2266, C. B. V–1, 13 (1926), and O. D. 1028, C. B. No. 5, 83 (1921), modified.

Reconsideration has been given to the second and third holdings in I. T. 3835, C. B. 1947–1, 53, in order to attain realistic treatment, for Federal income tax purposes, of "put" and "call" option transactions such as are therein involved. For the same reason, reconsideration has also been given to O. D. 1028, C. B. No. 5, 83 (1921), and the third holding in I. T. 2266, C. B. V–1, 13 (1926). Further, it is to be noted that gain realized by an optionor from the failure of the optionee to exercise such options is ordinary income under the Internal Revenue

Code of 1954, whereas, as set forth in the first holding in I. T. 3835, *supra*, it was short-term capital gain under section 117(g)(2) of the Internal Revenue Code of 1939.

I. T. 3835, C. B. 1947–1, 53, held, under the Internal Revenue Code of 1939, (1) that the amount (premium) received by the seller (writer) of a "put" or "call" option which is not thereafter exercised constitutes a short-term capital gain, under section 117(g)(2) of that Code, to be taken into account in computing gross income, for Federal income tax purposes, only for the year in which the failure to exercise the option becomes final; (2) that, "Where the 'put' or 'call' is exercised, the amount received by the seller (writer) constitutes a reduction in the cost or other basis of the securities with respect to which the option is exercised for the purpose of determining gain or loss"; and (3) that the conclusions reached in holdings (1) and (2) "do not apply to amounts received from the sale of 'puts' or 'calls' which are written by dealers in securities in the ordinary course of their business."

O. D. 1028, C. B. No. 5, 83 (1921), held, under the Revenue Act of 1918, that an "amount received by the taxpayer to bind the option to acquire an interest in the profits from royalties that may accrue from the processes or patents in question is taxable income to the recipients for the year in which received." Presumably, the option had not expired without being exercised in the taxable year of receipt of the option premium involved.

I. T. 2266, C. B. V–1, 13 (1926), held, under the Revenue Act of 1924, (1) that the cost of a "put" to sell stock should not be entered as a part of the purchase price of any particular block of stock but should be carried to a deferred account as a capital expenditure made in an incompleted transaction entered into for profit; (2) that the cost of "puts" which were not exercised may be taken as allowable deductions in the taxable year in which they expire by limitation of time; and (3) that, "On sale of the stock 'put', the cost of the 'put' should be reallocated and added to the cost of the stock with respect to which it was exercised for the purpose of determining gain or loss on the sale."

Section 61 of the Internal Revenue Code of 1954 provides, generally, that, except as otherwise provided, gross income means all income from whatever source derived, including (but not limited to) certain specified items.

Section 1234 of the Internal Revenue Code of 1954 provides as follows:

> Gain or loss attributable to the sale or exchange of, or loss on failure to exercise, a privilege or option to buy or sell property which in the hands of the taxpayer constitutes (or if acquired would constitute) a capital asset shall be considered gain or loss from the sale or exchange of a capital asset; and, if the loss is attributable to failure to exercise such privilege or option, the privilege or option shall be deemed to have been sold or exchanged on the day it expired. This section shall not apply to losses on failure to exercise options described in section 1233(c) [relating to gains and losses from short sales].

The option rights and obligations here concerned generally are relatively simple options, usually assignable, *to sell* (generally termed "puts"), or *to buy* (generally termed "calls"), certain property, usually securities or commodities, at a stipulated price on or before a specified future date or within a specified future period of time, usually 30, 60, or 90 days, or 6 months, but sometimes longer, granted by the writer (issuer or optionor) to the holder (optionee) for a consideration,

usually a cash payment (generally termed "premium"). Such option contracts terminate automatically upon expiration if they are not exercised. Upon their timely exercise, they are terminated, as such, but they become contracts of sale and purchase wherein the rights and obligations provided in the option contracts in the event of timely exercise are embodied.

Option rights and obligations are sometimes referred to as "privileges," stemming from the choice or privilege which their holders (optionees) have of exercising them. Hence, the term "privilege," as used in section 1234, *supra*, is considered synonymous with the term "option," as also used therein, and not to refer to any materially different rights or obligations.

Whether "puts" and "calls" are assignable or not is considered to be immaterial for the purposes here concerned, so, also, is whether "put" or "call" options are exercisable within a specified period of time (sometimes referred to as "ordinary") or on or before a specified date (sometimes referred to as "special").

If a "put" or "call" option is purchased from an original optionee, or assignee, rather than from the optionor, such option purchaser, as option holder, is also an optionee, and the amount paid by him for the option constitutes an option premium paid, insofar as he is concerned. However, in such case, the seller is not an optionor (writer or issuer); nor is the amount, though received by him for the option, a premium received for granting (writing or issuing) the option, but is an amount realized by him upon its disposition to be taken into account in computing gain or loss from the sale of the option as an asset.

Where "put" or "call" options are issued through an option broker, commissions or fees usually are charged for handling the transactions. In such cases, it may not definitely appear whether the commissions or fees were charged to the option issuer (writer or optionor), to the option purchaser (optionee), or to both. For example, in a common such transaction, the purchaser of the option (optionee) pays $137.50 for a 30-day "call" option on 100 shares of corporate stock; and the option writer (issuer or optionor) receives $112.50 for granting the option. However, for Federal income tax purposes, the total amount ($137.50) thus paid by the option purchaser (optionee) for the option is considered the (total) premium which he paid to acquire the option, and the net amount ($112.50) thus received by the option writer (issuer or optionor) is considered the (net) premium which he received for granting the option. Compare *Helvering* v. *Robert C. Winmill*, 305 U. S. 79, Ct. D. 1365, C. B. 1938–2, 212; *Adolph B. Spreckels* v. *Helvering*, 315 U. S. 326, Ct. D. 1547, C. B. 1942–1, 198.

Probably most "put" and "call" options involving securities are for corporate stocks. Under common past practice, the holder (optionee) of a corporate stock "put" option, upon exercising it, became obligated to deliver to the optionor (writer or issuer) or his designated agent, in addition to the stock involved, the *amount* of all, regular and extra, cash dividends, and also all subscription rights, that accrued with respect to the stock during the option period, without receiving any additional or increased option price. Conversely, under such practice, the holder (optionee) of a corporate stock "call" option, upon exercising it, became entitled to receive from the optionor, in addition

to the stock involved, the *amount* of all, regular and extra, cash dividends, and also all subscription rights, that accrued with respect to the stock during the option period, without paying any additional or increased option price. Under common current practice, the "put" option price is, under the terms of the option, adjusted (reduced) by the amount of such dividends and the value of such subscription rights, and the optionee-seller need not deliver such amount and such subscription rights in addition to the stock. Conversely, under such practice, the "call" option price is, under the terms of the option, adjusted (reduced) by the amount of such dividends and the value of such subscription rights, and the optionee-buyer is not entitled to such amount and such subscription rights in addition to the stock. Where "put" or "call" option prices are thus adjusted (reduced) on account of such interim cash dividends and subscription rights, the transactions are not complicated, for Federal income tax purposes, by their occurrences, since, in such cases, the seller of the stock involved simply receives therefor the adjusted (reduced) option price, in addition to the option premium received, and retains, or need not deliver, the amount of such dividends and also such subscription rights; and the buyer of the stock simply pays therefor the adjusted (reduced) option price, in addition to the option premium paid. However, where the seller of corporate stock, upon either a "put" or "call" option being exercised, must deliver the *amount* of such dividends and also such subscription rights, without becoming entitled to any additional or increased option price, the effect is that the seller receives for the stock and such subscription rights the option price, in addition to the option premium received, less the amount of such dividends that he delivers with the stock and such subscription rights; and the buyer pays for the stock and such subscription rights the option price, in addition to the option premium paid, less the amount of such dividends that he receives with the stock and such subscription rights. In all such cases, such dividends, to the extent that they constitute taxable dividend income, are includible in the gross income of whomsoever owned the stock when its holder became entitled to the dividend, or dividends, as such. See, generally I. T. 4007, C. B. 1950–1, 11; Rev. Rul. 56–153, C. B. 1956–1, 166; and Rev. Rul. 56–211, C. B. 1956–1, 155; *cf.* Rev. Rul. 54–399, C. B. 1954–2, 279.

Certain "put" and "call" corporate stock option contract forms now extensively used provide for "endorsement" on the reverse side thereof by a member of the New York Stock Exchange, and for exercising such options by delivery of the stock involved in a "put" option to such endorser, or by call on such endorser for the stock involved in a "call" option, instead of by delivery to, or by call on, the option writer (issuer or optionor) himself. Also, in such forms, directly above the line provided for the signature of the writer, it is stated, "The undersigned acts as intermediary only, without obligation other than to obtain a New York Stock Exchange firm as Endorser." However, such endorser-firms require the writers of such "put" options to deposit with them, for payment to the optionees in the event of exercise, cash in the amount of the option price, and require the writers of such "call" options to so deposit, for delivery to the optionees in the event of exercise, the stock involved. Thus, the writer of such "put" or "call" options is actually a real optionor

(and neither dealer nor broker), and the endorser-firm is his trustee-agent and surety (and not the optionor), with respect to them.

Usually, the premium paid for either a "put" or a "call," is not, under its terms or otherwise, applicable, if it is exercised, against its option price, but it is sometimes so provided in "call" options. However, it is considered unrealistic to distinguish, for the purpose of determining proper Federal income tax treatment, between an option whereunder the amount of the premium is applicable, in such event, against the option price and one whereunder the amount of the premium is not so applicable, since there is no real difference between them. Their substance is the same, and their formal difference involves merely a different way of stating the (real) option price. For example, a 90-day "call" option granted for a $500 premium to buy certain stock at $10,000 with no provision for applicability of the premium thereagainst in the event of exercise of the option is, in reality and substance insofar as option price is concerned, identical with a 90-day "call" option granted for $500 premium to buy the same stock at $10,500 with the $500 premium paid applicable thereagainst in the event of exercise of the option. The real option price is the same in both options, namely $10,000. The decision in *Virginia Iron, Coal & Coke Co.*, 37 B. T. A. 195, affirmed 99 F. (2d) 919, certiorari denied 307 U. S. 630, is not to the contrary despite certain *dicta* contained in the opinions.

An optionor, by the mere granting of an option to sell ("put"), or buy ("call"), certain property, may not have parted with any physical or tangible assets; but, just as the optionee thereby acquires a right to sell, or buy, certain property at a fixed price during a specified future period or on or before a specified future date, so does the optionor become obligated to accept, or deliver, such property at that price, if the option is exercised. Since the optionor assumes such obligation, which may be burdensome and is continuing until the option is terminated, without exercise, or otherwise, there is no closed transaction nor ascertainable income or gain realized by an optionor upon mere receipt of a premium for granting such an option. The open, rather than closed, status of an unexercised and otherwise unterminated option to buy (in effect a "call") was recognized, for Federal income tax purposes, in *A. E. Hollingsworth* v. *Commissioner*, 27 B. T. A. 621, acquiescence, C. B. XII–1, 6 (1933). It is manifest, from the nature and consequences of "put" or "call" option premiums and obligations, that there is no Federal income tax incidence on account of either the receipt or the payment of such option premiums, *i. e.*, from the standpoint of either the optionor or the optionee, unless and until the options have been terminated, by failure to exercise, or otherwise, with resultant gain or loss. The optionor, seeking to minimize or conclude the eventual burden of his option obligation, might pay the optionee, as consideration for cancellation of the option, an amount equal to or greater than the premium. Hence, no income, gain, profits, or earnings are derived from the receipt of either a "put" or "call" option premium unless and until the option expires without being exercised, or is terminated upon payment by the optionor of an amount less than the premium. Therefore, it is considered that the principle of the decision in *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417, Ct. D. 499,

C. B. XI–1, 293 (1932), which involved the receipt of "earnings," is not applicable to receipts of premiums on outstanding options.

G. C. M. 23677, C. B. 1943, 370, held, under the Internal Revenue Code of 1939, that gain or loss arising from the *sale* (not writing, issuing, or granting) of an option to acquire stock (in effect a "call") to a person other than the owner of the stock subject to the option, is long term capital gain or loss, *provided* such option was a "capital asset" (as defined in section 117(a)(1) of that Code) in the hands of the vendor and had been held by him for more than six months. In other words, if the vendor of the option were an option dealer and the option had been held by him primarily for sale to customers in the ordinary course of his business as such dealer, the gain or loss to him from its sale would constitute ordinary gain or loss, because, in such case, the option would not have been a "capital asset" (as so defined) in his hands.

The first holding in I. T. 3835, *supra*, namely, that the amount (premium) received by the writer (issuer or optionor) of a "put" or "call" option which is not exercised constitutes a short-term capital gain, under section 117(g)(2) of the Internal Revenue Code of 1939, to be taken into account in computing his gross income, for Federal income tax purposes, only for the taxable year in which the failure to exercise the option becomes final, is considered to be correct under that Code.

However, it is to be noted that section 117(g)(2) of the Internal Revenue Code of 1939 specifically provided that "gains * * * attributable to the failure to exercise privileges or options to buy or sell property shall be considered as short-term capital gains * * *," whereas in the Internal Revenue Code of 1954 there is no corresponding or other provision under which such gains shall or may be considered or treated as capital gain, either short-term or long-term. Therefore, it is held that the amount (premium) received by the writer (issuer or optionor) of a "put" or "call" option which is not exercised constitutes ordinary income, for Federal income tax purposes, under section 61 of the Internal Revenue Code of 1954, to be included in his gross income only for the taxable year in which the failure to exercise the option becomes final.

As aforestated, O. D. 1028, *supra*, held that "an amount received by the taxpayers to bind the option to acquire an interest in the profits from royalties that may accrue from the processes or patents in question is taxable income to the recipients for the year in which received," *i. e.*, even though the option period had not expired therein with failure to exercise the option. Insofar as that ruling may be deemed to relate to a true premium received for granting a bona fide and arm's-length option to acquire an interest in a patent or processes, it is considered to be unrealistic and in conflict with the foregoing holdings that the amount (premium) received by the writer (issuer or optionor) of a "call" option which is not exercised constitutes gain or income only for the taxable year in which the failure to exercise becomes final, and is modified to hold that such a premium is not taxable income when received but is taxable income if and when the option expires without being exercised. See, in this connection, Revenue Ruling 57–40, C. B. 1957–1, 266.

The second holding in I. T. 3835, *supra*, namely that, where a "put" or "call" option is exercised, the amount (premium) received by the writer (issuer or optionor) for granting it constitutes "a reduction in the cost or other basis of the securities with respect to which the option is exercised for the purpose of determining capital gain or loss," is not clearly stated insofar as it relates to "put" options and is considered to be unrealistic insofar as it relates to "call" options. Realistically, where a "put" option is exercised, the amount (premium) received by the writer (issuer or optionor) for granting it constitutes an offset against the option price, which he paid upon its exercise, in determining his (net) cost basis of the securities that he purchased pursuant thereto, for subsequent gain or loss purposes. In other words, the securities purchased by the writer (issuer or optioner) of the "put" option, upon its exercise, actually cost him, not the option price which he paid pursuant thereto, but such price less the amount (premium) which he received when he granted the option. Also, realistically, where a "call" option is exercised, the amount (premium) received by the writer (issuer or optionor) for granting it is includible by him, with the option price, which he received upon its exercise, in the (total) amount realized for the securities that he sold pursuant thereto, for purposes of determining his gain or loss on their sale. In other words, an amount (premium) received for granting a "call" option does not constitute to the writer (issuer or optionor) an adjustment (reduction) of the cost or other basis of his securities involved in the option, regardless of whether or not the option is exercised; but, where such option is exercised, he actually realizes for the securities, not merely the option price that he received upon their sale pursuant thereto, but also the amount (premium) which he received when he granted the option. Accordingly, the second holding of I. T. 3835, *supra*, is modified to hold that, where a "put" option is exercised, the amount (premium) received by the writer (issuer or optioner) for granting it constitutes an offset against the option price, which he paid for the securities involved upon its exercise, in determining the (net) cost basis to him of the securities that he purchased pursuant thereto, for subsequent gain or loss purposes; and that, where a "call" option is exercised, the amount (premium) received by the writer (issuer or optionor) for granting it is includible by him, with the option price, which he received for the securities involved upon its exercise, in the (total) amount realized by him for the securities that he sold pursuant thereto, for the purpose of determining his gain or loss on their sale. For the latter purpose, if the amount (premium) received for granting a "call" option is, under its terms, applicable, upon its exercise, on, to, or against the option price specified therein, such price thus adjusted (reduced) is considered the real option price.

The third holding in I. T. 3835, *supra*, namely that the first and second holding of that ruling "do not apply to amounts received from the sale of 'puts' and 'calls' which are written by dealers in securities in the ordinary course of their business," is considered to be inaccurate and misleading. A "dealer" is a merchant, whether in merchandise, commodities, securities, or options. A person clearly is not engaged as an option dealer in "writing" (issuing or granting) options for premiums, since such activity plainly is not "sale" in the sense of an option dealer (merchant) selling to his customers in the ordinary course of

his business as such dealer. However, as G. C. M. 23677, *supra*, reasonably implies, an option dealer can, as such, buy and sell options written (issued or granted) by someone else, which may include options of which he is the original optionee provided they are held by him for sale to his customers in the ordinary course of his business as such dealer. Some persons or firms, who also may be option dealers, are option brokers, particularly with respect to "ordinary" options (issued for specified periods, rather than having specified expiration dates). They, as such brokers, are merely agents in buying and selling options for their principals, who may be optionors or optionees, or both, and for such services they usually receive commissions or fees. Upon reconsideration, the third holding of I. T. 3835, *supra*, is modified to hold that its first holding, and its second holding (as hereinbefore modified), do not apply to amounts (sales proceeds) received by an option dealer from sales of "put" and "call" options which were written (issued or granted) by others and held by him for sale to his customers in the ordinary course of his business as such dealer, nor to amounts (commissions or fees) received by an option broker for selling "put" and "call" options for his principals as such broker.

The third holding in I. T. 2266, *supra*, namely that, "On the sale of the stock 'put', the cost [premium] of the 'put' should be reallocated and added to the cost of the stock with respect to which it was exercised for the purpose of determining gain or loss on the sale," is considered to be an unrealistic application to the option holder (optionee), upon exercise of a "put" option, of the premium which he paid for it, although the end result may be the same as if a realistic rule had been applied. While a premium paid for a "put" option is properly taken into account in determining gain or loss to the option holder (optionee) on sale of the optioned property pursuant to exercise of the option, such premium should not be added to his cost or other basis of such property, but should be offset against the option price, which he received for such property, in computing the (net) amount realized by him therefor, for the purpose of determining his gain or loss on its sale. In other words, the premium paid for the "put" option was not acquisition or other cost of the property sold pursuant thereto by the optionee upon its exercise, but was cost to him of obtaining the sum specified therein as the sale (option) price, and, thus, the (net) amount realized by him for the property was the amount of such price less that cost. It has been held, conversely, that where an option to buy property (in effect a "call") is exercised, the option cost (premium) should be included by the optionee, with the option price thereupon paid or accrued, in determining the (total) cost basis to him of the property that he purchased pursuant thereto, for subsequent gain or loss purposes. See *Realty Sales Co.* v. *Commissioner*, 10 B. T. A. 1217, acquiescence C. B. VII–2, 33 (1928). Upon reconsideration of the third holding in I. T. 2266, *supra*, it is modified to hold that, on the sale by the option holder (optionee) of the stock involved in a "put" option, upon its exercise, the cost (premium) of the option to him should be offset against the option price, thereupon received or accrued, in computing the (net) amount realized by him for the stock that he sold pursuant thereto, for the purpose of determining his gain or loss on its sale.

SUBCHAPTER Q.—READJUSTMENT OF TAX BETWEEN YEARS AND SPECIAL LIMITATIONS

PART I.—INCOME ATTRIBUTABLE TO SEVERAL TAXABLE YEARS

SECTION 1301.—COMPENSATION FROM AN EMPLOYMENT

(Also Section 1303.) Rev. Rul. 58-326

The offer of the Commissioner of Internal Revenue to pay a reward for information leading to the detection and punishment of persons guilty of violating the internal revenue laws does not, as between the Commissioner and the informer, result in such a contractual arrangement as to constitute "an employment" as such term is comprehended under section 1301 of the Internal Revenue Code of 1954; nor do amounts received thereunder constitute "back pay" within the meaning of section 1303 of the Code.

Advice has been requested whether the income tax liability reduction provisions of sections 1301 and 1303 of the Internal Revenue Code of 1954 are applicable to rewards paid by the Commissioner of Internal Revenue to informers.

A taxpayer furnished information which was used in an investigation of violation of internal revenue laws by an individual who was subsequently convicted and sentenced for tax evasion. During the taxable year in question, the convicted tax evader paid an amount in settlement of his total tax liability and a reward was paid to the informer.

Section 1301 of the Code provides for the readjustment of the tax on income received in the taxable year where such income is attributable to several years. However, as provided in subsection (a) of section 1301, this readjustment is applicable only if the income in question results from "an employment." Subsection (b) of that section defines "an employment" as an arrangement for the performance of personal services by an individual or partnership to effect a particular result.

Section 7623 of the Code (the counterpart of section 3792 of the Internal Revenue Code of 1939) authorizes the Secretary of the Treasury or his delegate to pay such sums "as he may deem necessary" for detecting and punishing persons guilty of violating the internal revenue laws.

Under the regulations relating to section 3792 of the Internal Revenue Code of 1939 (Treasury Decision 5770, C. B. 1950–1, 126, applicable to the 1954 Code by authority of Treasury Decision 6091, C. B. 1954–2, 47), all relevant factors, including the value of the information furnished in relation to the facts developed by the investigation, are taken into account in determining whether a reward shall be paid, and, if so, the amount, and no person is authorized to bind the Commissioner of Internal Revenue as to the payment of any reward or the amount thereof.

The provisions of section 7623 of the Code, and the regulations applicable thereto, clearly indicate that the Commissioner is under no obligation to pay any definite sum for information leading to the detection and punishment of persons guilty of violating the internal revenue laws; therefore, no contract of employment arises between the Commissioner and a party submitting information.

Section 1303(a) of the Code provides for a limitation on the income tax attributable to "back pay" included in gross income if the amount

of back pay received or accrued during the taxable year exceeds 15 percent of the gross income of the individual for such year. In determining the applicability of this section, "back pay" is defined in subsection (b) of section 1303 as remuneration, including wages, salaries, retirement pay, and other similar compensation, which is received or accrued during the taxable year by an employee for services performed before the taxable year for his employer, and which would have been paid before the taxable year except for the intervention of any one of certain enumerated events, none of which occurred in the instant case.

Accordingly, it is held that the offer of the Commissioner to pay a reward for information leading to the detection and punishment of persons guilty of violating the internal revenue laws does not, as between the Commissioner and the informer, result in such a contractual arrangement as to constitute "an employment" as such term is comprehended under section 1301 of the Code; nor does the amount received by the informer constitute "back pay" within the meaning of section 1303 of the Code.

The preparation and entry of an essay in a contest is not "employment". See Rev. Rul. 58–181, page 238.

---

26 CFR 1.1301: Statutory provisions; compensation from an employment.
(Also Sections 1302, 1303, 1304, 1306; 1.1302, 1.1303, 1.1304, 1.1306.)

T. D. 6294[1]

TITLE 26, INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations under sections 1301 through 1304 and 1306 of the Internal Revenue Code of 1954.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On December 31, 1957, notice of proposed rulemaking regarding the regulations under sections 1301 through 1304 and 1306 of the Internal Revenue Code of 1954, as amended by the Act of August 11, 1955 (Public Law 366, 84th Cong., 69 Stat. 688) [C. B. 1955–2, 767] and the Act of August 26, 1957 (Public Law 85–165, 71 Stat. 413) [C. B. 1957–2, 1058], was published in the Federal Register (22 F. R. 11078). No objection to the rules proposed was received with-

[1] The publication of this Treasury Decision in 23 F. R. 3765, dated May 30, 1958, contains (1) instructions for modifying the notice of proposed rulemaking published in 22 F. R. 11078, dated December 31, 1957, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

in the 30-day period prescribed in the notice nor were there any requests for a public hearing. Accordingly, the following regulations are hereby adopted. Such regulations shall apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954, except where otherwise specifically provided. Regulations under section 1305 are not included but will be published later with a separate notice of proposed rulemaking.

TABLE OF CONTENTS

INCOME ATTRIBUTABLE TO SEVERAL TAXABLE YEARS

Section
1.1301 Statutory provisions; compensation from an employment.
1.1301–1 Introduction.
1.1301–2 Compensation from an employment.
1.1302 Statutory provisions; income from an invention or artistic work.
1.1302–1 Income from an invention or artistic work.
1.1303 Statutory provisions; income from back pay.
1.1303–1 Income from back pay.
1.1304 Statutory provisions; compensatory damages for patent infringement.
1.1304–1 Compensatory damages for patent infringement.
1.1305 Statutory provisions; breach of contract damages.
1.1305–1 [Reserved for regulations under section 1305.]
1.1306 Statutory provisions; rules applicable to sections 1301, 1302, 1303, 1304, and 1305.
1.1306–1 Rules applicable to sections 1301, 1302, 1303, 1304, and 1305.

Authority: §§ 1.1301 to 1.1304–1, incl., and 1.1306 to 1.1306–1, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

§ 1.1301 Statutory Provisions; Compensation From an Employment.

SEC. 1301. COMPENSATION FROM AN EMPLOYMENT.

(a) Limitation on Tax.—If an individual or partnership—

(1) Engages in an employment as defined in subsection (b); and

(2) The employment covers a period of 36 months or more (from the beginning to the completion of such employment); and

(3) The gross compensation from the employment received or accrued in the taxable year of the individual or partnership is not less than 80 percent of the total compensation from such employment,

then the tax attributable to any part of the compensation which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had it been included in the gross income of such individual ratably over that part of the period which precedes the date of such receipt or accrual.

(b) Definition of an Employment.—For purposes of this section, the term "an employment" means an arrangement or series of arrangements for the performance of personal services by an individual or partnership to effect a particular result, regardless of the number of sources from which compensation therefor is obtained.

(c) Rule With Respect to Partners.—An individual who is a member of a partnership receiving or accruing compensation from an employment of the type described in subsection (a) shall be entitled to the benefits of that subsection only if the individual has been a member of the partnership continuously for a period of 36 months or the period of the employment immediately preceding the receipt or accrual. In such a case the tax attributable to the part of the compensation which

is includible in the gross income of the individual shall not be greater than the aggregate of the taxes which would have been attributable to that part had it been included in the gross income of the individual ratably over the period in which it was earned or the period during which the individual continuously was a member of the partnership, whichever period is the shorter. For purposes of this subsection, a member of a partnership shall be deemed to have been a member of the partnership for any period, ending immediately prior to becoming such a member, in which he was an employee of such partnership, if during the taxable year he received or accrued compensation attributable to employment by the partnership during such period.

§ 1.1301–1 INTRODUCTION.—Sections 1301 through 1306 provide special rules to relieve a taxpayer from the amount of tax which otherwise results when an amount of income which has been earned over a period of years is received or accrued in one taxable year. Because of the graduated income tax rates this so-called bunching of income in one year usually subjects it to a higher rate of tax than would be payable if it had been received or accrued over the several years during which it was earned. Sections 1301 (relating to compensation from an employment), 1302 (relating to income from an invention or artistic work), 1303 (relating to back pay), 1304 (relating to compensatory damages for patent infringement), and 1305 (relating to damages for breach of contract) mitigate the tax consequences of such bunching of income by placing a limit upon the amount of tax to be paid for the taxable year in which such income is received or accrued. In effect, these sections generally treat the income as having been included in gross income ratably over the years (preceding receipt or accrual) in which it was earned. However, these sections have no effect on the income tax liability for prior taxable years; they simply provide a special method of computing the amount of tax for the year of receipt or accrual.

§ 1.1301–2 COMPENSATION FROM AN EMPLOYMENT.—(a) *Qualifications for limitation on tax.*—If an individual or partnership—

(1) Engages in an employment (as defined in section 1301 (b) and paragraph (b) of this section); and

(2) The employment covers a period of 36 months or more (from the beginning to the completion of such employment); and

(3) The gross compensation from the employment received or accrued in the taxable year of the individual or partnership is not less than 80 percent of the total compensation from such employment,

then the tax attributable to any part of the compensation which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had it been included in the gross income of such individual ratably over that part of the period of the employment which precedes the date of such receipt or accrual. The application of this paragraph may be illustrated by the following examples:

Example (1). A, an individual who makes his income tax returns on a calendar year basis and uses the cash receipts and disbursements method of accounting, began an employment, as defined in section

1301(b) and paragraph (b) of this section, on February 17, 1951, and completed it on July 1, 1954. A's total compensation from such employment was $9,000, of which he received $1,000 on July 1, 1953, and $8,000 on the completion date. Since the employment covered more than 36 months and the $8,000 received in 1954 was not less than 80 percent of A's total compensation from such employment, he is entitled to the benefits of section 1301 in computing the tax payable with respect to the $8,000 reflected in his 1954 return. Section 1301 does not apply to the $1,000 received in 1953. Under section 1301(a) the tax attributable to the $8,000 included in A's gross income for 1954 is not greater than the aggregate of the taxes attributable to such amount had it been received ratably over the calendar months included in the period from February 17, 1951, to July 1, 1954. However, if A had received an additional $5,000 in 1955 from such employment, he would not be entitled to the benefits of section 1301 with respect to either the $8,000 or the $5,000, since he would not have received in one taxable year at least 80 percent of the total compensation from such employment.

Example (2). If, in example (1) of this paragraph, A had commenced the employment on March 3, 1954, and completed it on August 22, 1957, and had been paid a total compensation of $10,000 for that employment on July 5, 1956, he would be entitled to the benefits of section 1301. However, the tax attributable to the $10,000 included in A's gross income for 1956 cannot be greater than the aggregate of the taxes attributable to such amount had it been received ratably over the calendar months included in the period from March 3, 1954, to July 5, 1956, the date on which the $10,000 was received.

(b) *Definition of an employment.*—(1) (i) The term "an employment" means an arrangement or series of arrangements for the performance of personal services by an individual or partnership to effect a particular result, regardless of the number of sources from which compensation for such services is obtained. Thus, there must be an arrangement, and the arrangement must be for the performance of a particular project. In other words, there must be an understanding for the performance of services to accomplish a particular result. Accordingly, an arrangement to perform general services is not an employment within the meaning of section 1301 either as to any particular project on which services are performed or as to the general services since there is no understanding that the services are to accomplish a particular result.

(ii) Whether an employment exists is a question which must be determined by a consideration of all the facts in each case. The primary factor in making such a determination is what the particular profession, business, or industry would normally consider as a distinct project or result. The statements of the parties and the contracts they make, if any, shall be considered in those cases where the project or result cannot be determined under the preceding sentence.

(iii) To qualify as an employment the services must relate to a particular project, such as a particular law case, and must not con-

sist of a set of unrelated services performed for the same person. Furthermore, the individual steps performed by a taxpayer in connection with his project do not each constitute an employment; the services rendered by the taxpayer with respect to the entire project represent the employment.

(iv) The time when an employment begins and ends, and whether the period over which an employment extends includes conference and study time, depend upon the facts of each case. However, in determining the period over which an employment extends, there shall be included the time during which the efforts of the individual or partnership were unsuccessful in effecting the particular result.

(2) The application of the rules described in subparagraph (1) of this paragraph may be illustrated by the following examples:

Example (1). A was retained by X Corporation to perform general legal services. During the period 1955 through 1960, A performed miscellaneous legal services on numerous unrelated matters, each of which effected a particular result, and some of which extended over a period of more than 36 months. A was compensated by a single payment in 1960. A's services do not constitute an employment either as to the unrelated matters on which he worked or the general services performed over the period 1955 through 1960, since the arrangement was for the performance of services generally and not for the performance of any particular results.

Example (2). B was retained as an attorney by the Y Corporation to perform general legal services. An anti-trust action was brought against Y and, since the defense of such an action was beyond the scope of the agreement to perform general legal services, a separate arrangement was entered into between Y and B, whereby B was to be paid a specified additional amount for defending Y in the anti-trust suit. B's services in connection with such suit represent an employment separate and distinct from his general legal services for Y, and such services were performed pursuant to a separate arrangement.

Example (3). As part of a traffic flow improvement program the City of Z enters into a contract with C, a civil engineer, under which C agrees to perform services in connection with the construction of a highway bypassing the city, a vehicular tunnel under a river, and an elevated roadway in a congested industrial area of the city. C's compensation for his services with respect to each of these construction projects is fixed in the contract. Since the services performed in connection with each such construction project would normally be viewed by the engineering profession as a distinct project, C's services in connection with each of these construction projects constitute a separate employment. No contractual arrangement between the parties can operate to change the determination of the projects involved. Regardless of its terms, the contract will be viewed as an arrangement for the performance of services to effect three specifically identifiable results. Thus, the arrangement would constitute three distinct employments, even though the contract might provide for a single lump sum payment to be made only upon completion of all three projects.

Example (*4*). D entered into an agreement with Z Corporation to direct 5 motion picture productions for it in 5 years. Each of the 5 pictures was to be wholly unrelated to the others as entertainment products for public consumption. D's compensation for his services with respect to each picture was to be a certain percentage of the gross proceeds received from its showing. Each picture would normally be viewed by the motion picture industry as a distinct undertaking or project, and D's services in connection with each picture constitute a separate employment. As in the case of example (3), no contractual arrangement between the parties can operate to change the determination of the projects involved.

Example (*5*). E, a producer of television programs, entered into a contract with Y Television Network to produce a series of documentary films. While each film produced by E was a complete presentation of the specific subject matter, the entire series of films dealt with such subjects and was presented in such a manner as to identify the series as a unit in the public mind. Production of the films required coordinated planning of the whole series. The entire series of films would normally be viewed by the television industry as a distinct undertaking or project and, therefore, E's services in connection with production of the series of films constitute a single employment. As in the case of examples (3) and (4), no contractual arrangement between the parties can operate to change the determination of the projects involved.

Example (*6*). F was appointed trustee of a trust which consisted of income producing and non-income producing property. Under a decree of the state court having jurisdiction over the trust, F was awarded certain commisions with respect to principal and certain commissions with respect to income. The fact that such separate compensation was awarded by the court did not establish that two employments were involved. F's services with respect to the principal and those with respect to the income of the trust were merely integral parts of one employment, i. e., the administration of the trust in its entirety.

Example (*7*). G was retained and served as legal counsel to the trustees of a trust. He also served as one of the trustees of the trust. G's services in each capacity constituted a separate employment, regardless of whether under the laws of the state having jurisdiction of the trust the services rendered by a trustee as legal counsel are eligible for compensation distinct from those rendered by him as trustee.

Example (*8*). H, an architect, was employed by the City of Z to draft the plans for, and supervise the construction of, a school building. The building was of a type that is normally both planned by and constructed under the supervision of an architect. His employment consisted of his entire services from the beginning of the preparation of the plans to his completion of supervision of the building's construction. The drafting of the plans and the supervision of the construction were merely interrelated steps in the performance of the entire employment.

475254°—58——20

Example (9). K, an attorney, received a fee from certain stockholders of corporation X, who employed him to represent them in a stockholders' suit. K also received as compensation for his services in connection with such suit an amount allowed by the court out of the shares of the proceeds of the suit payable to the stockholders of corporation X who were unrepresented by counsel. The fact that K receives compensation from two sources will not cause two employments to exist. For purposes of section 1301 the number of sources from which the compensation is obtained is immaterial in determining the number of employments.

(c) *Allocation of income.*—The compensation from an employment is to be treated as if it had been received in equal portions in each of the calendar months (including those of the current taxable year) which fall within the period of employment preceding the receipt or accrual of the compensation. Thus, the portion of the compensation allocable to each taxable year involved in such period of employment is an amount equal to the entire compensation from the employment received or accrued in the current taxable year, divided by the entire number of calendar months included within the part of the period of employment which precedes the date of receipt or accrual of such compensation, and multiplied by the number of such calendar months falling within the particular taxable year. The provisions of this paragraph may be illustrated by the following examples:

Example (1). A, an individual who makes his income tax returns on a calendar year basis and uses the cash receipts and disbursements method of accounting, receives $40,000 on September 30, 1954. This amount is the entire compensation from an employment (as defined in section 1301(b)) covering a 40-month period beginning on June 1, 1951, and ending on September 30, 1954. $1,000 must be allocated to each of the calendar months included within the period of the employment. Thus, $7,000 is allocated to 1951, $12,000 to 1952, $12,000 to 1953, and $9,000 to 1954.

Example (2). Assume the same facts as in example (1), except that A makes his income tax returns on the basis of a taxable year ended June 30. The $40,000 is allocated as follows: $1,000 to the taxable year ended June 30, 1951, $12,000 each to the taxable years ended June 30, 1952, June 30, 1953, and June 30, 1954, and $3,000 to the taxable year ended June 30, 1955 (the current taxable year).

Example (3). Assume the same facts as in example (1), except that A receives the $40,000 on February 1, 1954 (before completion of the employment), instead of September 30, 1954. In this case, there are 32 calendar months included within the part of the period of the employment which precedes the date the compensation is received. Accordingly, $1,250 ($40,000 divided by 32) must be allocated to each of the calendar months included within the period from June 1, 1951, through January 31, 1954. Thus, $8,750 is allocated to 1951, $15,000 to 1952, $15,000 to 1953, and $1,250 to 1954.

Example (4). B, an individual who makes his income tax returns on a calendar year basis and used the cash receipts and disbursements

method of accounting, is engaged in an employment which covers a 40-month period beginning on May 1, 1951, and ending on August 31, 1954. The total compensation from the employment is $74,000, of which $34,000 is paid to B on March 1, 1954, and $40,000 on August 31, 1954. The $34,000 payment must be allocated to the 34 calendar months included within the part of the peroid of the employment which precedes the date such payment is received (March 1, 1954). Accordingly, with respect to the $34,000 payment, $8,000 is allocated to 1951, $12,000 to 1952, $12,000 to 1953, and $2,000 to 1954. Since the $40,000 payment was received on the date the employment ended it must be allocated to the 40 calendar months included within the entire period of the employment. Accordingly, with respect to such payment, $8,000 is allocated to 1951, $12,000 to 1952, $12,000 to 1953, and $8,000 to 1954. The entire compensation of $74,000 will therefore be allocated as follows: $16,000 to 1951, $24,000 to 1952, $24,000 to 1953, and $10,000 to 1954.

Example (*5*). C, an individual who makes his income tax returns on a calendar year basis and uses the cash receipts and disbursements method of accounting, is engaged in an employment which covers a 36-month period beginning on February 1, 1954, and ending on January 31, 1957. The total compensation from the employment of $36,000 is paid to C on June 1, 1957. In this case, there are 36 months in the period of the employment which precede the date of receipt of the $36,000 by C. The months of February through May 1957, are not part of the period of employment and therefore no income is to be allocated to those months. Accordingly, the $36,000 is allocated as follows: $11,000 to 1954, $12,000 to 1955, $12,000 to 1956, and $1,000 to 1957.

(d) *Computation of tax.*—(1) *Steps of computation.*—The following computation shall be made in order to determine whether the limitation on tax prescribed in section 1301 (a) and paragraph (a) of this section applies to compensation from an employment received or accrued in a taxable year:

(i) Compute the tax for the current taxable year by including in the gross income of such year the compensation from an employment received or accrued in such year.

(ii) Compute the tax for the current taxable year without such inclusion.

(iii) Compute the tax attributable to the compensation from an employment allocated to each of the taxable years in accordance with paragraph (c) of this section. The amount of the tax attributable to the compensation from the employment so allocated is the difference between the tax for each such year computed with the inclusion in gross income of each year of the allocable portion of such compensation and the tax for each year computed without such inclusion.

(iv) The tax for the current taxable year shall be the lesser of (*a*) the tax for the current taxable year as computed under subdivision (i) of this subparagraph, or (*b*) the tax for such year as computed under subdivision (ii), plus the aggregate of the taxes attributable to the allocated compensation as computed under subdivision (iii).

(2) *Effect of allocation of income on items based on amount of income and with respect to a net operating loss or a capital loss carryover.*—(i) In computing the tax for any taxable year under this paragraph, any item which depends upon the amount of gross income, adjusted gross income, or taxable income shall be recomputed to take into consideration the amount of compensation allocated to such year (or from such year in the case of the current taxable year). For example, if by allocating $1,000 of compensation to 1955, adjusted gross income for 1955 is increased from $5,000 to $6,000, then the general limitation on allowable charitable deductions under section 170(b)(1)(B) is increased from $1,000 to $1,200 and the amount of the nondeductible medical expenses under section 213 is increased from $150 to $180.

(ii) In computing the tax attributable to the compensation from an employment under this paragraph for any taxable year to or from which compensation is allocated, the effect of amounts of compensation allocated to any taxable year (or from the current taxable year) with respect to a net operating loss carryback or carryover or a capital loss carryover, shall be taken into account. Moreover, in determining the amount of tax attributable to such compensation, a computation shall also be made for any taxable year to which no amount of compensation is allocated but which is affected by a net operating loss carryback or carryover or by a capital loss carryover determined by reference to a taxable year to which amounts are so allocated and which net operating loss carryback or carryover or capital loss carryover is reduced or increased by such amounts so allocated. See subparagraph (3) (iv) (*d*) and (*e*) of this paragraph.

(3) *Example.* The computations described in subparagraph (1) of this paragraph may be illustrated by the following example: On January 1, 1952, A, unmarried, was retained as an attorney in an antitrust suit. This employment continued until June 30, 1955, when the action was terminated and A received a fee of $84,000 as total compensation for his services. Since all the requirements of section 1301 are met with respect to the $84,000, the following tax results will occur, assuming that A's net income (or loss) for the years 1951, 1952, 1953 and his taxable income for 1954 and 1955 were as follows: 1951, $20,600 (which reflects a net operating loss carryback from 1952); 1952, net operating loss $2,000; 1953, $50,600; 1954, $32,000; 1955, $100,000 ($16,000 plus the $84,000 fee).

(i) Allocation of fee to period of employment:

1955 (6 months)	$12,000
1954 (12 months)	24,000
1953 (12 months)	24,000
1952 (12 months)	24,000

(ii) Tax for 1955 computed by including the $84,000 fee in gross income $67,320

(iii) Tax for 1955 computed without including the $84,000 fee in gross income 5,200

(iv) Taxes attributable to the $84,000 fee allocated to the various taxable years:

	Prior to allocation under section 1301		Under section 1301
(a) Tax attributable to 1955 Taxable income			$28,000 ($16,000 plus $12,000)
Tax		$11,980	11,980
Less:		5,200	
Amount of tax attributable to 1955 under section 1301			6,780
(b) Tax attributable to 1954			
Taxable income	$32,000		56,000
Tax	14,460		31,320
		31,320	
Less:		14,460	
Section 1301 increase attributable to 1954			16,860
(c) Tax attributable to 1953			
Net income	$50,600		74,600
Less: Personal exemption	600		600
	50,000		74,000
Tax	28,916		47,936
		47,936	
Less:		28,916	
Section 1301 increase attributable to 1953			19,020
(d) Tax attributable to 1952			
Net income	($2,000 net operating loss)		22,000
Less: Personal exemption			600
			21,400
Tax and section 1301 increase attributable to 1952			8,984
(e) Tax attributable to 1951			
Net income	$20,600		22,600
Less: Personal exemption	600		600
	20,000		22,000
Tax	7,396		8,536
		$8,536	
Less:		7,396	
Section 1301 increase attributable to 1951			1,140
(f) Aggregate of taxes resulting from allocation of compensation under section 1301:			
1955			$ 6,780
1954			16,860
1953			19,020
1952			8,984
1951			1,140
			$52,784
(v) Tax for 1955 under section 1301			$57,984

Since the tax for 1955 computed without including the $84,000 fee in gross income ($5,200), plus the aggregate of taxes attributable to the allocation of such fee over the period of employment ($52,784) equals $57,984, which is a lesser sum than $67,320 (the amount of tax for 1955 computed by including the entire fee in income for 1955), $57,984 is the amount of tax for 1955 under the provisions of section 1301.

(4) *Compensation received from several employments allocated to same period.*—If an individual computes his income tax under section 1301 for a particular taxable year and in a subsequent taxable

year receives or accrues compensation from another employment, the period of which coincides to any extent with the period covered by the employment involved in the previous taxable year, such individual must, in availing himself of section 1301 for such subsequent taxable year, take into consideration the fact that he has previously allocated compensation to all or a part of the period covered by the employment later compensated. The same principle is applicable where income entitled to the benefits of section 1302, 1303, 1304, or 1305 is allocated to a year to which other income entitled to the benefits of section 1301, 1302, 1303, 1304, or 1305 had previously been allocated. For example, an individual commenced an employment on January 1, 1950, and completed it on December 31, 1954, at which time he received $60,000 as total compensation therefrom. In connection with his return for 1954, he allocated $1,000 to each of 60 calendar months included within the period of the employment and determined his income tax under the provisions of section 1301. He also commenced a second employment on January 1, 1952, and completed it on December 31, 1955, at which time he received total compensation of $48,000. In determining whether the limitation on tax prescribed in section 1301 (a) is applicable for the calendar year 1955, he must, in connection with allocating $1,000 to each of the 48 calendar months included within the period of such employment and computing the tax attributable thereto, also include in his income for the years 1952, 1953, and 1954, the amount of $12,000 previously allocated to each of such years in connection with his return for the calendar year 1954.

(e) *Rules with respect to partners.*—(1) *Qualifications for limitations on tax.*—An individual who is a member of a partnership receiving or accruing compensation from an employment of the type described in section 1301 (a) shall be entitled to the benefits of section 1301 only if: (i) He has been a member of the partnership continuously for a period of 36 months immediately preceding the receipt or accrual of such compensation by the partnership, or (ii) he has been a member of the partnership continuously for the period of the employment immediately preceding such receipt or accrual. It is immaterial whether the individual actually rendered services with respect to the employment to which the compensation is attributable.

(2) *Limitation on tax.*—(i) If a partner qualifies under section 1301 (c) and subparagraph (1) of this paragraph for the benefits of section 1301 with respect to a share of partnership income includible in his gross income, the tax attributable to such share shall not be greater than the aggregate of the taxes which would have been attributable to such share had it been included in the gross income of the partner ratably over (*a*) the period in which it was earned immediately preceding the receipt or accrual of the compensation by the partnership, or (*b*) the period during which the individual continuously was a member of the partnership immediately preceding such receipt or accrual, whichever is the shorter period.

(ii) If (*a*) a partnership receives or accrues compensation from an employment of the type described in section 1301(a) and the period of such employment immediately preceding the date of receipt or accrual is less than 36 months, and (*b*) if any individual has been

a member of such partnership continuously for such period, then such individual shall be entitled to allocate his share of the compensation over such period.

(iii) If an individual has been a member of a partnership continuously for a period of at least 36 months immediately preceding the receipt or accrual of compensation from an employment of the type described in section 1301(a), but such individual has not been a member of the partnership for the total period during which such compensation was earned by the partnership, the allocation of such individual's share of the compensation is limited to the period during which he was continuously a member of the partnership.

(iv) For purposes of section 1301 a partner who has retired under local law will nevertheless be treated as a partner until his interest in the compensation of the partnership from an employment has terminated, but only if such partner would have satisfied the employment requirement of section 1301(c) if the partnership had received or accrued compensation from such employment on the date of his retirement. In such a case the retired partner shall be entitled to allocate his share of the compensation only over the period of employment preceding his retirement and during which he was a member of the partnership.

(v) The provisions of this paragraph may be illustrated by the following examples:

Example (1). A became a member of the ABC partnership on June 1, 1950. The partnership, which is on the calendar year basis, began an employment on June 1, 1952, and completed it on July 1, 1955. On June 1, 1954, the partnership had received $24,000 as total compensation from such employment. A's $8,000 share of such compensation was included in his gross income for 1954. Since the $24,000 payment was from an employment of the type described in section 1301(a) and since A had been a member of the partnership continuously for more than 36 months at the date of the receipt of the payment, A is entitled to allocate his $8,000 share over the period in which the income was earned prior to the date of its receipt by the partnership. Thus, for purposes of making the tentative tax computation, A must allocate the $8,000 ratably over the period from June 1, 1952, through May 31, 1954.

Example (2). Assume the same facts as in example (1) of this subdivision except that A retires from the partnership on July 1, 1954. Such retirement is immaterial for purposes of section 1301; the tax consequences would be the same as in example (1) of this subdivision for the reasons therein set forth.

Example (3). A became a member of the ABC partnership on February 1, 1953. The partnership began an employment on July 1, 1953, and completed it on July 1, 1956. The partnership received $24,000 as compensation from such employment on January 1, 1955. The $24,000 payment was at least 80 percent of the partnership's total compensation from the employment. A included his $8,000 share in his gross income for 1955. Since the employment was of the type described in section 1301(a) and since A was a member of the partnership continuously for the period of the employment immediately preceding the receipt of the payment, A is entitled to the benefits of section 1301 (a) with respect to his share, even though

he had not been a partner for 36 months at the time of the receipt of the compensation. The period over which his share must be allocated for purposes of computing the tentative tax is July 1, 1953, through December 31, 1954.

Example (4). Assume the same facts as in example (3), except that the employment is completed on February 1, 1956. In such case A would not be entitled to the benefits of section 1301 (a), since the employment by the partnership did not cover a period of 36 months or more from its beginning to its completion.

Example (5). The ABC partnership began an employment on June 1, 1952. D became a member of the partnership on June 1, 1955. On June 1, 1957, the partnership received $30,000 as compensation from the employment. D's share of this payment included in his gross income for 1957 was $5,000. The employment terminated on June 1, 1959. The $30,000 payment was at least 80 percent of the total compensation from the employment. D is not entitled to the benefits of section 1301 since he was neither a member of the partnership continuously for a period of 36 months immediately preceding the receipt of the payment by the partnership, nor was he a member of the partnership continuously for the period of employment immediately preceding such receipt.

Example (6). The AB partnership began an employment on February 1, 1955. On February 1, 1957, after the employment had been in progress for two years, C joined the partnership. The employment was completed on July 31, 1960, and covered a period of 66 calendar months. The total compensation from the employment was $198,000 and was received on August 1, 1960, each partner's share amounting to $66,000. A and B are entitled to allocate their shares of the compensation over the full period of the employment, that is, over the 66 calendar months from February 1, 1955, through July 31, 1960. However, C can allocate his share only over a 42-month period extending from February 1, 1957, through July 31, 1960, the period during which he was continuously a member of the partnership. The shares of the total compensation received by A and B are allocable in the amount of $1,000 per month over 66 months, while C must allocate his share at the rate of $1,571.43 per month over 42 months.

Example (7). The ABC partnership began an employment on February 1, 1955. On July 31, 1957, after the employment had been in progress for 30 months, B retired from the partnership. The employment was completed on July 31, 1960, and covered a period of 66 calendar months. The total compensation from the employment was $180,000 and was received on August 1, 1960. Pursuant to the terms of the partnership agreement, A and C each received $75,000, while B received $30,000 as his share. A and C are entitled to allocate their shares of the compensation over the full period of the employment, that is, over the 66 calendar months from February 1, 1955, through July 31, 1960. Since under the terms of the partnership agreement B retained an interest in the compensation from the employment when he retired from the partnership, B will be treated as a partner and be entitled to allocate his $30,000 share over the 30 months of the period of employment preceding his retirement.

(3) *Individual engaged in an employment who becomes a member of a partnership which continues with such employment.*—If an individual begins an employment in an individual capacity and later becomes a member of a partnership which continues with such employment, the employment shall be considered, with respect to such individual, as one employment covering both the period during which a portion of the employment was performed by such individual in his capacity as such and the period during which a portion of the employment was performed by the partnership. However, with respect to the other members of the partnership, the period of the employment is limited to the period of the employment performed by the partnership. For example, A, an individual, begins an employment for the X Company on June 1, 1952. On January 1, 1953, A forms a partnership with B and C. The partnership continues with the employment for the X Company and completes it on June 1, 1955, at which time the partnership receives $25,000 as total compensation for the services rendered on the employment. A is entitled to the benefits of section 1301 with respect to his share of the $25,000 and can allocate it over the period June 1, 1952, through May 31, 1955, but B and C are not entitled to such benefits. If, however, the partnership had completed the employment on January 1, 1956, and had received the $25,000 on that date, all three partners would be entitled to section 1301 benefits. A would allocate his share over the period June 1, 1952, through December 31, 1955, whereas B and C would allocate their shares over the period January 1, 1953, through December 31, 1955. Furthermore, if the employment had been completed on January 1, 1956, but the $25,000 had been received by the partnership on January 1, 1955, all partners would be entitled to section 1301 benefits; A allocating his share over the period June 1, 1952, through December 31, 1954, and B and C allocating their shares over the period January 1, 1953, through December 31, 1954.

(4) *Period of allocation where income received by a partner who was formerly an employee.*—Where a member of a partnership who was formerly an employee of such partnership includes in his gross income a part of the compensation received or accrued by the partnership from an employment of the type described in section 1301(a), he shall be deemed to have been a member of such partnership for the period during which he was an employee ending immediately prior to his becoming such a member. It is immaterial for purposes of this paragraph whether such an individual, as an employee, actually rendered services with respect to the employment to which such compensation is attributable. The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A, an individual, became an employee of the XYZ law partnership on June 1, 1952, and a member of the partnership on June 1, 1956. The partnership commenced an employment on June 1, 1954, and completed it on June 1, 1958, at which time it received a payment of $50,000, which satisfied all of the requirements of section 1301(a). A's share of the $50,000 payment includible in his gross income for 1958 was $5,000. For purposes of section 1301(c), A is deemed to have been a partner for the period June 1, 1954, through May 31, 1958, and the amount of $5,000 must be allocated ratably over the period June 1, 1954, through May 31, 1958.

Example (*2*). Assume the same facts as in example (1), except that on June 1, 1955, A left the employ of the partnership and returned on January 1, 1956. In such a case, A is a partner for the purposes of section 1301 for the period January 1, 1956, to June 1, 1958. Under such circumstances, A would not qualify for the benefits of section 1301(a), since he was not a member of the partnership continuously for the period of 36 months immediately preceding receipt by the partnership of the compensation from the employment, nor was he a member of the partnership continuously for the period of employment immediately preceding the receipt of the compensation by the partnership.

(5) *Effect of withdrawal of a partner or termination of a partnership.*—The withdrawal of a partner from a partnership or the termination of a partnership will not bring an employment to an end with respect to any partner who continues to participate in such employment either in his individual capacity or as a partner in a partnership which continues with such employment. For example, partnership AB began an employment on January 1, 1955. On January 1, 1957, B sold his interest to C under such circumstances as to cause the partnership to terminate under section 708(b)(1). However, partnership AC continued with the employment and completed it on January 1, 1959, at which time the partnership received $100,000 as total compensation for the employment. Since A had an interest in the employment as a partner continuously for a period of 48 months he is entitled to the benefits of section 1301 with respect to his share of the compensation from the employment. C does not qualify, however, since he participated in the employment as a member of a partnership for a period of less than 36 months.

(6) *Effective date.*—Section 1301(c) and this paragraph shall apply only to amounts received or accrued after March 1, 1954. Pursuant to section 7851(a)(1)(C), the regulations prescribed in this paragraph shall also apply to taxable years beginning before January 1, 1954, and ending after December 31, 1953, and to taxable years beginning after December 31, 1953, and ending before August 17, 1954, although such years are generally subject to the Internal Revenue Code of 1939. Notwithstanding any other provision of the Internal Revenue Code of 1954, section 107 of the Internal Revenue Code of 1939 shall apply to amounts received or accrued as a partner on or before March 1, 1954, and to the computation of tax on amounts received or accrued on or before March 1, 1954.

§ 1.1302 Statutory Provisions; Income From an Invention or Artistic Work.

SEC. 1302. INCOME FROM AN INVENTION OR ARTISTIC WORK.

(a) Limitation on Tax.—If—

(1) An individual includes in gross income amounts in respect of a particular invention or artistic work created by the individual; and

(2) The work on the invention or the artistic work covered a period of 24 months or more (from the beginning to the completion thereof); and

(3) The amounts in respect of the invention or the artistic work includible in gross income for the taxable year are not less than 80 percent of the gross income in respect of such invention or artistic work in the taxable year plus the gross income there-

from in previous taxable years and the 12 months immediately succeeding the close of the taxable year,

then the tax attributable to the part of such gross income of the taxable year which is not taxable as a gain from the sale or exchange of a capital asset held for more than 6 months shall not be greater than the aggregate of the taxes attributable to such part had it been received ratably over, in the case of an invention, that part of the period preceding the close of the taxable year or 60 months, whichever is shorter, or, in the case of an artistic work, that part of the period preceding the close of the taxable year but not more than 36 months.

(b) DEFINITIONS.—For purposes of this section—

(1) INVENTION.—The term "invention" means a patent covering an invention of the individual.

(2) ARTISTIC WORK.—The term "artistic work" means a literary, musical, or artistic composition or a copyright covering a literary, musical, or artistic composition.

§ 1.1302–1 INCOME FROM AN INVENTION OR ARTISTIC WORK.—(a) *Qualifications for limitation on tax.*—(1) The tax attributable to amounts included in gross income by an individual in respect of a particular invention or artistic work which he created shall be limited in accordance with the provisions of paragraph (c) of this section, provided:

(i) The work upon the invention or artistic work covered a period of 24 months or more (from the beginning to the completion thereof), and

(ii) The amounts includible in gross income of the individual for the taxable year from such invention or artistic work are not less than 80 percent of the gross income therefrom in the taxable year, the preceding taxable years, and the 12 months immediately succeeding the close of the taxable year.

(2) That part of the gross income from such artistic work or invention which is taxable as a gain from the sale or exchange of a capital asset held for more than 6 months is excluded from the benefits of section 1302.

(3) For the purpose of determining the tax which would be attributable to gain on the sale or exchange of an artistic work had such gain been received ratably in any prior taxable year, such gain shall be treated as gain from the sale or exchange of property which is not a capital asset.

(b) *Definitions.*—(1) *Invention.*—For purposes of section 1302 and this section the term "invention" means a patent covering an invention of the individual.

(2) *Artistic work.*—For purposes of section 1302 and this section the term "artistic work" means a literary, musical, or artistic composition or a copyright covering a literary, musical, or artistic composition.

(c) *Limitation on tax.*—(1) *Rule.*—When amounts includible in gross income qualify under paragraph (a) of this section, the tax attributable thereto in the taxable year shall not be greater than the aggregate of the taxes attributable thereto had such amounts been received ratably over the period for allocating the income in accordance with subparagraph (2) of this paragraph.

(2) *Allocation of income.*—The period for allocating the income shall end with the close of the taxable year in which the amounts qualifying under paragraph (a) of this section are received or accrued, and the length of such period shall equal the lesser of—

(i) The part of the period of work which precedes the close of such taxable year, or

(ii) A period of 60 calendar months in the case of an invention or 36 calendar months in the case of an artistic work.

The gross income from the invention or artistic work is to be treated as if it had been received in equal portions in each of the calendar months which fall within the allocation period. The portion of the gross income from the invention or artistic work allocable to each taxable year involved in the allocation period is an amount equal to the entire amount of gross income from the invention or artistic work received or accrued in the current taxable year, divided by the entire number of calendar months included within the allocation period and multiplied by the number of such calendar months falling within the particular taxable year. The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A, an individual who makes his returns on a calendar year basis and uses the cash receipts and disbursements method of accounting, received $36,000 (taxable as ordinary income) on October 1, 1954, in full payment for a musical composition. A commenced work on this composition on July 10, 1950, and completed it on January 29, 1955. Although the period of work covers 55 calendar months, allocations may be made to only the last 36 calendar months included within the part of the period of work which precedes the close of 1954 (the current taxable year). Therefore, $1,000 ($36,000 divided by 36), must be allocated to each of the 36 calendar months preceding January 1, 1955. Accordingly, $12,000 is allocated to 1952, $12,000 to 1953, and $12,000 to 1954 (the current taxable year).

Example (2). Assume the same facts as in example (1) except that A received $54,000 (taxable as ordinary income) for a patent covering an invention of his. In this case, allocations must be made to each of the 54 calendar months included within the part of the period of work which precedes the close of 1954 (the current taxable year). Therefore, $1,000 ($54,000 divided by 54) must be allocated to each of the 54 calendar months preceding January 1, 1955. Accordingly, $6,000 is allocated to 1950 and $12,000 is allocated to each of the years 1951, 1952, 1953, and 1954.

Example (3). Assume the same facts as in example (1) except that the period of work was commenced by A on July 1, 1953, and completed on September 1, 1956. Although the period of work covers 38 calendar months, allocations may be made to only the 18 calendar months which are included within the part of the period of work which precedes the close of 1954 (the current taxable year). Therefore, $2,000 ($36,000 divided by 18) must be allocated to each of the 18 calendar months preceding January 1, 1955. Accordingly, $12,000 is allocated to 1953 and $24,000 to 1954.

Example (4). B, an individual who makes his return on a calendar year basis and uses the cash receipts and disbursements method of accounting, received $36,000 (taxable as ordinary income) on October 1, 1956, in full payment for a musical composition. B commenced work on this composition on March 1, 1950, and completed it on March 1, 1953. The amount received may be allocated over a 36-month period ending with the close of the taxable year in which

received. Such amount cannot be allocated over the 36-month period during which B actually worked on the composition. Therefore, $1,000 ($36,000 divided by 36) must be allocated to each of the 36 calendar months preceding January 1, 1957. Accordingly, $12,000 is allocated to 1954, $12,000 to 1955, and $12,000 to 1956.

(d) *Computation of tax.*—(1) *Steps of computation.*—The following computation shall be made in order to determine whether the limitation on tax prescribed in section 1302(a) and paragraph (c) of this section applies to income from an invention or artistic work:

(i) Compute the tax for the current taxable year by including in the gross income of such year the amount of gross income from the invention or artistic work received or accrued in such year.

(ii) Compute the tax for the current taxable year without such inclusion.

(iii) Compute the tax attributable to the gross income from the invention or artistic work allocated to each of the taxable years in accordance with paragraph (c) (2) of this section. The amount of the tax attributable to the gross income from the invention or artistic work so allocated is the difference between the tax for each year computed with the inclusion in gross income of each year of the allocable portion of the gross income from the invention or artistic work and the tax for each such year computed without such inclusion.

(iv) The tax for the current taxable year shall be the lesser of (*a*) the tax for the current taxable year as computed under subdivision (i) of this subparagraph, or (*b*) the tax for such year as computed under subdivision (ii), plus the aggregate of the taxes attributable to the allocated gross income from an invention or artistic work as computed under subdivision (iii).

(2) For effect of allocation of income on items based on amount of income and with respect to a net operating loss or a capital loss carryover, see paragraph (d) (2) of § 1.1301–2.

(3) See paragraph (d) (4) of § 1.1301–2 for the computations which are necessary when an amount of gross income from an invention or artistic work is allocated to a period to which there has also been allocated other income entitled to the benefits of sections 1301, 1302, 1303, 1304, or 1305.

§ 1.1303 Statutory Provisions; Income From Back Pay.

SEC. 1303. INCOME FROM BACK PAY.

(a) Limitation on Tax.—If the amount of the back pay received or accrued by an individual during the taxable year exceeds 15 percent of the gross income of the individual for such year, the part of the tax attributable to the inclusion of such back pay in gross income for the taxable year shall not be greater than the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for the taxable years to which such portions are respectively attributable, as determined under regulations prescribed by the Secretary or his delegate.

(b) Definition of Back Pay.—For purposes of this section, the term "back pay" means amounts includible in gross income under this subtitle which are one of the following—

(1) Remuneration, including wages, salaries, retirement pay, and other similar compensation, which is received or accrued during the taxable year by an employee for services performed before the taxable year for his employer and which would have been paid

before the taxable year except for the intervention of one of the following events:

(A) Bankruptcy or receivership of the employer;

(B) Dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings;

(C) If the employer is the United States, a State, a Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any of the foregoing, lack of funds appropriated to pay such remuneration; or

(D) Any other event determined to be similar in nature under regulations prescribed by the Secretary or his delegate.

(2) Wages or salaries which are received or accrued during the taxable year by an employee for services performed before the taxable year for his employer and which constitute retroactive wage or salary increases ordered, recommended, or approved by any Federal or State agency, and made retroactive to any period before the taxable year.

(3) Payments which are received or accrued during the taxable year as the result of an alleged violation by an employer of any State or Federal law relating to labor standards or practices, and which are determined under regulations prescribed by the Secretary or his delegate to be attributable to a prior taxable year.

§ 1.1303–1 INCOME FROM BACK PAY.—(a) *Qualifications for limitation on tax.*—If the amount of "back pay", as defined in section 1303(b) and paragraph (b) of this section, received or accrued by an individual during the taxable year exceeds 15 percent of the individual's gross income for such year, the part of the tax attributable to the inclusion of such back pay in gross income for the taxable year shall not be greater than the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for the taxable years to which such portions are respectively attributable. The computation of this limitation on tax shall be more in accordance with the provisions of paragraph (d) of this section.

(b) *Definition of back pay.*—(1) *Remuneration delayed because of certain events.*—"Back pay" means remuneration including wages, salaries, pensions, retirement pay, and other similar compensation, received or accrued during the taxable year and includible in gross income by an employee for services performed prior to the taxable year for his employer and which would have been paid prior to the taxable year but for the intervention of any one of the following events:

(i) Bankruptcy or receivership of the employer;

(ii) Dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings;

(iii) If the employer is the United States, a State, a Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any of the foregoing, lack of funds appropriated to pay such remuneration; or

(iv) Any other event determined to be similar in nature under this subparagraph. An event will be considered similar in nature to those events specified in subdivisions (i), (ii), and (iii) of this subparagraph only if the circumstances are unusual, if they are of the type specified therein, if they operate to defer payment of the remuneration for the services performed, and if payment,

except for such circumstances, would have been made prior to the taxable year in which received or accrued.

For the purposes of section 1303 and this section, the term "back pay" does not include remuneration which is deemed to be constructively received in the taxable year or years in which the services were performed, remuneration paid in the current year in accordance with the usual practice or custom of the employer even though received in respect of services performed in a prior year or years, additional compensation for past services where there was no prior agreement or legal obligation to pay such additional compensation, or any amount which is not includible in gross income under subtitle A of the Internal Revenue Code of 1954.

(2) *Retroactive wage and salary increases.*—"Back pay" also includes retroactive wage or salary increases received or accrued during a taxable year by an employee for services performed in a prior taxable year which have been ordered, recommended, or approved by any Federal or State agency such as, but not limited to, boards authorized by the Railway Labor Act, as amended (45 U. S. C. 151–188), comparable State organizations, and United States and State courts.

(3) *Payments resulting from alleged employer violation of certain laws.*—"Back pay" also includes payments which are received or accrued during the taxable year as a result of an alleged violation by an employer of sections 6 and 7 of the Fair Labor Standards Act of 1938, as amended (29 U. S. C. 206, 207), and which are made retroactive to any period prior to the taxable year and payments which are received or accrued during the taxable year arising out of an alleged violation by an employer of any State or Federal law relating to labor standards or practices, such as payments received to effectuate the policies of the National Labor Relations Act, as amended (29 U. S. C. 151 et seq.).

(c) *Allocation of back pay to prior years.*—For the purpose of determining under section 1303(a) the particular taxable year or years to which the back pay in attributable and, if such back pay is attributable to more than one taxable year, the amount thereof which is attributable to each of such taxable years, the following rules will be applicable:

(1) Back pay, as defined in section 1303(b)(1), shall be deemed to be attributable to a particular taxable year to the extent that it would have been paid in such year except for the intervention of one of the events described in section 1303(b)(1).

(2) Back pay, as defined in section 1303(b)(2), shall be deemed to be attributable to a particular taxable year to the extent that it would have been paid in such year had the wage or salary increase described in section 1303(b)(2) been actually put into effect on the date to which it was first made retroactive.

(3) Back pay, as defined in section 1303(b)(3), shall be deemed to be attributable to a particular taxable year to the extent that it represents payments in respect of the alleged violation described in section 1303(b)(3) which occurred in such year or which continued during any part of such year.

(4) In those cases where a computation has been made by, or under the direction of, a Federal or State agency (including any Federal or State court) by whom the back pay was awarded, which compu-

tation indicates that particular portions of such back pay are attributable to certain definite periods of time, such computation shall be accepted as the appropriate allocation for the purposes of this paragraph.

(5) Where no computation has been made as provided in subparagraph (4) of this paragraph, and where the allocation cannot be accurately made in accordance with subparagraph (1), (2), or (3) of this paragraph, then the back pay shall be allocated to each of the taxable years within which falls one or more calendar months included within the entire period for which such back pay has been paid, as if such back pay had been received or accrued in equal portions in each of such calendar months.

(6) An individual must compute his taxable income for any taxable year to which back pay is attributable even though he was not required to make a return for such year. Thus, all amounts properly includible in gross income for any taxable year to which back pay is attributable must be included in the computation.

(d) *Computation of tax.*—(1) The following computation shall be made in order to determine whether the limitation on tax prescribed in section 1303(a) and paragraph (a) of this section applies to back pay received or accrued in the taxable year:

(i) Compute the tax for the current taxable year by including in the gross income of such year the back pay received or accrued in such year.

(ii) Compute the tax for the current taxable year without such inclusion.

(iii) Compute the tax attributable to the back pay allocated to each of the prior taxable years in accordance with paragraph (c) of this section. The amount of tax attributable to back pay in each of such prior taxable years is the difference between the tax for each year computed with the inclusion in gross income of each year of the portion of such back pay so allocated to each year and the tax for each year computed without such inclusion.

(iv) The tax for the current taxable year shall be the lesser of (*a*) the tax for the current taxable year as computed under subdivision (i) of this subparagraph, or (*b*) the tax for such year as computed under subdivision (ii), plus the aggregate of the taxes attributable to the allocated back pay as computed under subdivision (iii).

(2) For effect of allocation of income on items based on amount of income and with respect to a net operating loss or a capital loss carryover, see paragraph (d)(2) of § 1.1302-2.

(3) See paragraph (d)(4) of § 1.1301-2 for the computations which are necessary when an amount of back pay is allocated to a period to which there has also been allocated other income entitled to the benefits of section 1301, 1302, 1303, 1304, or 1305.

(4) The provisions of this paragraph may be illustrated by the following example:

Example. A, an unmarried individual with no dependents, makes his returns on the cash receipts and disbursements method of accounting and on the basis of a calendar year. It is assumed that he is entitled to use and uses for the taxable years 1950, 1951, and 1954, the optional tax table provided in section 3 of the 1954 Internal Revenue Code, and Supplement T of the 1939 Internal Revenue Code.

In 1954, A received adjusted gross income in the amount of $4,200, of which $1,000 constituted back pay. His tax for the calendar year 1954 on $4,200 would be $665. On $3,200 ($4,200 minus $1,000), the tax would be $467. That part of the tax for 1954 attributable to back pay is, therefore $198 ($665 minus $467). Of the back pay, $600 was attributable to the year 1951. For such year his adjusted gross income (without such back pay) was $1,700 and his tax thereon was $192. The amount of tax which he would have paid for 1951 had he included in gross income the $600 of back pay attributable to 1951 is $302. The increase in the tax for such year would have been $110 ($302 minus $192). The remainder of the back pay, $400, was attributable to the year 1950, when his adjusted gross income (without such back pay) was $1,200, and his tax was $85. The amount of tax which he would have paid for 1950 had he included in gross gross income the $400 of back pay attributable to 1950 is $148. The increase in the tax for 1950 would be $63 ($148 minus $85). The aggregate of the increases of taxes for 1951 and 1950 would be $173. A's tax for the calendar year 1954 is $640 ($467 plus $173).

§ 1.1304 STATUTORY PROVISIONS; COMPENSATORY DAMAGES FOR PATENT INFRINGEMENT.

SEC. 1304. COMPENSATORY DAMAGES FOR PATENT INFRINGEMENT.

If an amount representing compensatory damages is received or accrued by a taxpayer during a taxable year as the result of an award in a civil action for infringement of a patent issued by the United States, then the tax attributable to the inclusion of such amount in gross income for the taxable year shall not be greater than the aggregate of the increases in taxes which would have resulted if such amount had been included in gross income in equal installments for each month during which such infringement occurred.

[Section 1304 as added by sec. 1, Act of Aug. 11, 1955 (Pub. Law 366, 84th Cong., 69 Stat. 688)]

§ 1.1304–1 COMPENSATORY DAMAGES FOR PATENT INFRINGEMENT.—(a) *Qualifications for limitation on tax.*—If an amount representing compensatory damages is received or accrued by a taxpayer during a taxable year as a result of an award in a civil action for infringement of a patent issued by the United States, then the tax attributable to the inclusion of such amount in gross income for the taxable year shall not be greater than the aggregate of the increases in taxes which would have resulted if such amount had been included in gross income in equal installments for each month over the period during which such infringement occurred.

(b) *Definition of terms.*—(1) "*Compensatory damages*".—(i) For purposes of section 1304 and this section the term "compensatory damages" means an amount awarded pursuant to a judgment or decree by a court as the result of a civil action for infringement of a patent (or contributory infringement) which action is authorized by title 35 U. S. C. (1952 ed.) sec. 281. The term is limited to that portion of the award which represents damages to compensate the taxpayer for the actual infringement sustained. It does not include that portion of the award which represents increased damages awarded by the court over and above the amount found adequate to compensate for

the infringement, attorney's fees, interest or costs. See title 35 U. S. C. (1952 ed.) secs. 284 and 285.

(ii) An amount awarded pursuant to a consent decree or judgment may be considered compensatory damages for purposes of this section.

(iii) An amount received or accrued pursuant to a settlement of the action, after a decree or judgment awarding damages to the taxpayer has been entered, may be considered as compensatory damages even though such amount is not made a part of a consent decree. In such case the taxpayer must show which portion of the amount received or accrued represents compensatory damages.

(iv) An amount received or accrued pursuant to a settlement of the action where no judgment or decree, or consent judgment or decree, is entered will not constitute compensatory damages.

(2) "*Patent issued by the United States.*"—The term "patent issued by the United States" means any patent issued or granted by the United States under the authority of the Commissioner of Patents pursuant to U. S. C. title 35 (1952 ed.) sec. 153. The term "patent issued by the United States" does not include a patent issued or granted by a foreign government.

(c) *Allocation of compensatory damages.*—The amount representing compensatory damages is to be treated as if it had been received in equal portions in each of the calendar months (including those of the current taxable year) which fall within the period during which the court has determined the infringement to have occurred. Thus, the portion of the compensatory damages allocable to each taxable year involved in such period is an amount equal to the entire amount of compensatory damages, divided by the entire number of calendar months included within such period of infringement, and multiplied by the number of such calendar months falling within the particular taxable year.

(d) *Computation of tax.*—(1) The following computation shall be made in order to determine whether the limitation on tax prescribed in section 1304 and paragraph (a) of this section applies to compensatory damages for a patent infringement received or accrued in the taxable year:

(i) Compute the tax for the current taxable year by including in the gross income of such year the amount of compensatory damages received or accrued in such year.

(ii) Compute the tax for the current taxable year without such inclusion.

(iii) Compute the tax attributable to the portion of the compensatory damages allocated to each of the taxable years in accordance with paragraph (c) of this section. The amount of tax attributable to compensatory damages in each of such years is the difference between the tax for each year computed with the inclusion in gross income of each year of the portion of such compensatory damages so allocated to each year and the tax for each year computed without such inclusion.

(iv) The tax for the current taxable year shall be the lesser of (*a*) the tax for the current taxable year as computed under subdivision (i) of this paragraph, or (*b*) the tax for such year as computed under subdivision (ii), plus the aggregate of the taxes at-

tributable to the allocated compensatory damages as computed under subdivision (iii).

(2) For effect of allocation of income on items based on amount of income and with respect to a net operating loss or a capital loss carryover, see paragraph (d) (2) of § 1.1301–2.

(3) See paragraph (d) (4) of § 1.1301–2 for the computations which are necessary when an amount of compensatory damages is allocated to a period to which there has also been allocated other income entitled to the benefits of section 1301, 1302, 1303, 1304, or 1305.

(e) *Capital gains treatment of compensatory damages.*—Section 1304 and this section are applicable to amounts considered as received from the sale or exchange of a capital asset. See section 1235 and the regulations thereunder. Whether the portion of the award allocable to each year pursuant to paragraph (c) of this section shall be considered as proceeds from the sale or exchange of a capital asset or as ordinary income shall be determined under the provisions of the internal revenue laws applicable for each such year and the regulations thereunder.

(f) *Effective date of this section.*—The provisions of section 1304 and this section shall be applicable with respect to taxable years ending after August 11, 1955, but only with respect to amounts of compensatory damages received or accrued after such date as the result of awards made after such date.

(g) *Illustrations.*—The provisions of section 1304 may be illustrated by the following examples:

Example (1). A, the claimant in a patent infringement action, made his return on a calendar year basis and used the cash receipts and disbursements method of accounting. On October 1, 1960, the court awarded him $72,000. Of this amount $10,000 represented legal fees, $6,000 interest, and $4,000 court costs. The balance of $52,000 represented compensatory damages. Moreover, the court found that the infringement began on June 3, 1956, and continued to the date of the award, thus covering a period of 52 calendar months. For the purpose of determining the limitation on tax under section 1304, A must allocate the amount of $52,000 of compensatory damages at the rate of $1,000 per month over the 52 calendar months as follows: $7,000 to 1956, $12,000 to 1957, $12,000 to 1958, $12,000 to 1959, and $9,000 to 1960.

Example (2). Assume the same facts as in example (1) except that on January 2, 1956, A sold his patent to the X Company within the meaning of section 1235. The sale agreement provided that, in the case of any patent infringement, A would bring any necessary actions and would share in any damages collected by such actions. For the purpose of determining the limitation on tax under section 1304, A must treat the amounts allocated to the several years as long-term capital gains.

§ 1.1305 Statutory Provisions; Breach of Contract Damages.

SEC. 1305. BREACH OF CONTRACT DAMAGES.

(a) General Rule.—If an amount representing damages is received or accrued by a taxpayer during a taxable year as a result of an award in a civil action for breach of contract or breach of a fiduciary duty

or relationship, then the tax attributable to the inclusion in gross income for the taxable year of that part of such amount which would have been received or accrued by the taxpayer in a prior taxable year or years but for the breach of contract, or breach of a fiduciary duty or relationship, shall not be greater than the aggregate of the increases in taxes which would have resulted had such part been included in gross income for such prior taxable year or years.

(b) CREDITS AND DEDUCTIONS ALLOWED IN COMPUTATION OF TAX.—The taxpayer in computing said tax shall be entitled to deduct all credits and deductions for depletion, depreciation, and other items to which he would have been entitled, had such income been received or accrued by the taxpayer in the year during which he would have received or accrued it, except for such breach of contract or for such breach of a fiduciary duty or relationship. The credits, deductions, or other items referred to in the prior sentence, attributable to property, shall be allowed only with respect to that part of the award which represents the taxpayer's share of income from the actual operation of such property.

(c) LIMITATION.—Subsection (a) shall not apply unless the amount representing damages is $3,000 or more.

[Section 1305 as added by sec. 1, Act of Aug. 26, 1957 (Pub. Law 85-165, 71 Stat. 413)]

§ 1.1305-1 [Reserved for regulations under section 1305]

§ 1.1306 STATUTORY PROVISIONS; RULES APPLICABLE TO SECTIONS 1301, 1302, 1303, 1304, AND 1305.

SEC. 1306. RULES APPLICABLE TO THIS PART.

(a) FRACTIONAL PARTS OF A MONTH.—For purposes of this part, a fractional part of a month shall be disregarded unless it amounts to more than half a month, in which case it should be considered as a month.

(b) TAX ON SELF-EMPLOYMENT INCOME.—This part shall be applied without regard to, and shall not affect, the tax imposed by chapter 2 relating to self-employment income.

(c) COMPUTATION OF TAX ATTRIBUTABLE TO INCOME ALLOCATED TO PRIOR PERIOD.—For the purpose of computing the tax attributable to the amount of an item of gross income allocable under this part to a particular taxable year, such amount shall be considered income only of the person who would be required to include the item of gross income in a separate return filed for the taxable year in which such item was received or accrued.

(d) EFFECTIVE DATE OF CERTAIN SUBSECTIONS.—Subsection (c) of section 1301 and subsection (c) of this section shall apply only to amounts received or accrued after March 1, 1954. Notwithstanding any other provision of this title, section 107 of the Internal Revenue Code of 1939 shall apply to amounts received or accrued as a partner on or before March 1, 1954, under this section and to the computation of tax on amounts received or accrued on or before March 1, 1954.

[Section 1306 as renumbered by sec. 1, Act of Aug. 11, 1955 (Pub. Law 366, 84th Cong., 69 Stat. 688); sec. 1, Act of Aug. 26, 1957 (Pub. Law 85-165, 71 Stat. 413)]

§ 1.1306-1 RULES APPLICABLE TO SECTIONS 1301, 1302, 1303, 1304, AND 1305.—(a) *Fractional parts of a month.*—For purposes of sections 1301, 1302, 1303, 1304, and 1305, and the regulations thereunder, a fractional part of a month shall be disregarded unless it amounts to more than one half of a month, in which case it shall be considered as a month.

(b) *Tax on self-employment income.*—The provisions of sections 1301, 1302, 1303, 1304, and 1305, and the regulations thereunder, shall

be applied without regard to, and shall not affect, the tax imposed by chapter 2 of subtitle A of the Internal Revenue Code of 1954 and section 480 of the Internal Revenue Code of 1939, relating to the tax on self-employment income.

(c) *Computation of tax attributable to income allocated to prior period.*—In the case of either a husband or wife receiving income to which the provisions of section 1301, 1302, 1303, 1304, or 1305 apply, the tax attributable to the portion of the income allocated to a prior period shall be computed by considering such income as includible by the spouse who would have been required to include it in a separate return for the taxable year in which such income was received or accrued, assuming a separate return had been filed for such year. For example, A, an attorney on a calendar year basis, resides in a State in which the common law with respect to the ownership of property is applicable. In 1955, A receives compensation upon the completion of an employment which began in 1945. All the requirements for the application of section 1301(a) are satisfied. A and his wife file a joint income tax return for the taxable year 1955. They filed separate returns for the years 1945, 1946, and 1947 and joint returns in 1948 and subsequent years. The entire portion of such compensation allocable to the years for which separate returns were filed shall be includible in A's return and no part thereof shall be includible in the separate return filed by A's wife for such years.

(d) *Effective date.*—Section 1304(c) and this paragraph shall apply only to amounts received or accrued after March 1, 1954. Pursuant to section 7851(a)(1)(C), the regulations prescribed in this paragraph shall also apply to taxable years beginning before January 1, 1954, and ending after December 31, 1953, and to taxable years beginning after December 31, 1953, and ending before August 17, 1954, although such years are generally subject to the Internal Revenue Code of 1939. Notwithstanding any other provision of the Internal Revenue Code of 1954, section 107 of the Internal Revenue Code of 1939 shall apply to amounts received or accrued on or before March 1, 1954, and to the computation of tax on amounts received or accrued on or before March 1, 1954.

O. Gordon Delk,
Acting Commissioner of Internal Revenue.

Approved May 26, 1958.

Fred C. Scribner, Jr.,
Acting Secretary of the Treasury

(Filed by the Division of the Federal Register on May 29, 1958, at 8:46 a. m., and published in the issue of the Federal Register for May 30, 1958, 23 F. R. 3765.)

SECTION 1302.—INCOME FROM AN INVENTION OR ARTISTIC WORK

26 CFR 1.1302: Statutory provisions; income from an invention or artistic work.

Regulations under the Internal Revenue Code of 1954. See T. D. 6294, page 288.

SECTION 1303.—INCOME FROM BACK PAY

Rev. Rul. 58–33

A taxpayer whose rights to retroactive pay accrue by virtue of court proceedings in a factually similar case is not required to commence court proceedings on his own behalf in order to meet the requirements of section 1303(b)(1)(B) of the Internal Revenue Code of 1954. Thus, for example, where a reserve officer of the army or other component of the Armed Forces of the United States receives retroactive retirement pay (not by reason of disability) on the basis of the decision in the case of *Paul Tanner, et al.*, and such retroactive pay exceeds 15 percent of his total gross income for the year in which it is received, it qualifies as back pay and his Federal income tax thereon may be computed in accordance with the provisions of section 1303(a) of the Code.

Advice has been requested whether the provisions of section 1303 of the Internal Revenue Code of 1954 apply to retroactive retirement payments received by a reserve officer of the United States Army in the circumstances described below.

An army reserve officer was found eligible for retired pay (not by reason of disability) under the provisions of sections 301 and 302, Title III, Army and Air Vitalization and Retirement Equalization Act of 1948, 62 Stat. 1081, at 1087, 10 U. S. C. 1036, and was placed on the Army of the United States Retired List as of June 30, 1949. However, retirement payments were not made because the officer was receiving pay in excess of $3,000 as a civilian employee of the Federal Government, and the army, in view of section 212 of Part II, Title I, of the Act of June 30, 1932, Public Law 212, 72nd Congress, 47 Stat. 382, at 406, 5 U. S. C. 59(a), as amended, took the position that dual compensation was illegal.

In *Paul Tanner et al.* v. *United States*, 125 Fed. Supp. 240, certiorari denied 350 U. S. 842, the court held that an army or air force reserve officer, who is entitled to receive retired pay, may receive such pay even though he is paid $3,000 or more per year as a civilian employee, because the Act of July 1, 1947, Public Law 153, 80th Congress, 1st Session, 61 Stat. 238, 10 U. S. C. 371(b), amending existing laws and as amended, precludes the application of the Act of June 30, 1932, *supra*, to the retired pay of such officer.

Subsequent to and on the basis of the decision in the *Tanner* case, the army allowed the claims of the officer in the instant case and he was paid retroactive retirement pay for the period July 1, 1949, through June 30, 1956, in a lump sum. Commencing July 1, 1956, his retirement is payable currently at a fixed monthly rate.

Section 1303 of the Code provides that if an employee receives remuneration, including wages, salaries, retirement pay, or other similar compensation during the taxable year for services performed before the taxable year for his employer and which would have been paid before the taxable year except for one of several events, among which is a dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings, and such remuneration exceeds 15 percent of the gross income of the individual for such year, the part of the tax attributable to the inclusion of such back-pay in gross income for the taxable year shall not be greater than the aggregate of the increases in taxes which

would have resulted from the inclusion of the respective portions of such back-pay in gross income for the taxable years to which such portions are respectively attributable.

Section 1303(b)(1)(B) of the Code does not require that the taxpayer be a party to the court proceedings which establish his right to receive retroactive payments and, in the instant case, issues relating to the allowance of retired pay to the army reserve officer are substantially the same as those presented in the *Tanner* case.

Accordingly, it is held that a taxpayer, whose rights to retroactive pay accrue by virtue of court proceedings in a factually similar case, is not required to commence court proceedings on his own behalf in order to meet the requirements of section 1303(b)(1)(B) of the Code. Thus, if such retroactive pay exceeds 15 percent of the recipient's total gross income for the year in which it is received, it qualifies as back pay and his Federal income tax may be computed thereon in accordance with the provisions of section 1303(a) of the Code. Any interest received on the back pay is taxable at the rates in effect in the year such interest is received.

The provisions of this Revenue Ruling will apply to retired reserve officers of any of the other components of the Armed Forces of the United States who, on the basis of the rationale established in the *Tanner* case, are now held to be entitled to the retirement pay which had previously been denied them because they were receiving in excess of $3,000 as civilian employees of the Federal Government.

Income received as a reward for information leading to the detection of a violation of the internal revenue laws. See Rev. Rul. 58-326, page 287.

---

26 CFR 1.1303: Statutory provisions; income from back pay.

Regulations under the Internal Revenue Code of 1954. See T. D. 6294, page 288.

SECTION 1304.—COMPENSATORY DAMAGES FOR PATENT INFRINGEMENT

26 CFR 1.1304: Statutory provisions; compensatory damages for patent infringement.

Regulations under the Internal Revenue Code of 1954. See T. D. 6294, page 288.

SECTION 1306.—RULES APPLICABLE TO THIS PART

26 CFR 1.1306: Statutory provisions; rules applicable to sections 1301, 1302, 1303, 1304, and 1305.

Regulations under the Internal Revenue Code of 1954. See T. D. 6294, page 288.

PART II.—MITIGATION OF EFFECT OF LIMITATIONS AND OTHER PROVISIONS

SECTION 1311.—CORRECTION OF ERROR

26 CFR 1.1311(a)–2: Purpose and scope of section 1311.

Inventory adjustments. See Rev. Rul. 58–327, below.

SECTION 1312.—CIRCUMSTANCES OF ADJUSTMENT

26 CFR 1.1312–1: Double inclusion of an item of gross income. Rev. Rul. 58–327

(Also Section 1311; 1.1311(a)–2.)

(Also Part II, Section 3801(a), 3801(b); Regulations 118, Sections 39.3801(a)(1)–1, 39.3801(b)–1.)

Inventories constitute items of gross income within the meaning of sections 1311 to 1315 inclusive, of the Internal Revenue Code of 1954, or section 3801 of the Internal Revenue Code of 1939, relating to the mitigation of effect of limitations and other provisions with regard to items affecting taxable income.

Advice has been requested whether the provisions of sections 1311 to 1315 inclusive, of the Internal Revenue Code of 1954 or section 3801 of the Internal Revenue Code of 1939 are applicable to inventory adjustments.

As a result of an examination of a taxpayer's Federal income tax return for the calendar year 1951, adjustments were made in the pricing of inventories and as a result thereof the inventory as of December 31, 1951, was increased in the amount of 300x dollars. The resulting deficiency for 1951 was properly assessed in 1956, pursuant to an agreement. The taxpayer, in his return for the calendar year 1952, included as opening inventory the same amount shown as closing inventory in its return filed for 1951. No corresponding adjustment to opening inventory for 1952 was made by the examining officer upon examination of the taxpayer's income tax return for that year.

Since the period of limitation during which a deficiency may be assessed, or a refund or credit made in the regular manner has expired for the taxable year 1952, the question to be resolved is whether the taxpayer may now adjust its opening inventory for the taxable year 1952 by an amount equal to that by which the closing inventory for the taxable year 1951 was adjusted, under the provisions of section 1311 of the Internal Revenue Code of 1954.

Section 1311 of the Internal Revenue Code of 1954 provides, in part, as follows:

(a) GENERAL RULE.—If a determination (as defined in section 1313) is described in one or more of the paragraphs of section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law, other than this part and other than section 7122 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314.

Section 1312 of the Code provides, as far as pertinent, as follows:

The circumstances under which the adjustment provided in section 1311 is authorized are as follows:

(1) DOUBLE INCLUSION OF AN ITEM OF GROSS INCOME.—The determination requires the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer.

In *Gooch Milling and Elevator Company* v. *United States*, 78 Fed. Supp. 94, which involved the fiscal years ending June 30, 1935, and June 30, 1936, the court held that inventories constitute items of gross income within the meaning of section 820 of the Revenue Act of 1938 (section 3801 of the 1939 Code and sections 1311 to 1315 of the 1954 Code). The court stated:

* * * The term "item" was not defined or limited by Congress, and in our opinion it should be interpreted to include any item or amount which affects gross income in more than one year, and produces, as a result, double taxation, double deduction or inequitable avoidance of tax. While it is true that inventories are not of themselves items of income or deduction, they are vital in the determination of gross income, and when their cost or value, as disclosed in a return, is changed, gross income is, as we have pointed out above, directly affected and the result and amount by which income is affected and the amount in which it is increased or decreased, through an increase or decrease in the operating profit or loss, is as specific and identifiable as an item or dividends, salaries, loss or the like. We think Congress was concerned with results rather than with a particular class of items. Otherwise, as the facts in this case show, the relief which it apparently intended to provide would be incomplete. It is clear that the statute was intended, first, to prevent double taxation; secondly, to prevent double deductions or credits, and, third, to prevent income from escaping taxation, by reason of the correction or errors with respect to the treatment of an item or items which enter into and affect the proper determination and computation of gross income. Inventories are clearly within that class of items * * *.

In *Dubuque Packing Company* v. *United States*, 126 Fed. Supp. 796, affirmed 233 Fed. (2d) 453, the court also recognized that inventories constitute items of gross income.

In view of the above, it is held that the inventories constitute items of gross income within the meaning of sections 1311 to 1315 inclusive, of the 1954 Code, formerly section 3801 of the 1939 Code, relating to the mitigation of effect of limitations and other provisions with regard to items affecting taxable income.

---

26 CFR 1.1312–4: Double disallowance of deduction or credit. Rev. Rul. 58–12

Taxpayer, employing the accrual method of accounting, failed to deduct the amount of certain accrued expenses on his 1951 calendar-year return, but deducted such amounts for 1952, when paid. On February 15, 1956, the taxpayer filed an amended return for the calendar year 1952 excluding therefrom the deduction for such expenses attributable to 1951 and paid the additional tax due. At the same time the taxpayer filed an untimely claim for refund for 1951 resulting from the deduction for accrued expenses for such year which were erroneously deducted in 1952. *Held*, the acceptance by the Commissioner of Internal Revenue of the amended return for 1952, in which the item of accrued expenses was correctly treated by the taxpayer, resulted in a deficiency for 1952 which was paid on February 15, 1956. Under such circumstances, the year 1952 remains an open year to effectuate a determination under section 1311 of the Internal Revenue Code of 1954, as limited by section 6511 thereof, at least until February 15, 1958. A determination made during such

period would permit an adjustment for accrued expenses which should properly have been taken into account on the original Federal income tax return for 1951, but which was erroneously taken into account in the return for 1952.

(Also Section 1314; 1.1314(c)–1.) Rev. Rul. 58–24

Taxpayer, a corporation employing the accrual method of accounting, erroneously deducted accruable vacation pay in the year paid rather than the year accrued. During the taxable year 1953, the taxpayer paid and deducted vacation pay which was a proper deduction for the taxable year 1952, a year now barred by the statute of limitations. For 1953, the taxpayer also deducted vacation pay which was properly accruable for such year. *Held*, the deduction for vacation pay which accrued in 1952 is not a proper deduction for 1953, when paid, and, therefore, is not allowable. However, since a credit or refund attributable to the deduction for vacation pay accrued in 1952 was not barred by the statute of limitations at the time such deduction was originally claimed in 1953, an adjustment for 1952 is permissible under section 1312(4) of the Internal Revenue Code of 1954, provided the provisions of sections 1311 to 1315, inclusive, of the Code are otherwise met. See Revenue Ruling 57–13, C. B. 1957–1, 552. The allowance of the deduction in the year 1952 for vacation pay disallowed for 1953 results in a pyramiding of vacation pay deductions in 1952, one on the cash method, attributable to 1951, and one on the accrual method. Despite this result, section 1314(c) of the Code provides that the amount to be refunded or credited in the same manner as an overpayment shall not be diminished by any credit or set-off based upon any item other than the one which was the subject of the adjustment.

SECTION 1314.—AMOUNT AND METHOD OF ADJUSTMENT

26 CFR 1.1314(c)–1: Adjustment unaffected by other items.

Effect of other items under the adjustment for accrued vacation pay erroneously deducted in the year paid rather than the year accruable, where the adjustment is made under section 1312 of the 1954 Code. See Rev. Rul. 58–24, above.

PART V.—CLAIM OF RIGHT

SECTION 1341.—COMPUTATION OF TAX WHERE TAXPAYER RESTORES SUBSTANTIAL AMOUNT HELD UNDER CLAIM OF RIGHT

26 CFR Section 1.1341–1: Restoration of amounts received or accrued under claim of right. Rev. Rul. 58–226

Where at the close of an escrow arrangement, a taxpayer has an unrestricted right to receive prepaid interest on a note, the pro-

visions of section 1341 of the Internal Revenue Code of 1954 are not applicable in the computation of Federal income tax for a subsequent year in which, due to the prepayment in whole or in part of the principal amount of the note, the taxpayer credits the payer with any portion of such prepaid interest.

Advice has been requested whether the provisions of section 1341 of the Internal Revenue Code of 1954 are applicable where at the close of an escrow arrangement prepaid interest is received on a note and in a subsequent taxable year, due to the prepayment in whole or in part of the principal amount of the note, the taxpayer credits the payer with any portion of such prepaid interest.

The taxpayer sold real property for 25x dollars. The consideration received therefor consisted of cash, the assumption of a first trust note, and a second trust note due in ten years with interest at a stipulated rate per annum. The cash and the first and second trust notes were deposited with an escrow agent, pending purchaser's approval of the title and fulfillment of certain other conditions. At the close of escrow, the purchaser, through the escrow agent, prepaid the interest for ten years on the second trust note. It was agreed that if the purchaser should prepay any part of the principal of such second trust note, credit would be given by the taxpayer for the portion of the prepaid interest applicable to the period from the date of the prepayment of the principal to the date ot which the interest was prepaid.

Section 1341 of the Code provides rules for computing the tax for a taxable year during which the taxpayer is entitled to a deduction because of the restoration to another of an item which was included in the taxpayer's gross income for a prior taxable year. It reads, in part, as follows:

(a) GENERAL RULE.—If—

(1) an item was included in gross income for a prior taxable year (or years) because it appeared that the taxpayer had an unrestricted right to such item;

(2) a deduction is allowable for the taxable year because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item or to a portion of such item; and

(3) the amount of such deduction exceeds $3,000, then the tax imposed by this chapter for the taxable year shall be the lesser of the following: * * *

In the instant case, the taxpayer had what not only "appeared" to be, but which was in fact and in law, an unrestricted right to receive the total amount of the prepaid interest on the second trust note in the year in which the escrow was closed. Thus, if due to prepayment of the principal amount of the second trust note, or any part thereof, the taxpayer in a subsequent year credits the payer with any of the prepaid interest, it will not be because it is established after the close of the prior taxable year in which the prepayment of interest occurred that the taxpayer did not have an unrestricted right thereto in such prior year, but because a liability on his part has later accrued which does not in any way establish that he had no right to the interest when received.

It is held, therefore, that a credit by taxpayer of any of the prepaid interest in the manner shown above will not constitute a transaction meeting the requirements of section 1341 of the Code and, accordingly, the provisions of that section will not be applicable in

the computation of taxpayer's income tax liability for the taxable year in which the credit is given.

CHAPTER 2.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 1401.—RATE OF TAX

26 CFR 1.1401–1: Tax on self-employment income. Rev. Rul. 58–137 (Also Section 6102; 301.6102–1.)

Optional tax table for determining self-employment tax on the Individual Income Tax Return, Form 1040, for any taxable year beginning after December 31, 1956, and before January 1, 1960.

The Internal Revenue Service has prepared an optional table, as set out below, for the use of taxpayers, to eliminate the necessity of making computations involving fractions or decimals, in determining the amount of self-employment tax on Form 1040, "U. S. Individual Income Tax Return."

Section 1401 of the Self-Employment Contributions Act (chapter 2, subtitle A, of the Internal Revenue Code of 1954) provides that, in addition to other taxes there shall be imposed for each taxable year, on the self-employment income of every individual, a tax of three and three-eighths percent of the amount of self-employment income for any taxable year beginning after December 31, 1956, and before January 1, 1960. This tax is to be reported on the Individual Income Tax Return, Form 1040.

Under the provisions of section 6102 of the Internal Revenue Code of 1954, and the regulations prescribed thereunder, the Secretary of the Treasury or his delegate is authorized to provide, with respect to any amount required to be shown on a form prescribed for any internal revenue return, that if such amount of such item is other than a whole-dollar amount, either the fractional part of a dollar shall be disregarded, or the fractional part of a dollar shall be disregarded unless it amounts to one-half dollar or more, in which case the amount (determined without regard to the fractional part of a dollar) shall be increased by one dollar. See section 301.6102–1 of the Regulations on Procedure and Administration.

The table has been developed as a simple method of computing the self-employment tax for the year 1957 which is at the rate of three and three-eighths percent. The table will eliminate the necessity for making any computations involving fractions or decimals. For example, a taxpayer having self-employment income of $862.81 would merely consult the table and enter a tax of $29 in separate Schedule C or F and in line 15, page 1, Form 1040. If an exact computation had been made by multiplying out the three and three-eighths percent rate the tax on $862.81 would have been $29.12. Similarly, a taxpayer with self-employment income of $855.70 would enter a tax of $29 from the table, whereas the tax would be $28.88 if computed by the long method.

Copies of the table are available in offices of the District Directors of Internal Revenue and may be privately reproduced.

OPTIONAL SELF-EMPLOYMENT TAX TABLE

[Self-employment tax rate of 3⅜%]

If the amount of income subject to self-employment tax is—		The self-employment tax is—	If the amount of income subject to self-employment tax is—		The self-employment tax is—	If the amount of income subject to self-employment tax is—		The self-employment tax is—
At least	But less than		At least	But less than		At least	But less than	
$0	$15	$0	$1,408	$1,438	$48	$2,830	$2,860	$96
15	45	1	1,438	1,467	49	2,860	2,889	97
45	75	2	1,467	1,497	50	2,889	2,919	98
75	104	3	1,497	1,526	51	2,919	2,949	99
104	134	4	1,526	1,556	52	2,949	2,978	100
134	163	5	1,556	1,586	53	2,978	3,008	101
163	193	6	1,586	1,615	54	3,008	3,038	102
193	223	7	1,615	1,645	55	3,038	3,067	103
223	252	8	1,645	1,675	56	3,067	3,097	104
252	282	9	1,675	1,704	57	3,097	3,126	105
282	312	10	1,704	1,734	58	3,126	3,156	106
312	341	11	1,734	1,763	59	3,156	3,186	107
341	371	12	1,763	1,793	60	3,186	3,215	108
371	400	13	1,793	1,823	61	3,215	3,245	109
400	430	14	1,823	1,852	62	3,245	3,275	110
430	460	15	1,852	1,882	63	3,275	3,304	111
460	489	16	1,882	1,912	64	3,304	3,334	112
489	519	17	1,912	1,941	65	3,334	3,363	113
519	549	18	1,941	1,971	66	3,363	3,393	114
549	578	19	1,971	2,000	67	3,393	3,423	115
578	608	20	2,000	2,030	68	3,423	3,452	116
608	638	21	2,030	2,060	69	3,452	3,482	117
638	667	22	2,060	2,089	70	3,482	3,512	118
667	697	23	2,089	2,119	71	3,512	3,541	119
697	726	24	2,119	2,149	72	3,541	3,571	120
726	756	25	2,149	2,178	73	3,571	3,600	121
756	786	26	2,178	2,208	74	3,600	3,630	122
786	815	27	2,208	2,238	75	3,630	3,660	123
815	845	28	2,238	2,267	76	3,660	3,689	124
845	875	29	2,267	2,297	77	3,689	3,719	125
875	904	30	2,297	2,326	78	3,719	3,749	126
904	934	31	2,326	2,356	79	3,749	3,778	127
934	963	32	2,356	2,386	80	3,778	3,808	128
963	993	33	2,386	2,415	81	3,808	3,838	129
993	1,023	34	2,415	2,445	82	3,838	3,867	130
1,023	1,052	35	2,445	2,475	83	3,867	3,897	131
1,052	1,082	36	2,475	2,504	84	3,897	3,926	132
1,082	1,112	37	2,504	2,534	85	3,926	3,956	133
1,112	1,141	38	2,534	2,563	86	3,956	3,986	134
1,141	1,171	39	2,563	2,593	87	3,986	4,015	135
1,171	1,200	40	2,593	2,623	88	4,015	4,045	136
1,200	1,230	41	2,623	2,652	89	4,045	4,075	137
1,230	1,260	42	2,652	2,682	90	4,075	4,104	138
1,260	1,289	43	2,682	2,712	91	4,104	4,134	139
1,289	1,319	44	2,712	2,741	92	4,134	4,163	140
1,319	1,349	45	2,741	2,771	93	4,163	4,193	141
1,349	1,378	46	2,771	2,800	94	4,193	4,200	142
1,378	1,408	47	2,800	2,830	95		inclusive	

SECTION 1402.—DEFINITIONS

26 CFR 1.1402(a)–1: Net earnings from self-employment. Rev. Rul. 58–5

Guides to be used in determining whether income received by fiduciaries of decedents' estates should be considered in computing net earnings from self-employment under the Self-Employment Contributions Act of 1954.

The Internal Revenue Service has been requested to outline guides for determining when income received by fiduciaries of decedents' estates should be considered in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954.)

Section 1402 of the Act provides, in part, as follows:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle [subtitle A] which are attributable to such trade or business, * * *.

In order for an individual to have net earnings from self-employment, he must carry on a trade or business, either as an individual or as a member of a partnership. Whether or not a person is engaged in a trade or business is dependent upon all of the facts and circumstances in the particular case. However, the following will serve as guides in determining this question in the case of fiduciaries of decedents' estates:

(1) Professional fiduciaries will always be treated as being engaged in the trade or business of being fiduciaries, regardless of the assets contained in the estate.

(2) Generally, nonprofessional fiduciaries (that is, for example, persons who serve as executor or administrator in isolated instances, and then as personal representative for the estate of a deceased friend or relative) will not be treated as receiving income from a trade or business unless all of the following conditions are met:

(a) There is a trade or business among the assets of the estate,

(b) The executor actively participates in the operation of this trade or business,

(c) The fees of the executor are related to the operation of the trade or business.

The following examples represent applications of the above guides with respect to nonprofessional executors or administrators of decedents' estates:

EXAMPLE (1). *Executor who receives a flat fee for administering the estate.* *A*, a nonprofessional fiduciary, receives a flat $10,000 for administering the estate of *B*. *B*'s gross estate is valued at $150,000 and includes a trade or business which *A* manages for the period of time required to distribute the assets of the estate. Under the laws of the State in which *B*'s estate is probated, an executor is entitled to a five percent commission based upon the value of the assets distributed. Since *A* distributed the entire estate worth $150,000 he would have been entitled to $7,500 executor's commissions, based upon the statutory five percent allowance. Inasmuch as *A*, pursuant to court order, actually received $10,000 instead of $7,500 in commissions,

the excess, or $2,500, is regarded as being attributable to the operation of the trade or business of the estate. *A* must therefore treat this $2,500 as earnings from self-employment. The remaining $7,500 is regarded as being attributable to the normal fiduciary duties of marshalling the assets of the estate and should not be treated as trade or business income. On the other hand, if *A*'s total fee for administering the estate was equal to or less than $7,500 (the statutory executor's allowance in this case), and if nothing was said in the court order with respect to allocation of the fee, the entire fee would be regarded as being attributable to *A*'s fiduciary activities and no part of the fee would be treated as trade or business income to *A*.

EXAMPLE (2). *Executrix who receives a special fee for handling the estate's business.* *C*, the sole executrix of the estate of her husband, operates a drugstore belonging to the estate, pending dissolution of the estate. As her commission for handling the estate, *C* receives, pursuant to court order, $5,125 (based upon a percentage of the value of the assets distributed) and $500, in addition, for the operation of the drugstore. Under these circumstances, only the $500 commission for the operation of the drugstore constitutes earnings from self-employment. The $5,125 commission, based upon the value of the assets distributed is not related to the operation of the trade or business, and, accordingly, does not constitute earnings from self-employment.

EXAMPLE (3). *Coexecutor who does not participate in the operation of the estate's business.* *D* and *E* are coexecutors of an estate which includes a trade or business. *D* is totally unfamiliar with the operation of the business and leaves the entire management of the business to *E*. Under these circumstances, *D*, who does not participate in the operation of the business, cannot be treated as being in a trade or business. The fees received by *D* do not constitute net earnings from self-employment. *E*, however, actively participates in the operation of the business and the compensation received by him for the management of the estate's trade or business constitutes net earnings from self-employment.

In some cases the activities of the executor of a single estate may constitute the conduct of a trade or business even though the assets of the estate do not include a trade or business as such. If, for example, an executor manages an estate which requires extensive management activities on his part over a long period of time, an examination of the facts may show that such activities are sufficient in scope and duration to constitute the carrying on of a trade or business. If doubt exists concerning the status of a fiduciary believed to be in this category, the complete facts should be transmitted to the National Office for consideration. See Rev. Rul. 54–172, C. B. 1954–1, 394.

Rev. Rul. 58–112

An individual, while serving as an officer of a company, negotiated a sale of his company's stock to another corporation. For such services the purchaser corporation paid him a commission in four equal installments during the following year. The individual does not maintain an office or otherwise hold himself available to the public for the negotiation of stock transactions. *Held*, the services

performed by the individual in arranging for the sale of the company's stock to the corporation did not constitute the carrying on of a trade or business as contemplated by the Self-Employment Contributions Act of 1954. Accordingly, such income may not be taken into consideration in computing net earnings from self-employment for purposes of the tax imposed under such Act.

Advice has been requested whether services performed under the circumstances described herein constitute the carrying on of a trade or business within the contemplation of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954).

An individual, while serving as an officer of a company, concluded an agreement for the sale of the stock of the company to another corporation. Settlement of the transaction was completed in December 1956. In payment for his services in arranging the sale of the stock, the purchaser corporation paid him a commission in four equal installments during the year 1957. This is the one and only transaction of its kind in which he was ever engaged.

Section 1402 of the Self-Employment Contributions Act of 1954 provides in part:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle [Subtitle A] which are attributable to such trade or business, * * *

* * * * * * *

(c) TRADE OR BUSINESS.—The term "trade or business," when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162, (relating to trade or business expenses) * * *

In determining the existence or nonexistence of a trade or business, certain factors are taken into consideration, such as (1) continuity and regularity of activities, as distinguished from an occasional action, and (2) the purpose of livelihood or profit from the activity in which the individual is engaged. While neither of these factors is in itself controlling in all cases, when considered in conjunction with other existent facts, they do have a bearing in reaching a conclusion in a particular case.

On the basis of the facts set forth herein, it is held that the services performed by the individual during the year 1956 in arranging for the sale of the stock of the company to the corporation did not constitute the carrying on of a trade or business within the meaning of section 1402 of the Self-Employment Contributions Act of 1954. Accordingly, the income received with respect to such services may not be taken into consideration in computing net earnings from self-employment for the purpose of the tax imposed under the Act. Such income does, however, constitute gross income for Federal income tax purposes. See Rev. Rul. 55–431, C. B. 1955–2, 312.

(Also Section 761; 1.761–1.) Rev. Rul. 58–166

Income derived by an individual from his participation as a co-owner of a mineral lease is includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954, where the individual's interest therein is acquired pur-

suant to a joint operating agreement providing for (1) payment by the coowner of his share of operating expenses involving the lease; (2) delegation of authority to an agent to manage and control the development and operation of properties in connection with the lease; and (3) revocable authority of the agent to dispose of the coowner's share of the production.

A question has been raised relative to the treatment, for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), of income received by an individual from his participation as a coowner of a mineral lease under the circumstances described below.

In the instant case the coowner entered into an agreement with the owner of certain mineral leases, pursuant to which such coowner acquired title to a fractional working interest in an oil and gas lease. The agreement provides, among other things, that the coowner shall pay his pro rata share of costs of development and expenses of operations involving the lease. Under the terms of the agreement, the coowner appointed the owner as his agent and delegated to him complete authority to manage and control the development and operation of properties involving the lease. The owner-agent was also authorized, until otherwise instructed by the coowner to enter into selling contracts for the sale of the coowner's share of the production of any producing well for such reasonable periods of time as are consistent with the minimum needs of the industry, but not to exceed one year; and to arrange for the purchaser to pay the proceeds to a corporate trustee for distribution after deduction of expenses and trustee's charges.

Section 1402 of the Self-Employment Contributions Act of 1954, *supra*, provides in part:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle [Subtitle A] which are attributable to such trade or business, plus his distributive share (whether or not distributed) of income or loss described in section 702(a)(9) from any trade or business carried on by a partnership of which he is a member; * * *

* * * * * * *

(c) TRADE OR BUSINESS.—The term "trade or business," when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162, (relating to trade or business expenses) * * *

Whether coownership in a mineral lease constitutes the carrying on of a "trade or business" is dependent upon all the facts and circumstances in the particular case. In this connection a determination must be made whether, by the terms of the agreement pursuant to which the coowner acquired his interest in such lease, he is participating in the venture as a party to a joint operating agreement or whether, by such agreement, an association taxable as a corporation has been created.

In the instant case the coowner of the leasehold interest has a corresponding fractional interest in the operating rights which inhere in the leasehold and entitles each owner thereof to extract and sell his share of the oil, gas, or other hydrocarbons produced from the property. An investment in the working interest of an oil

and gas lease is not analogous to investments in securities or rental properties. The proper development of an oil and gas lease requires a high degree of skill and discretion on the part of those having an interest in the lease, or their agents. Neither is the operation of a producing lease a simple matter. In order to adopt suitable production methods, considerable knowledge and skill in ascertaining the characteristics of the reservior from which the wells are producing are required in order to accomplish maximum recovery. For self-employment tax purposes, the trade or business need not be carried on by the individual personally, but may be conducted through an agent acting in his behalf. See section 1.1402(a)-1(b)(2) of the Income Tax Regulations.

It appears clear that the coowner has avoided the formation of an association taxable as a corporation for Federal income tax purposes by making the agent's authority to dispose of his share of production revocable at his will, and by limiting the agent's authority to sell his share of production so that the agent may not commit such share for a period in excess of one year. See I. T. 3948, C. B. 1949-1, 161.

It is the opinion of the Internal Revenue Service, based on the information set forth above, that the activities of the coowner in question constitute the carrying on of a trade or business under a joint operating agreement. Accordingly, income derived by such individual from his participation as coowner of the mineral lease in question is includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

Section 1.761-1(a)(1) of the Income Tax Regulations provides, in part, that the term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not a corporation within the meaning of the Internal Revenue Code of 1954.

In clarifying the requirement for exclusion of an unincorporated organization from the treatment as a partnership under subchapter K of Chapter 1 of the Code, section 1.761-1(a)(2) of the regulations, as amended by Treasury Decision 6198, C. B. 1956-2 461, provides, in part, as follows:

> (iii) *Operating agreements.*—Where the participants in a joint production, extraction or use of property—
>
> (*a*) Own the property as coowners, either in fee or under lease or other form of contract granting exclusive operating rights, and
>
> (*b*) Reserve the right separately to take in kind or dispose of their shares of any property produced, extracted, or used, and
>
> (*c*) Do not jointly sell services or the property produced or extracted, although each separate participant may delegate authority to sell his share of the property produced or extracted for the time being for his account, but not for a period of time in excess of the minimum needs of the industry, and in no event for more than one year, then
>
> such group may be excluded from the application of the provisions of subchapter K under the rules set forth in subdivision (iv) of this subparagraph. * * *

In the instant case, there is no indication that an election to be excluded from subchapter K was filed by the members of the organization created by the joint operating agreement. Until an election to be excluded from subchapter K is filed on behalf of this organization, it constitutes a partnership under the regulations cited above,

and is required to file a partnership information return on Form 1065. If no election has been filed on behalf of this organization, the coowner's share of the net production income would constitute his distributive share from a trade or business carried on by a partnership of which he is a member and is includible in computing his net earnings from self-employment. On the other hand, if an election was in fact filed on behalf of this organization, the coowner's share would constitute income derived from a trade or business carried on by him within the meaning of section 1402(a) of the Self-Employment Contributions Act of 1954, *supra*.

Rev. Rul. 58–267

The income from a trade or business carried on by a guardian or committee for a person adjudicated incompetent is includible in computing the self-employment income of the incompetent person under the Self-Employment Conrtibutions Act of 1954.
Revenue Ruling 56–22, C. B. 1956–1, 588, modified.

Reconsideration has been given to the last paragraph of Revenue Ruling 56–22, C. B. 1956–1, 558, wherein it is stated:

It is concluded that the husband owned his business until he was adjudicated of unsound mind and that his wife carried on the business for him as agent or employee until such time. Accordingly, it is held that the business income reported on the return by the wife for the husband constitutes self-employment income to the husband within the meaning of section 1402(b) of the Code. It is further concluded that subsequent to being adjudicated of unsound mind, the husband was the beneficiary of an estate which consisted of property which he had previously owned legally. The income derived from the business during this period does not constitute self-employment income to the husband.

Upon reconsideration, the Internal Revenue Service is of the opinion that the last two sentences of the quoted paragraph are incorrect inasmuch as an adjudication of incompetency does not divest the incompetent of title to property owned by him at the time of the adjudication and creates no separate estate of the incompetent which constitutes a taxable entity for Federal tax purposes. The view of the Service that the estate of an incompetent is not a taxable entity separate and distinct from the incompetent for Federal income tax purposes was the subject of I. T. 3996, C. B. 1950–1, 130. The tax on self-employment income under section 1401 of the Code is an income tax and the general income tax rule treating the incompetent himself as the taxpayer must clearly be applied with respect to that tax as well. See especially in that regard the report of the Senate Committee on Finance on the Social Security Act Amendments of 1950, S. Rept. No. 1669, 81st Cong. C. B. 1950–2, 302, at pages 352–353, 354. Accordingly, the income of a trade or business in fact carried on for an incompetent by his guardian or committee is to be included in computing his net earnings from self-employment.

Rev. Rul. 58–328

No part of the income distributed or accruing to members of a corporation exempt from Federal income tax under section 501(d) of the Internal Revenue Code of 1954, as a religious or apostolic organization, is includible in the computation of the members' net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

Advice has been requested whether income distributed or accruing to members of an incorporated religious society, which is exempt from Federal income tax under section 501(d) of the Internal Revenue Code of 1954, as a religious or apostolic organization, should be included in the computation of the members' net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954).

The instant organization is composed of individuals who are required to be members of a particular church. It is incorporated as a religious corporation under the laws of its state. The corporation is engaged in farming, stock raising, and other branches of agriculture. Its affairs are directed by a board of directors and any profit made is the profit of the corporation and of no individual. The members are not engaged in business on their own account but for the benefit of the corporation and under the supervision of a member appointed by the board of directors. The members all join in the conduct of the business of the corporation without pay, wages, or salary. The members of the society eat in a community dining hall and are assigned living quarters by the corporation according to their needs. The income of the corporation is used to support the members, their dependents, and their church. Any surplus earnings are accumulated and used to create trust funds and acquire property for the descendants of the members. The bylaws provide that no member of the corporation and no member of his family shall have any property right or rights in any property of the corporation.

The organization is exempt from Federal income tax under the provisions of section 501(d) of the Code. Section 501(d) provides for exemption from taxation of "Religious apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the taxable income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a *dividend received.*" [Italics supplied.]

Section 1402(a) of the Self-Employment Contributions Act of 1954 provides, among other things, that the term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the allowable deductions attributable thereto, plus his distributive share (whether or not distributed) of income or loss described in section 702(a)(9) from any trade or business carried on by a partnership of which he is a member; except that in computing such gross income and deductions and such distributive share of partnership ordinary income or loss, there shall be excluded among other things, dividends on any share of stock, unless such dividends are received in the course of a trade or business as a dealer in stocks or securities.

It is the position of the Internal Revenue Service that a member's share of the income of the corporation constitute a "dividend received" for purposes of section 501(d) of the Code. Although section 501(d) does not specifically refer to dividends on stock, it seems clear that the Congress, by its use in that section of the term "dividends received,"

did not intend that the share of income of a religious or apostolic corporation reported by an individual member be considered gross income derived from business or a distributive share of partnership gross income.

Accordingly, it is held that, although includible in gross income for Federal income tax purposes, no part of a member's pro rata share of the taxable income of the instant corporation (whether distributed or not) is includible in the computation of his net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

Income derived from the sale of cattle raised on allotted and restricted Indian lands while such lands are held in trust by the United States, as trustee, under section 5 of the General Allotment Act of 1887. See Rev. Rul. 58–64, page 12.

Net earnings under a landlord-tenant arrangement where the landlord materially participates in the production of agricultural and horticultural crops. See Rev. Rul. 58–257, page 9.

Income derived by an Indian from cultivation of unallotted tribal land. See Rev. Rul. 58–320, page 24.

---

26 CFR 1.1402(c)–1: Trade or business. Rev. Rul. 58–195

An individual is employed by a local government on a full-time basis. As sideline activities, separate and apart from his services for the city, the individual is engaged in making and servicing loans at interest which are secured by real estate and chattel mortgages. *Held*, such sideline activities constitute a trade or business for purposes of the Self-Employment Contributions Act of 1954, and the amounts received as interest are includible in computing such individual's net earnings from self-employment for purposes of such Act.

Advice has been requested whether amounts received by an individual as interest on loans made as a sideline activity under the circumstances stated below are includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954).

In the instant case, *A* has been employed on a full-time basis by the city of *M* for a number of years. During such time and separate and apart from his work as a city employee, *A* has regularly made loans to individuals at interest as a side line activity. These loans are generally secured by real estate and chattel mortgages. *A* does not advertise as being in the business of lending money and does not have a business address as such. Most of *A*'s clients come to him on the recommendations of realtors, accountants, banks, and former clients. He receives all payments on loans directly, makes all necessary disbursements, determines whether the taxes, insurance, etc., are currently paid and inspects any property involved for proper maintenance.

Section 1402 of the Act provides in part:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by the individual from any trade or business carried on by such individuals, less the deductions allowed by this subtitle (Subtitle A) which are attributable to such trade or business, * * *; except that in computing such gross income and deductions * * *

(2) there shall be excluded dividends on any share of stock, and interest on any bond, debenture, note, or certificate, or other evidence of indebtedness, issued with interest coupons or in registered form by any corporation * * * unless such dividends and interest * * * are received in the course of a trade or business as a dealer in stocks or securities;

* * * * * * *

(c) TRADE OR BUSINESS.—The term "trade or business", when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162, * * * except that such term shall not include—

* * * * * * *

(2) the performance of service by an individual as an employee * * *;.

Section 1.1402(a)-1(c)(2)(ii) of the Income Tax Regulations provides in part that interest other than interest excluded in accordance with section 1402(a)(2) of the Act, *supra*, "received in the course of any trade or business (such as interest received by a pawnbroker on his loans or interest received by a merchant on his accounts or notes receivable) is not excluded" in computing net earnings from self-employment.

Admittedly, *A* is an employee of the city of *M*, for Federal employment tax purposes, under the usual common law rules applicable in making such a determination. This is true even though his services are excepted from "employment" by section 3121(b)(7) of the Federal Insurance Contributions Act and section 3306(c)(7) of the Federal Unemployment Tax Act (chapters 21 and 23, subtitle C, Internal Revenue Code of 1954). See Rev. Rul. 55-385, C. B. 1955-1, 100. Since *A* has the status of an employee with respect to the services performed by him for the city of *M*, such services are excluded from the term "trade or business" by virtue of the provisions of section 1402(c)(2) of the Self-Employment Contributions Act of 1954. However, with respect to his sideline activities, which are separate and apart from his services as a city employee, *A* is not an employee.

Whether or not an individual is engaged in a trade or business depends upon the facts in the particular case. As a general rule, a person who is regularly engaged in an occupation or profession for profit which constitutes in whole or in part his livelihood, and who, with respect to such activity, is not regarded as an employee for Federal Insurance Contributions Act purposes or not otherwise excluded from the self-employment provisions, is engaged in a trade or business for self-employment tax purposes.

In the instant case, since *A* personally makes and services the loans as a regular sideline activity from which he earns a part of his livelihood, it is held that such activities carried on under the circumstances described constitute a trade or business within the purview of the Self-Employment Contributions Act of 1954. Inasmuch as the interest *A* receives in the course of such trade or business is not excluded under such Act, it is includible in computing his net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

It should be pointed out, in this connection, that interest derived from sources other than the conduct of a trade or business is not includible in computing net earnings from self-employment. For example, an individual who merely lends money and holds the mortgage until maturity may not include the interest in computing his net earnings from self-employment, since this is an investment rather than a trade or business. See section 1.1402(a)-1(c)(2)(ii) of the Income Tax Regulations.

---

26 CFR 1.1402(e)-1: Election by ministers, members of religious orders, and Christian Science practitioners for self-employment coverage. Rev. Rul. 58-229

> *A* is a duly ordained minister of a church and a member of a religious order which requires its members to take an oath of poverty. His monastic order has released him from his oath of poverty, effective for the period during which he is performing services as secretary of the *M* Diocese. This position is outside of the monastery in which he lives and is not under its jurisdiction. *A* is paid the sum of *x* dollars per annum for the performance of such services and is permitted to dispose of such earnings as he sees fit. *Held*, *A* is performing services in the exercise of his ministry and is eligible to file a waiver certificate for self-employment coverage pursuant to the provisions of section 1402(e) of the Self-Employment Contributions Act of 1954. *Held further*, if *A* files a valid waiver certificate, his remuneration for such services will be includible in computing his net earnings from self-employment for purposes of the tax imposed by such Act.

Advice has been requested whether a duly ordained minister of a church may qualify for voluntary self-employment coverage under the provisions of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), in a situation in which he was required to take an oath of poverty to meet the requirements of membership in a monastic order but, because of his appointment to a position outside of the monastery which is not subject to monastic jurisdiction, was released from his oath of poverty by such order.

A has been appointed as secretary to the *M* Diocese by his Bishop at a salary of *x* dollars per annum. *A* is a member of a monastic order which requires all of its members to take an oath of poverty. The rules of the order provide that certain of its members may be allowed to teach in schools and accept public position and, as such, they are permitted to enjoy the same privileges extended to laymen. The rules also provide that if, by permission of his Diocesan Bishop, a member is appointed to a position outside of his own monastery and if such a position does not fall under the jurisdiction of his own monastery, the member may be released from his oath of poverty by such order and, in such event, any earnings received by the member for the performance of such services may be disposed of by him as he sees fit. *A*'s secretarial position is outside of the monastery; it is not under the jurisdiction of the monastery; *A* is not required to act as such secretary by the monastic order; and *A* has been released from his oath of poverty by such order while he acts as secretary to the *M* Diocese.

Section 1402(c) of the Self-Employment Contributions Act of 1954 provides that the term "trade or business," when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162 of the Code (relating to trade or business expenses), except that such term shall not include, among others, the performance of services by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order. Services performed by a minister in the exercise of his ministry includes the ministration of sacerdotal functions and the conduct of religious worship, and the control, conduct, and maintenance of religious organizations (including the religious boards, societies, and other integral agencies of such organizations), under the authority of a religious body constituting a church or church denomination. Services performed by a member of a religious order in the exercise of duties required by such order includes all duties required of the member by the order. The nature or extent of such service is immaterial so long as it is a service which he is directed or required to perform by his ecclesiastical superiors. See Rev. Rul. 57–129, C. B. 1957–1, 313.

Section 1402(e) of the Act, as added by the Social Security Amendments of 1954, extends self-employment coverage, on a voluntary basis, to both employed and self-employed ministers and members of certain religious orders, for taxable years ending after 1954. A duly ordained, commissioned, or licensed minister of a church or a member of a religious order (other than a member of a religious order who has taken a vow of poverty as a member of such order) may file a certificate certifying that he elects to have the insurance system established by title II of the Social Security Act extended to services performed by him in the exercise of his ministry or in the exercise of duties required by such order, as the case may be.

A strict construction of the words "who has taken a vow of poverty" as applied to members of religious orders, would seem to exclude such members from self-employment coverage, including those members who also are ordained ministers, irrespective of whether they are subsequently released from their vows. However, it is not believed that it was the intent of the Congress to exclude from coverage members of religious orders which have taken vows of poverty but who are subsequently released from their vows, either temporarily or permanently, for the performance of ministerial services. Therefore, it is the position of the Service that members of religious orders who have been released from their vows of poverty, either temporarily or permanently, for the performance of services in the exercise of the ministry, are eligible to file waiver certificates under the provisions of section 1402(e), *supra*.

In the instant case, *A* is a duly ordained minister as well as a member of a religious order which requires its members to take an oath of poverty. *A*'s monastic order has released him from his oath of poverty because his Bishop has appointed him secretary to the *M* Diocese, which position is outside of the monastery and not subject to its jurisdiction. It is concluded, therefore, that such services are performed by *A* in the exercise of his ministery and not as a part of his duties as a member of a religious order. Accordingly, it is held

that *A* is eligible to file a waiver certificate for self-employment coverage pursuant to the provisions of section 1402(e) of the Self-Employment Contributions Act of 1954.

If *A* files a valid waiver certificate and performs services in the exercise of his ministery and during such performance he is subject neither to the jurisdiction of his order nor to his oath of poverty, such services will constitute a trade or business within the meaning of section 1402(c), *supra*, and any remuneration received by him for the performance of services as secretary of the *M* Diocese, under the circumstances stated, will be includible in computing his net earnings from self-employment for purposes of the tax imposed by the Self-Employment Contributions Act of 1954.

CHAPTER 3.—WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS AND TAX-FREE COVENANT BONDS

SUBCHAPTER A.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

SECTION 1441.—WITHHOLDING OF TAX ON NONRESIDENT ALIENS

26 CFR 1.1441–1: Requirement for withholding of tax on nonresident aliens and foreign corporations.

Withholding of tax on a total distribution under an employees' exempt trust, with respect to an employee who is a nonresident alien residing in Australia. See Rev. Rul. 58–248, page 621.

---

26 CFR 1.1441–2: Income subject to withholding. Rev. Rul. 58–34

A state-chartered savings and loan association, controlled by its stockholders and "borrower members" and whose investment certificate holders are not members of the association, is a person carrying on the banking business within the meaning of section 1441 of the Internal Revenue Code of 1954. Amounts paid on the investment certificates owned by nonresident alien individuals not engaged in trade or business in the United States constitute interest on deposits with persons carrying on the banking business and, therefore, are not subject to the withholding of tax under section 1441 of the Code.

Advice has been requested whether a state-chartered savings and loan association whose investment certificate holders are not members of the association is a person carrying on the banking business within the meaning of section 1441 of the Internal Revenue Code of 1954, and whether amounts paid to nonresident alien individuals on its investment securities constitute income from sources within the United States, subject to withholding of tax under section 1441 of the Code.

M savings and loan association is a guarantee stock organization incorporated under the laws of the State of *R* as a state savings and loan association. The corporation was formed to transact the general business of a savings and loan association and for the purpose of issuing membership shares, stock and investment certificates. Its authorized capital is divided into shares of guarantee stock having a stated value, all of which are set apart as a fixed and permanent capital. The owners of the stock are the owners of the corporation, and, together with the borrower members who have one vote each, are the only ones who have a vote in the election of corporate officers at annual meetings. The investment certificates, issued as fully paid investment certificates or as periodic payment investment certificates, with or without passbooks, in effect represent deposits in the association which may be withdrawn in whole or in part on demand, subject only to a statutory notice or intention to withdraw. The holders of these certificates are not members of the association and have none of the rights, powers, and liabilities incident thereto. They have no right to participate in the profits or dividends of the association. They are, however, entitled to interest on the value of their investment as determined by the board of directors and/or the state savings and loan commissioner and as provided by law.

Section 1441 of the Code requires the withholding of tax at the source with respect to all items of fixed or determinable annual or periodical income from sources within the United States paid to a nonresident alien individual, except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States.

In Revenue Ruling 54–624, C. B. 1954–2, 16, it is held that saving accounts in Federal savings and loan associations are not deposits with persons carrying on the banking business and that distributions of earnings by these associations constitute dividend income to the holders of such savings accounts. These rules apply equally to state-chartered savings and loan associations unless it can be shown that such associations are not in fact similar in all material respects to the organizational make-up of Federal savings and loan associations. In a Federal savings and loan association, funds deposited therein are placed in savings accounts, and earnings, less expenses of operation and surplus, are periodically paid to, or credited to, the holders of such savings accounts. All holders of an association's savings accounts and all borrowers therefrom are members of the association and have, through participation in the election of a board of directors, a voice in the management of the association.

M savings and loan association, however, differs from a Federal savings and loan association in that holders of investment certificates are not members of the association, have no voice in its management or right to participate in the event of dissolution, and are entitled only to a return of their deposit plus interest. A debtor-creditor relationship exists between *M* and its investment certificate holders, whereas such relationship does not exist between a Federal savings and loan association and holders of savings accounts in such association.

Accordingly, it is held that a state-chartered savings and loan association, controlled by its stockholders and "borrower members" and

whose investment certificate holders are not members of the association, is a person carrying on the banking business within the meaning of section 1441 of the Code. Amounts paid on the investment certificates owned by nonresident alien individuals not engaged in trade or business in the United States constitute interest on deposits with persons carrying on the banking business and, therefore, are not subject to the withholding of tax under section 1441 of the Code.

CHAPTER 6.—CONSOLIDATED RETURNS

SUBCHAPTER A.—RETURNS AND PAYMENT OF TAX

SECTION 1502.—REGULATIONS

26 CFR 1.1502–31: Bases of tax computation. Rev. Rul. 58–56
(Also Sections 863, 904, 921, 922.)

In an affiliated group of corporations, those members of the group which operate in the Western Hemisphere outside of the United States and whose only source of income is from dividends, interest, and capital gains shall, for the purpose of the consolidated section 922 deduction, be excluded in determining the consolidated taxable income attributable to members of the group which are Western Hemisphere trade corporations.

In computing the limitation under section 904(a) of the Internal Revenue Code of 1954, to determine the allowable foreign tax credit, the Western Hemisphere trade corporation deduction provided by section 922 of the Code should be apportioned or allocated between income from sources within and income from sources without the United States as required by section 863 of the Code.

Revenue Ruling 56–316, C. B. 1956–2, 597, amplified.

Advice has been requested (1) concerning the applicability of the consolidated section 922 deduction provided for in section 1.1502–31(a)(15) of the Income Tax Regulations where some members of an affiliated group of corporations, which operate in the Western Hemisphere but outside the United States, have gross income only from dividends, interest, and capital gains; and (2) whether the Western Hemisphere trade corporation deduction may be apportioned or allocated between income from sources within and income from sources without the United States in computing the limitation under section 904(a) of the Internal Revenue Code of 1954.

The taxpayer is a member of an affiliated group of corporations, some of which qualify as Western Hemisphere trade corporations within the meaning of section 921 of the Code. The affiliated group also includes several members whose sole operations consist of exploration activities conducted in the Western Hemisphere outside the United States, and have gross income solely from dividends, interest, and capital gains. The affiliated corporations filed consolidated income tax returns for several years and, in computing the limitation on foreign tax credits, allocated the Western Hemisphere trade corporation deduction between income from sources within and income from sources without the United States.

Section 1.1502–31 of the Income Tax Regulations provides, in part, as follows:

(a) DEFINITIONS.— * * *

* * * * * * *

"(15) *Consolidated Section 922 Deduction.*—The consolidated section 922 deduction, relating to Western Hemisphere trade corporations, shall be that portion of the consolidated taxable income attributable to those members of the affiliated group which are Western Hemisphere trade corporations (computed without regard to the consolidated section 922 deduction) multiplied by the fraction specified in section 922(2)."

The special deduction allowed by section 922 of the Code is a fraction of the taxable income of a Western Hemisphere trade corporation computed without regard to the deduction allowed by that section. Section 921 of the Code defines the term "Western Hemisphere trade corporation" as a domestic corporation all of whose business (other than incidental purchases) is done in any country or countries in North, Central, or South America, or in the West Indies, if 95 percent or more of the corporation's *gross income* for the three-year period immediately preceding the close of the taxable year was derived from sources without the United States, and if 90 percent or more of its gross income for such period was derived from the active conduct of a trade or business.

Corporations in similar circumstances, but having no gross income of any kind, may not be classified as Western Hemisphere trade corporations. See Revenue Ruling 56–316, C. B. 1956–2, 597. It is stated in I. T. 1785, C. B. II–2, 258 (1923), and I. T. 2318, C. B. V–2, 76 (1929), that dividends are not income derived from the active conduct of a trade or business. See also section 1.921–1(a)(3) of the Income Tax Regulations. Interest received on money loaned and gains from the sale of capital assets as defined in section 1221 of the Code are likewise not regarded as income derived from the active conduct of a trade or business. However, gains from the sale of property used in the trade or business, which are treated as capital gains under section 1231 of the Code, are considered as income derived from the active conduct of a trade or business, unless such sales are made in connection with a complete or partial liquidation of the corporation. Accordingly, it is held that those members of an affiliated group of corporations, which operate in the Western Hemisphere outside the United States and whose only source of income is from dividends, interest, and capital gains, shall, for the purpose of the consolidated section 922 deduction, be excluded in determining the consolidated taxable income attributable to members of the group which are Western Hemisphere trade corporations.

In determining the allowance of the foreign tax credit, section 904 of the Internal Revenue Code of 1954 places a limitation thereon, as follows:

(a) LIMITATION.—The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

Section 863 of the Code, pertaining to items not specified as income from sources within or without the United States, provides, in part, as follows:

(a) ALLOCATION UNDER REGULATIONS.—Items of gross income, expenses, losses, and deductions, other than those specified in sections 861(a), 862(a), shall be

allocated or apportioned to sources within or without the United States, under regulations prescribed by the Secretary or his delegate. Where items of gross income are separately allocated to sources within the United States, there shall be deducted (for the purpose of computing the taxable 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 cannot definitely be allocated to some item or class of gross income. * * *

Where the tax liability is based on income from sources within and without the United States, the special deduction allowed corporations by section 922 of the Code, relating to Western Hemisphere trade corporations, should be taken into account in the computation of taxable income from such sources. Inasmuch as the Western Hemisphere trade corporation deduction is computed on the taxable income of the corporation, including any income from sources within as well as without the United States, such deduction should be apportioned or allocated pursuant to the provisions of section 863 of the Code.

Accordingly, it is held that the Western Hemisphere trade corporation deduction should be allocated between income from sources within and income from sources without the United States in computing the limitation under section 904(a) of the Code.

(Also Section 172; 1.172–4.) Rev. Rul. 58–329

Where a subsidiary corporation, a member of an affiliated group which filed consolidated income tax returns on the calendar year basis, was sold in September, 1957, and filed a separate return for the short period ended December 31, 1957, a consolidated net operating loss carryover from prior years shall be carried over to the consolidated return of the affiliated group for the calendar year 1957. The amount of the consolidated net operating loss carryover attributable to the former subsidiary, not absorbed in such consolidated return, is available if within the time limitations of section 172 (b) (1) as a carryover to the separate income tax return of the former subsidiary for the short period ended December 31, 1957, which is regarded as a subsequent taxable year within the meaning and intent of section 1.1502–31(d) and 1.1502–31(e) of the Income Tax Regulations.

Advice has been requested as to the availability to the consolidated group and to the former subsidiary of a consolidated net operating loss carryover attributable to a subsidiary corporation whose stock was sold by the parent corporation during the taxable year and which filed a separate income tax return for the balance of the taxable year when it was no longer a member of the affiliated group.

M is the common parent of an affiliated group of corporations which has filed consolidated income tax returns on the calendar year basis since 1953. A consolidated return was also filed for the calendar year 1957. No Federal income tax was payable during the calendar years 1953 to 1956, inclusive, because of continuing losses of *N*, a wholly-owned subsidiary of *M* included in the affiliated group. The 1956 consolidated return of the affiliated group disclosed a consolidated net operating loss carryover to 1957 which was attributable entirely to losses of *N*. In September, 1957, *M* sold all of the stock of *N* to several individuals. *N* had substantial income in 1957 and filed a separate income tax return for the short period from the date of sale to December 31, 1957.

Section 172(b)(1) of the Internal Revenue Code of 1954 provides as follows:

> (1) YEARS TO WHICH LOSS MAY BE CARRIED.—A net operating loss for any taxable year ending after December 31, 1953, shall be—
>
> (A) a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and
>
> (B) a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

Section 1.1502–31(b)(6) of the Income Tax Regulations provides that if an affiliated group filing a consolidated return sustains a consolidated net operating loss within the provisions of section 172 of the Code, relating to the net operating loss deduction, and if there are included as members of such group, one or more corporations which made separate returns, or joined in a consolidated return filed by another affiliated group, either in a preceding taxable year or a succeeding taxable year, the portion of such consolidated net operating loss attributable to such corporations severally shall be determined, such portion in the case of any such corporation being determined in an amount proportionate to the net losses (capital net losses and ordinary net losses alike) of the several affiliated corporations having net losses, to the extent that such losses were taken into account in the computation of the consolidated net operating loss.

Section 1.1502–31–(d) of the regulations provides that the consolidated net operating loss of an affiliated group shall be used in computing the consolidated net operating loss deduction, notwithstanding that one or more corporations, members of the group in the taxable year in which such loss originates, make separate returns for a subsequent taxable year (or in the case of a carryback computation for a preceding taxable year), but only to the extent that such consolidated net operating loss is not attributable to such corporations; and such portion of such consolidated net operating loss as is attributable to the several corporations making separate returns for a subsequent taxable year (or in the case of a carryback computation for a preceding taxable year) shall be used by such corporations severally as carryovers or as carrybacks in such separate returns.

Section 1.1502–31(e) of the regulations provides that any period of less than 12 months for which either a separate return or a consolidated return is filed under the provisions of section 1.1502–13 of the regulations shall be considered as a taxable year.

In the instant case, the period for which the income of *N* was included in the consolidated return for the calendar year 1957 and the period during 1957 subsequent to the sale of its stock for which a separate return was filed by *N* are each considered to be a taxable year of *N* for the purpose of the net operating loss carryover and carryback provisions of the Code. See Rev. Rul. 57–294, I. R. B. 1957–26, 15.

Accordingly, it is held that where a subsidiary corporation, a member of an affiliated group which filed consolidated income tax returns on the calendar-year basis, was sold in September, 1957, and filed a separate return for the short period ended December 31, 1957, a consolidated net operating loss carryover from prior years shall be carried over to the consolidated return for the calendar year 1957.

The amount of the consolidated net operating loss attributable to the subsidiary, not absorbed in such consolidated return, is available as a carryover to the separate income tax return of the subsidiary for the short period ended December 31, 1957, which is regarded as a subsequent taxable year within the meaning and intent of section 1.1502–31(d) and section 1.1502–31(e) of the regulations.

SECTION 1503.—COMPUTATION AND PAYMENT OF TAX

26 CFR 1.1503–1: Computation and payment of tax. Rev. Rul. 58–246

> In the case of an affiliated group of corporations filing a consolidated return, the additional tax of two percent is imposed as a surtax, under the authority of section 11(c) of the Internal Revenue Code of 1954, upon the entire consolidated taxable income as defined in section 1503(a) of the Code. This is in addition to the surtax otherwise imposed on corporations under section 11(c) of the Code with respect to taxable income which exceeds $25,000.

Advice has been requested regarding the computation of the additional tax of two percent imposed upon an affiliated group of corporations filing a consolidated return.

Section 1503(a) of the Internal Revenue Code of 1954, relating to the computation and payment of tax, provides:

> GENERAL RULE.—In any case in which a consolidated return is made or is required to be made, the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under section 1502 prescribed prior to the last day prescribed by law for the filing of such return; except that the tax imposed under section 11(c) or section 831 shall be increased for any taxable year by 2 percent of the consolidated taxable income of the affiliated group of includible corporations. For the purposes of this section, the term 'consolidated taxable income' means consolidated taxable income computed without regard to the deduction provided by section 242 for partially tax-exempt interest.

Section 11(c) of the Code provides:

> SURTAX.—The surtax is equal to 22 percent of the amount by which taxable income (computed without regard to the deduction, if any, provided in section 242 for partially tax-exempt interest) exceeds $25,000.

It is evident from the above that the additional tax of two percent, in the case of a group of affiliated corporations filing a consolidated return, is imposed as a surtax and is computed upon the entire consolidated taxable income as defined in section 1503(a) of the Code. Such tax is imposed in addition to the surtax otherwise imposed upon such corporations under section 11(c) of the Code with respect to taxable income which exceeds $25,000.

Accordingly, in the case of an affiliated group of corporations filing a consolidated return, the additional tax of two percent is imposed as a surtax, under the authority of section 11(c) of the Code, upon the entire consolidated taxable income as defined in section 1503(a) of the Code. This is in addition to the surtax otherwise imposed on corporations under section 11(c) of the Code with respect to taxable income which exceeds $25,000.

SUBTITLE B.—ESTATE AND GIFT TAXES

CHAPTER 11.—ESTATE TAX

SUBCHAPTER A.—ESTATE OF CITIZENS OR RESIDENTS

PART II.—CREDITS AGAINST TAX

SECTION 2013.—CREDIT FOR TAX ON PRIOR TRANSFERS

Rev. Rul. 58–167

The amount received by a decedent from the estate of a prior decedent under a state statute as a widow's allowance represents property received by the decedent from the transferor's estate for the purpose of the credit for tax on prior transfers, provided it was paid out of the principal of the transferor's estate and was not allowed as a deduction from his gross estate as an amount expended for support of dependents under section 812(b)(5) of the Internal Revenue Code of 1939 where he died prior to September 24, 1950, or allowed as a marital deduction under either section 812(e) of the 1939 Code or section 2056 of the 1954 Code.

Advice has been requested whether a widow's allowance received by a decedent from the estate of her predeceased husband under a state statute may be considered as a "transfer of property" for the purpose of the credit for tax on prior transfers authorized by section 2013 of the Internal Revenue Code of 1954.

Section 2013 of the Code provides that the Federal estate tax imposed upon a decedent's estate shall be credited with all or a part of the amount of the Federal estate tax paid with respect to the transfer of property (including property passing as a result of the exercise or non-exercise of a power of appointment) to the decedent by or from a person who died within ten years before, or within two years after, the decedent's death.

Under the statutes in most jurisdictions a "widow's allowance," "widow's award," or "year's support" is treated as a charge against the estate in the same manner as an expense of administration. Nevertheless, a right to the allowance passes upon the decedent's death to his widow by operation of law and, to the extent actually paid, represents a transfer of property from the decedent to his widow within the meaning of section 2013 of the Code. If the widow has an absolute vested right to the allowance, it represents property passing to the surviving spouse which qualifies for the marital deduction but, if the right to the allowance is not an absolute vested right, it represents a terminable interest in property which passes to the surviving spouse and, hence, does not qualify for the marital deduction. The fact that the allowance may constitute a terminable interest is immaterial for the purpose of section 2013 of the Code.

The Report of the Senate Committee on Finance Senate Report No. 1622, 83d Congress, Second Session on section 2013 contains the following:

> In order to provide more certain rules under which property is valued for the purpose of computing the credit and the limitation of the credit under this section, your committee struck the provisions in the House bill on this matter and inserted new rules based on the principles established under the estate tax marital deduction. However, the distinction between terminable interests and other interests made in the case of the marital deduction is not continued in this section, since the terminable interest may have produced income that might be taxable in the decedent's estate. * * *

In view of the foregoing, it is held that the amount received by a decedent from the estate of a prior decedent under a State statute as a widow's allowance represents property received by the decedent from the transferor's estate for the purpose of the credit for tax on prior transfers, provided it was paid out of the principal of the transferor's estate and was not allowed as a deduction from his gross estate as an amount expended for support of dependents under section 812(b)(5) of the 1939 Code where he died prior to September 24, 1950, or allowed as a marital deduction under either section 812(e) of the 1939 Code or section 2056 of the 1954 Code. *See* Section 2013(d)(3) of the 1954 Code.

SUBCHAPTER B.—ESTATES OF NONRESIDENTS NOT CITIZENS

SECTION 2101.—TAX IMPOSED

Rev. Rul. 58–70

The decedent, a nonresident alien, was admitted to the United States in June, 1954, as a visitor for pleasure. He stayed until December, 1954. In August, 1954, he certified to a District Director of Internal Revenue that he was a nonresident alien residing in a European country. He was subsequently admitted again to the United States in November, 1955, temporarily until May, 1956. At this time he brought into the United States an automobile of foreign manufacture on which he did not pay duty. (This privilege is available only to nonresidents who bring automobiles into the United States for touring purposes.) In March of 1956 he left the United States for Montreal, Canada, for the purpose of obtaining an immigration visa in order to establish permanent residence in the United States so that he could apply for American citizenship. The visa was issued by the American Consul in Montreal on April 21, 1956. At that time he claimed that he was a resident of the country in Europe. He departed from the United States for Europe on April 25, 1956, having re-entered the United States on his visitor's permit, and remained in Europe until his death in July, 1956. *Held*, since the decedent never entered the United States except as a temporary visitor, he was not domiciled in the United States for the purpose of the Federal estate tax. Although the decedent may have formed the intent of establishing a domicile in the United States, his course of conduct does not support that degree of intent necessary to effect a change of domicile, *i. e.*, a present intent coupled with some affirmative act.

475254°—58——23

CHAPTER 12.—GIFT TAX

SUBCHAPTER A.—DETERMINATION OF TAX LIABILITY

SECTION 2503.—TAXABLE GIFTS

Exclusion applicable to donee's share of amount transferred to a reversionary trust. See Rev. Rul. 58–242, page 251.

Taxability and the computation of the exclusion for Federal gift tax purposes where an employee participant in a nonextempt employees' deferred compensation plan relinquishes all rights to amounts standing to his credit in the trust forming part of the plan to the trustees where such trustees have broad discretion in the allocation of trust funds. See Rev. Rul. 58–307, page 206.

SUBCHAPTER B.—TRANSFERS

SECTION 2512.—VALUATION OF GIFTS

Rev. Rul. 58–13

The failure of a spouse to relinquish her inchoate dower interest in real property will have no effect in determining the value of the property for Federal gift tax purposes.

Advice has been requested whether the failure of a spouse to relinquish her inchoate dower interest in real property will affect the value of the property for Federal gift tax purposes.

In the instant case the taxpayer conveyed a parcel of real estate to his two children as tenants in common. His wife did not join in the execution of the deed or to otherwise release her inchoate dower interest in the property. The question presented is whether the fair market value of the property should be reduced by the value of the wife's dower interest in determining the value of the gift for Federal gift tax purposes.

Section 2512 of the Internal Revenue Code of 1954 provides, in part, as follows:

(a) If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

(b) Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, * * *.

In the case of *Estate of Koert Bartman* v. *Commissioner*, 10 T. C. 1073, acquiescence C. B. 1948–2, 1, the donor transferred real property to each of his three children, his wife joining in the deeds and releasing her inchoate dower interest in the properties. With respect to the wife's dower interest, the court stated, "We shall not dwell upon the petitioner's second point, that the decedent's wife, by joining in the deeds, made a gift of her inchoate dower rights, and that the value

thereof should be deducted in determining the amount of the decedent's gifts. It is recognized in the petitioner's brief that *Correlia Mason Thompson*, 37 B. T. A. 793, is a direct ruling to the contrary; and, while we have carefully considered the petitioner's elaborate arguments in this connection, we adhere to the ruling in that case." See also the case of *David L. Hopkins* v. *Magruder*, 34 Fed. Supp. 381, affirmed, 122 Fed. (2d) 693, in which the court said, "the fact that the wife's dower interest had previously been created, namely, by her marriage to plaintiff, and therefore had previously attached to the property, does not justify making a deduction for its value."

In view of the foregoing, it is held that the failure of a spouse to relinquish her inchoate dower interest in real property will have no effect in determining the value of the property for Federal gift tax purposes.

Valuation of donee's share of amount transferred to a reversionary trust. See Rev. Rul. 58–242, page 251.

SUBTITLE C.—EMPLOYMENT TAXES

CHAPTER 21.—FEDERAL INSURANCE CONTRIBUTIONS ACT

SUBCHAPTER C.—GENERAL PROVISIONS

SECTION 3121.—DEFINITIONS

26 CFR 31.3121(a)–1: Wages. (Also 3306, 3401; 31.3306(b)–1.) Rev. Rul. 58–168

Tips or gratuities accounted for by an employee to the employer for purposes of determining the employee's compensation under the minimum wage act of a state constitute "wages" for Federal Employment tax purposes.

S.S.T. 301, C. B. 1938–1, 455, distinguished.

Advice has been requested whether tips or gratuities accounted for by an employee to the employer for purposes of determining the employee's compensation under a state minimum wage act constitute "wages" for Federal employment tax purposes.

The minimum wage act of the state here involved provides, among other things, that, in the case of industries where gratuities have customarily and usually constituted and have been recognized as a part of an employee's wages for hiring purposes, an employer may count such gratuities as cash wages in an amount not to exceed a stated sum per hour as a part of the required minimum hourly wages, provided he submits substantial evidence that the employee has actually received such amount. Gratuities are defined as voluntary monetary contributions received by the employee from a guest, patron, or customer for services rendered.

Under the Federal Employment Tax Regulations, the term "wages" means all remuneration for employment, with certain exceptions

and/or limitations not here material. Tips or gratuities paid directly to an employee by a customer of an employer, and not accounted for by the employee to the employer, do not constitute wages within the meaning of such regulations. See Rev. Rul. 57–71, C. B. 1957–1, 277. See also in this connection Rev. Rul. 57–397, C. B. 1957–2, 922, with respect to the status of so-called service charges made by an employer and subsequently disbursed to employees.

Under the provisions of the state minimum wage law referred to herein, a qualified employer may be granted an allowance in an amount not to exceed a stated sum per hour, on account of gratuities received by an employee from a guest, patron or customer, against the minimum cash wages required to be paid to the employee under that law, if the employer furnishes substantial evidence that gratuities to the extent of such claimed allowance have actually been received by the employee.

In order for the employer to obtain an allowance for gratuities in computing an employee's compensation under the foregoing provisions of law, he must of necessity require an accounting for gratuities from the employee. This situation fixes a definite relationship between the gratuities received by the employee and the compensation to be paid by the employer to the employee. Therefore, it is concluded that the amount of tips or gratuities claimed as a part of an employee's compensation under the state minimum wage law, constitutes additional "wages" as that term is defined in the Federal employment tax statutes.

Accordingly, it is held that the amount which the employer pays to an employee in cash and the amount of tips or gratuities accounted for by the employee in determining the employee's required compensation under the state minimum wage law must be taken into consideration, when computing the employee's "wages" for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act and the Collection of Income Tax at Source on Wages (chapters 21, 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

Compare S. S. T. 301, C. B. 1938–1, 455, which holds, in part, that the furnishing by an employee to an employer of a written statement of the amount of his tips merely for the purpose of enabling the employer to comply with the requirements of a state unemployment compensation act does not constitute an "accounting" as contemplated by Article 15(c) of Regulations 90 and S. S. T. 12, C. B. XV–2, 417 (1936).

(Also Section 3401; 31.3401(a)–1.) Rev. Rul. 58–269

The value of stock issued by a corporation to its organizers as compensation for services rendered prior to the incorporation thereof does not constitute "wages" for Federal employment tax purposes.

Advice has been requested whether the value of stock issued by a corporation to its officers as compensation for services rendered prior to its incorporation constitutes taxable wages for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), and for the Collection of Income Tax at Source on Wages (chapter 24, subtitle C, Internal Revenue Code of 1954).

In the process of forming the instant corporation, the organizers rendered services which contributed to its incorporation. Upon issuance of the charter the organizers became officers of the corporation and the corporation issued stock to them in exchange for the services they rendered prior to its formation.

In order for the compensation paid to the organizers to constitute taxable wages for purposes of the Federal Insurance Contributions Act, the organizers would have to be employees of the corporation at the time such services were rendered. Section 3121(d) of the Act provides, in part, that an "employee" is any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.

It is well settled as a matter of law that a contract of agency or employment cannot be created on behalf of a nonexistent principal. The corporation was nonexistent and incapable of entering into contracts of agency or employment or of exercising the degree of control necessary to constitute it an employer prior to its incorporation. Therefore, there could not be any employer-employee relationship existing between it and the organizers when the services in question were rendered.

Accordingly, it is held that the value of the stock which was issued by the corporation to the organizers as compensation for services rendered prior to its incorporation, although includible in gross income for Federal income tax purposes for the year in which received, does not constitute taxable wages for purposes of the Federal Insurance Contributions Act taxes. Likewise, the value of the stock does not constitute wages for purposes of the Collection of Income Tax at Source on Wages. However, the fair market value of any stock which such individuals receive for services as officers of the corporation constitutes taxable wages for purposes of such taxes at the time the stock is transferred to such individuals.

Payments of benefits from trust fund to employees under unemployment benefit plan voluntarily adopted by employer. See Rev. Rul. 58–128, page 89.

Lockout benefits received by members and nonmembers of a labor union. See Rev. Rul. 58–139, page 14.

Lump sum payment received by an employee for cancellation of an employment contract. See Rev. Rul. 58–301, page 23.

---

26 CFR 31.3121(a)(1)–1: $4,200 Limitation. Rev. Rul. 58–80
(Also Section 3306: 31.3306(b)(1)–1.)

Where two separate corporations, which qualify as successor-employers under sections 3121(a)(1) of the Federal Insurance Contributions Act and section 3306(b)(1) of the Federal Unemployment Tax Act, take over separate units of a business owned and operated by a sole proprietor under the management of a key employee and the employee continued his same supervisory services as an officer-employee thereof, each corporation may treat, for pur-

poses of the wage limitation provisions of the Acts, the entire amount of wages paid by the proprietor to his key employee during the calendar year, prior to the disposal of the business, as wages paid by it.

Advice has been requested whether the entire amount of wages paid to an employee during the calendar year by a predecessor employer may be treated, for purposes of the wage limitations provided in section 3121(a)(1) of the Federal Insurance Contributions Act and section 3306(b)(1) of the Federal Unemployment Tax Act, (chapters 21 and 23, respectively, subtitle C, Internal Revenue Code of 1954), as having been paid by successor-employers where each successor-employer takes over a separate unit of the business owned and operated by the predecessor-employer.

A sole proprietor owned two places of business which were operated as separate units of a business. A key employee of the sole proprietor was employed as supervisor of both places of business. The sole proprietor qualified as an employer under section 3306(a) of the Federal Unemployment Tax Act and reported and paid the taxes under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act with regard to the wages paid his key employee.

During the calendar year, each of the two places of business was taken over by a separate corporate entity and each entity qualified as a successor-employer within the meaning of sections 3121(a)(1) and 3306(b)(1), *supra*. The sole proprietor's key employee elected a corporate officer of each corporation and continued his same supervisory services as before but as an officer-employee of each corporation.

Section 3121(a)(1) of the Federal Insurance Contributions Act and section 3306(b)(1) of the Federal Unemployment Tax Act provides, in part, that if a successor employer acquires substantially all the property used in a business of a predecessor employer, or used in a separate unit of a business of a predecessor, and immediately after the acquisition employs in his business an individual who immediately prior to the acquisition was employed in the business of such predecessor, then, for the purpose of determining whether the successor employer has paid renumeration with respect to employment equal to $4,200 ($3,000 under the Federal Unemployment Tax Act) to such individual during such calendar year, any remuneration with respect to employment paid to such individual by such predecessor during such calendar year and prior to such acquisition shall be considered as having been paid by such successor employer.

Accordingly, it is held that inasmuch as the instant corporations are considered as successor-employers within the meaning of sections 3121(a)(1) and 3306(b)(1), *supra*, each corporation may treat the entire amount of wages paid to the key employee by the sole proprietor as having been paid by it for wage limitation purposes under the foregoing acts.

The special refund provisions of section 6413(c)(1) of the Code are applicable to employee tax deducted under the Federal Insurance Contributions Act with respect to wages in excess of $4,200 paid to the sole proprietor's key employee by his employers during the calendar year. See Rev. Rul. 57–32, C. B. 1957–1, 301.

26 CFR 31.3121(a)(6)–1: Payment by an employer of employee tax under section 3101 or employee contributions under a State law.

Methods of computing taxes to be withheld where the employer pays the income tax withholding and the employee tax under the Federal Insurance Contributions Act on behalf of an employee. See Rev. Rul. 58–113, page 362.

---

26 CFR 31.3121(d)–1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)–1.) Rev. Rul. 58–46

An individual is engaged by a company to haul products to its customers. The company has preferred call on his services and he may be required, upon an hour's notice, to make deliveries at times and to places specified by the company. Refusal to make deliveries would jeopardize his position with the company. It has control and legal ownership of the trucking equipment and pays the individual the full amount of the delivery charges collected from its customers. He is required to operate and maintain the equipment, provide and pay the necessary operators and helpers, and pay for all insurance coverage required by the company. He generally operates the company's equipment personally and is not permitted to use it to haul for others. *Held*, the individual and any operators or helpers engaged to assist him are employees of the company for Federal employment tax purposes with respect to services performed for the company.

Revenue Ruling 55–593, C. B. 1955–2, 610, distinguished.

Advice has been requested relative to the status, for Federal employment tax purposes, of an individual who performs hauling services for a company, using the company's trucks and equipment.

The company purchased two tractor-trailer type trucks to be used exclusively for the purpose of hauling its products to its customers. It entered into a contract with the operator which provides that the operator shall have the exclusive right to operate and maintain the company's equipment in hauling and delivering the company's products to its customers; shall pay all expenses in connection therewith, including the insurance coverage required by the company; shall hire and pay any necessary drivers or helpers; and shall repay the company the purchase price of the trucking equipment and any sums advanced by it for insurance premiums or other expenses, except that the company shall maintain an investment of one dollar in, and retain title to, each unit or piece of equipment in use until sold or disposed of by mutual agreement of the parties or until termination of the contract. All deliveries are to be made promptly and all delivery charges are based upon current freight rates between points of origin and delivery, the full amount thereof to be billed to the customer by the company, collected by the company, and paid over to the operator at agreed intervals. The contract may be terminated by either party upon thirty-days' written notice to the other.

The company's purpose in retaining title to the trucks is to maintain absolute control and legal ownership of the equipment in order to insure itself of a prompt delivery service, instead of having to rely on public carriers. The company has preferred call on the operator's time and efforts. He is required to operate the equipment immediately

upon notice of a delivery to be made, many times upon an hour's notice. Deliveries must be made at the times and to the places specified by the company. The operator cannot refuse to make a delivery for the company without jeopardizing his relationship with it. He generally operates the equipment personally and reports only when called, the time of reporting depending upon deliveries to be made. For example, there are times when he makes no deliveries for a period of two weeks, while at other times he may operate the equipment continuously for several days. The operator files reports with the company upon completion of deliveries. When not in use, the trailer units are stored on the company's premises and the tractor units are kept in the operator's private garage to facilitate maintenance and service.

The operator's services for the company are performed under the company's name which is clearly painted on the trucking equipment. All deliveries are made directly from the company's plant to its customers. No loads are hauled on return trips. The operator is not permitted to haul anything in the company's equipment for any other persons. All permits, licenses, liability insurance, property damage insurance, etc., covering the equipment and its operation are carried in the name of the company. The premiums on all of the above insurance policies are paid by the operator. His compensation is based entirely upon tonnage hauled and he is not guaranteed a minimum amount of compensation. The operator engages, discharges, determines the remuneration of and pays all truck drivers and/or helpers required to operate the equipment.

Section 3121(d) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) provides, among other things, that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. The guides for determining, under such rules, whether an employer-employee relationship exists are found in section 31.3121(d)–1(c) of the Employment Tax Regulations.

In Revenue Ruling 55–593, C. B. 1955–2,610, certain truck owner-drivers performing services in delivering merchandise for a company were held to be independent contractors. In that case, a company sold its trucks to certain truck drivers under an agreement whereby the drivers were required to pay the company the full purchase price of the trucks within a three-year period during which time the drivers were to provide hauling services exclusively for the company on a flat rate basis. The contract specified that there would be no charge to the company for merchandise not delivered; the owner-driver would keep the truck in his own custody, exercise reasonable care in using it, keep it clean and in good working order at his own expense, pay for all fuel and supplies needed to operate the truck, and pay all license fees and taxes required for the trucking operation. In the event of default in the performance of services or other provisions of the agreement, the entire balance remaining unpaid on the trucks would immediately become due and payable. It is the position of the Internal Revenue Service in that case that no control over the owner-drivers was contemplated by the agreement or practiced in the performance thereof, and that the default provisions of the

agreement imposed no more restraint than exists generally in cases of contractors who furnish performance bonds containing forfeiture clauses whereby they may be penalized for failure to fulfill their obligations under such agreements.

In the instant case, the company has signified its intent to control its trucks and the drivers thereof by maintaining legal ownership and, in most part, actual custody of the trucking equipment. The operator is precluded from any control over or independent action with respect to the company's equipment in that he may not solicit hauling jobs from other persons, not even to avoid having an empty truck on return trips from distant points. He is confined, in using such equipment, to hauling company products exclusively. Furthermore, he is required to be on call and to be prepared on an hour's notice to make deliveries at the times and to the places specified by the company. He may not refuse to make a company delivery without jeopardizing his relationship with it. These facts clearly indicate that the operator is performing personal services for the company, that the company may call upon him at any time, and that his services are performed on a continuing basis.

Although the operator may have an investment in the trucking equipment he uses in performing hauling services for the company, that factor is not, in and of itself, a basis for concluding that an independent contractor status exists. The fact that there is an investment is not controlling in determining the status, for Federal employment tax purposes, of an individual who renders services for another. See Rev. Rul. 56–129, C. B. 1956–1, 470, at 472. Similarly, the provisions of a contract purporting to establish an individual as an independent contractor are not controlling where it is otherwise shown, by the circumstances under which the individual's services are actually performed, that such a relationship does not, in fact, exist.

It is concluded on the basis of the facts set forth above that the company exercises or has the right to exercise such control over the operator in the performance of his services for it as is necessary to establish the relationship of employer and employee under the usual common law rules. Accordingly, it is held that the operator and any individuals engaged to assist him are employees of the company for purposes of the Federal Insurance Contributions Act, *supra*.

The above conclusion is also applicable for purposes of the Federal Unemployment Tax Act and the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

(Also Sections 3306, 3401; 31.3306(c)(14)–1, 31.3401(a)–1.) Rev. Rul. 58–176

An agent remunerated solely by way of commission who sells insurance for an association on the industrial or debit plan is an employee of the association for purposes of the taxes imposed by the Federal Insurance Contributions Act and for purposes of the Collection of Income Tax at Source on Wages.

The services of such an agent are excepted from "employment" under the Federal Unemployment Tax Act by reason of section 3306(c)(14) of that Act, because he is remunerated solely by way of commission.

The Internal Revenue Service has been requested to state its position with respect to the status, for purposes of the Federal employment tax statutes, of an agent who sells insurance for an association under circumstances similar to those under which industrial insurance agents perform services.

The instant association is engaged in writing accident and health insurance throughout the state in which it is organized. It operates on a so-called membership basis. Each agent or solicitor operates within the territory assigned to him and performs his services pursuant to the terms of a written contract. The agent's duties consist of selling insurance (memberships) and collecting premiums on all old and new business in his particular territory. He is given a debit book containing the names and addresses of the association's policyholders for the regular collections of accounts and for servicing their policies. The agent calls at the association's office weekly to report collections and submit new applications for insurance received by him during the week. The agent is paid a commission of $2x$ percent on all premiums collected by him on both new and old business. The agent deducts his commission from collections at the end of each week and remits the balance of the collections to the association. The agent performs his services on a full-time basis. He is required to canvass his assigned territory with specified frequency, to call on particular customers or prospects and to attend weekly sales meetings or conferences. The association furnishes the agent with stationery and all forms required in his work. Either party may terminate the contract at any time.

Under section 3121(d) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), the term "employee" means, among other things, any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Whether an individual is an employee depends upon the particular facts in each case. The guides for determining whether an employer-employee relationship exists are found in section 31.3121(d)–1(c) of the Employment Tax Regulations.

The agent in the instant case is engaged in the sale of insurance under circumstances analogous to those under which industrial insurance agents perform services. This is evidenced by the facts that he makes weekly collections, operates under the debit system, is required to make weekly reports with respect to his collections for the association, is encouraged by the terms of his contract to prevent lapses in his accounts, and works in a territory assigned to him. It is the position of the Service that agents engaged in the sale of insurance on the industrial plan are generally to be held to be employees with respect to the performance of such services. Accordingly, and on the basis of the facts presented, it is concluded that the association in the instant case exercises or has the right to exercise such control over the agent in the performance of his services as is necessary to establish the relationship of employer and employee. Therefore, it is held that the agent is an employee of the association for purposes of the taxes imposed under the Federal Insurance Contributions Act and for purposes of the Collection of Income Tax at Source on Wages (chapter 24, subtitle C, Internal Revenue Code of 1954).

Inasmuch as the agent in the instant case is remunerated for the services he performs for the association solely by way of commission, his services are excepted from "employment" under the Federal Unemployment Tax Act (chapter 23, subtitle C, Internal Revenue Code of 1954) by reason of the provisions of section 3306(c)(14) of that act.

See Rev. Rul. 58–175, page 28, which determines the status of an industrial insurance debit salesman for purposes of determining adjusted gross income under the provisions of section 62(2)(D) of the Code.

Rev. Rul. 58–177

An individual engaged by two related insurance companies as a salesman of general insurance on the industrial or debit plan is remunerated on a commission basis; determines his own work schedule and method of solicitation; is provided desk space, forms and collection books; receives instructions in selling by company personnel; is required to file reports, make regular collections on the accounts assigned to him, and remit collections on a weekly basis; and performs services solely for the two companies. *Held*, he is an employee of two insurance companies for Federal employment tax purposes. Revenue Ruling 54–312, C. B. 1954–2, 327, distinguished.

Advice has been requested as to the status, for Federal employment tax purposes, of an individual who serves as a salesman of general insurance on the industrial or debit plan for two insurance companies under the circumstances stated below.

The *M* life insurance company and the *N* fire insurance company (two related companies) engaged *A* as an insurance salesman to solicit and sell their respective types of insurance and to make regular collections of premiums from the policyholders assigned to him. *A* performs his services for the *M* company pursuant to the terms of a written agreement designated "Agent's Contract." The contract provides, among other things, that the company authorizes *A* to solicit applications for insurance in the company and to collect the initial payments due on the applications; that the company may from time to time prescribe rules respecting the eligibility of applicants for insurance and it is understood by the agent that applications not in accordance therewith shall be rejected; and that the agent shall be free at all times to exercise his own judgment as to the persons solicited and as to the method of solicitation. As compensation for services performed, the contract provides that *A* shall receive certain commissions based on collections of premiums and the sale of insurance policies. The contract provides that the agency may be terminated at any time by either party giving notice.

The contract entered into between *A* and the *N* fire insurance company (designated as a contract of employment) indicates that the company agrees to remunerate *A* on the same commission basis as the *M* life insurance company. This contract contains a statement to the effect that an agent, in accepting a position with the company, agrees and understands that he will faithfully follow all instructions of the company and that the agency may be terminated at any time by either party giving notice.

The information submitted discloses that *A*'s services for both companies are performed basically under identical circumstances. He may perform his services for both companies anywhere within a

specified county and is not required to conform to any particular schedule of work hours. He is required to visit the office to remit his collections on Tuesdays of each week, submit his reports of collections, lapse schedules, etc., on Thursdays, and receive his earnings every Friday. The companies employ salaried individuals to demonstrate, from time to time, approved selling methods for the benefit of their agents. *A* is provided desk space and the necessary forms and collection books to be used in his work, but otherwise he pays all expenses incurred in such work. The collection book forms provide spaces for recording the amounts collected each week from each policyholder and payments in arrears as well as those made in advance. It is contemplated by the agreement that substantially all of the services will be performed by *A* personally. *A* does not perform services for any other firm or individual, but divides his entire working time in the sale of life and fire insurance between the two companies.

Section 3121(d) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) provides, among other things, that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. The guides for determining, under such rules, whether an employer-employee relationship exist are found in section 31.3121(d)–1(c) of the Employment Tax Regulations.

While *A*, under his agreement with the companies, enjoys a certain degree of freedom as to the individuals to be contacted in the sale of policies and in establishing his routine of work, it is the opinion of the Internal Revenue Service, in view of the training *A* receives from company personnel, the records he is required to keep, the reports he is required to submit, the office space and forms provided for his use by the companies, and the fact that his relationship with the companies may be terminated by them at any time, that he is not operating as an independent contractor but is subject to the supervision and control of the two companies in question to the extent necessary to establish the relationship of employer and employee under the common law rules referred to above. See Rev. Rul. 58–176, page 349. Accordingly, it is held that *A* is an employee of the *M* life insurance company and the *N* fire insurance company for purposes of the Federal Insurance Contributions Act, *supra*. This conclusion is also applicable for purposes of the Collection of Income Tax at Source on Wages (chapter 24, subtitle C, Internal Revenue Code of 1954). See Revenue Ruling 54–312, C. B. 1954–2, 327, where under different facts the relationship between a full-time life insurance salesman and the company he represented was such that he was held to be an independent contractor.

Section 3306(c)(14) of the Federal Unemployment Tax Act (chapter 23, subtitle C, Internal Revenue Code of 1954) excepts from the term "employment," as defined in such Act, services performed by an individual for a person as an insurance agent or as an insurance solicitor, if all such services are performed for remuneration solely by way of commission. The services performed by *A* for the companies referred to herein come within this exception in any year during which remuneration for his services is solely by way of commission.

(Also Sections 3306, 3401; 31.3306(i)-1.) Rev. Rul. 58-268

For Federal employment tax purposes, a dental hygienist is an employee of the dentist for whom she performs services, where she reports to the dentist's office on designated days of each week and gives oral prophylaxis treatments to the patients of the dentist under an agreement with the dentist providing for the payment of a fee of 50 per cent of the amount charged each patient treated, whether or not collected from the patient.

Advice has been requested as to the status, for Federal employment tax purposes, of a dental hygienist who gives oral prophylaxis treatments to the patients of a dentist under the circumstances described below.

A practicing dentist has engaged the services of a licensed dental hygienist to give oral prophylaxis treatments to his patients in his office. The treatments consist of removing calcified deposits and cleaning teeth. The dental hygienist performs her services on one or two days of each week under an oral agreement which provides that she shall receive a fee of 50 percent of the amount charged the patient for each treatment. Such fee is paid whether or not collected from the patient. She is qualified to render her services without instructions from the dentist and uses her own discretion with respect to the methods employed in the treatments. She does not secure her own patients but does arrange the time the patients shall return for any subsequent treatments required. She also charts on each patient's card the location of any cavities observed in the course of her treatment. She holds herself available to perform oral prophylaxis services for the dentist on days selected to suit the convenience of both parties. Her name does not appear on the office door of the dentist, on his business cards, in the building directory, or in the classified section of the telephone directory, and she does not advertise her services to the public. All office expenses are borne by the dentist and he provides office space for the hygienist and furnishes all necessary supplies and equipment. The services of the hygienist may be terminated by either party at any time. The hygienist performs similar services for other dentists on days that she does not report to the office of the dentist herein concerned.

Under section 3121(d)(2) of Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship has the status of an employee. The guides for determining, under such rules, whether an employer-employee relationship exists are found in section 31.3121(d)-1(c) of the Employment Tax Regulations. Whether an individual is an employee or an independent contractor is largely a question of fact to be determined from the circumstances of a particular case.

Upon the basis of the information presented, it is concluded that the dentist exercises or has the right to exercise such control and direction over the dental hygienist in the performance of her services as is necessary, under the usual common law rules, to establish the relationship of employer and employee. Compare Rev. Rul. 57-380, C. B. 1957-2, 634, and Rev. Rul. 57-381, C. B. 1957-2, 636. Accordingly, it is held that the hygienist is an employee of the dentist for

the purposes of the taxes imposed under the Federal Insurance Contributions Act.

The foregoing conclusion also applies for purposes of the Federal Unemployment Tax Act and the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954.)

---

26 CFR 31.3121(d)–2: Who are employers. (Also Sections 3306, 3401; 31.3306(a)–1, 31.3401(a)–1.) Rev. Rul. 58–26

A surety corporation executed a performance bond on which a construction company was the principal obligor and a state board of education was the obligee in connection with a contract involving the construction of a school by the construction company. The bond provided that the board of education was to be saved harmless from loss, cost, or expense by reason of the contract. The company defaulted and failed to complete construction of the school, whereupon the surety corporation, under an agreement with the board, completed the project, using the same labor forces theretofore used by the construction company but supervised by the surety corporation's agent. Pursuant to such completion agreement, payrolls were approved by the corporation and paid by the board of education out of contract monies remaining in its hands. *Held*, the surety corporation was the employer, for Federal employment tax purposes, of the labor forces from the date on which it took over the construction project through the date of completion thereof. Revenue Ruling 54–471, C. B. 1954–2, 348, distinguished.

Advice has been requested whether (a) a surety corporation or (b) a state board of education is the employer, for Federal employment tax purposes of individuals working on a school construction project under the circumstances described below.

A construction company entered into a contract with a State board of education to construct a public school building for an agreed amount. In connection with such contract, a surety corporation executed a performance bond on which the construction company was named the principal obligor and the board of education the obligee. The bond provided, among other things, that the board was to be saved harmless from loss, cost, or expense by reason of the contract; and, in event of default by the contractor, the surety would not be liable for any obligations incurred by the contractor prior to such default. Shortly before the contract was completed, the construction company defaulted in its performance and failed to complete the construction of the school. As the result of such default, the surety corporation entered into an agreement with the board of education whereby the surety would complete the project, using the same labor crews theretofore engaged by the defaulting contractor, but under the supervision of the surety's own agent, in order that the building would be ready for use at the beginning of the school term. As a matter of convenience, the board agreed to supply the cash for the weekly payrolls, and the Federal employment taxes applicable thereto, out of contract monies remaining in its hands. Such cash was deducted from the payments due from the board on the construction contract. The weekly payrolls were subject to approval by the surety's agent.

It is evident from the facts presented that the surety corporation assumed control of the unfinished construction project in accordance with the provisions of the executed bond in order to save the board from any loss, etc., which might occur by reason of the contract described above. It appears that with respect to the payment of wages and the withholding of the applicable taxes, the board did so on behalf of the surety.

It is the position of the Internal Revenue Service that in a case such as this, where, upon default by a construction contractor, the contractor's surety assumes control of the project and the employees working thereon, the surety becomes the employer of such employees for purposes of the Federal employment tax statutes.

In view of the foregoing, it is concluded that from the time the surety corporation took over the construction project until it was completed, it was the employer, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), of the laborers working on such project. The wages paid by the board to such workers on behalf of the surety corporation and the Federal employment taxes applicable thereto should be included on the surety corporation's Federal employment tax returns.

This conclusion is also applicable with respect to the tax imposed by the Federal Unemployment Tax Act and for purposes of the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

In taking the position that the above conclusion is applicable for purposes of the Collection of Income Tax at Source on Wages, consideration was given to Revenue Ruling 54–471, C. B. 1954–2, 348. In that case an advertising agency was engaged by a State citrus commission to assist it in demonstrating citrus products. The demonstrators employed to perform the services were paid by the advertising agency (from its own funds), which in turn billed the commission for the amounts disbursed, plus a commission on each demonstrator, and received payment from the commission. That ruling held that, although a common law relationship of employer and employee existed between the State citrus commission and the demonstrators, the advertising agency had control of the payment of "wages" to the extent contemplated by section 3401(d) of the Internal Revenue Code of 1954 and was the employer of the demonstrators within the meaning of that section for the purpose of withholding of Federal income tax on "wages." The facts in the instant case are distinguishable from those in Revenue Ruling 54–471, *supra*, in that the surety, who became the common law employer of the labor crews upon the contractor's default, also paid, or controlled the payment of, their wages by arranging with the school board to pay such wages as shown on payrolls approved by the surety's agent out of monies due the surety for completing the contract, or in effect out of the surety's own funds.

It may be pointed out that the conclusion reached in this case does not necessarily apply to all cases in which a surety, under the provisions of a bond, guarantees the covenants and agreements undertaken by a contractor. Each ruling must be based upon the facts in the particular case, especially in view of possible variations in the bond agreements. Compare *United States* v. *Phoenix Indemnity Co. et al.*,

231 Fed. (2d) 573, and *General Casualty Co. of America* v. *United States*, 205 Fed. (2d) 753.

In both of the above cases, the issue related to the liability of sureties for defaulting contractors. In the *Phoenix* case it was determined that, based on the provisions of the bond under which the sureties guaranteed the performance of all covenants and agreements undertaken by the contractor, *which included an agreement to pay all taxes collectible because of the work*, the sureties were liable for all taxes payable prior, as well as subsequent, to the default. Thus, the liability of the surety, as determined by the court in this instance, was based upon its contractural liability and not upon the existence of an employer-employee relationship. Under the circumstances present in the *General Casualty* case (in which all withheld taxes subsequent to default had been fully paid), the court held that, prior to the contractor's default, the surety had no control over the payment of wages and could not be classed as the employer for that period; also, that it was not liable under any provision of the bond to the United States for taxes withheld by the principal prior to default which the latter failed to pay to the Government.

---

26 CFR 31.3121(k)–1: Waiver of exemption from taxes. Rev. Rul. 58–270

> An individual, who is an employee of an organization exempt from income tax under section 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(3) of such Code and which filed a valid certificate under section 3121(k) of the Federal Insurance Contributions Act prior to August 1, 1956 (the date of enactment of the Social Security Amendments of 1956), is not precluded, by such action on the part of the organization, from obtaining retroactive social security coverage under section 403(a) of the Social Security Amendments of 1954, as amended by the Social Security Amendments of 1956, provided the individual and the employer-organization otherwise meet the tests prescribed under that section.

Advice has been requested whether an individual, who is an employee of an organization exempt from income tax under sections 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(3) thereof and which filed a valid certificate under section 3121(k) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) prior to August 1, 1956 (the date of enactment of the Social Security Amendments of 1956), is precluded as a result of such filing from obtaining retroactive social security coverage under section 403 (a) of the Social Security Amendments of 1954, as amended by the Social Security Amendments of 1956, if the individual and the employer-organization otherwise meet the tests prescribed under that section.

The instant organization is exempt from Federal income tax under section 501(a) of the Internal Revenue Code of 1954, and the corresponding provisions of prior revenue acts, as a religious organization as described in section 501 (c)(3) of the Code. On September 12, 1954, the organization filed Form SS–15, Certificate Waiving Exemption from Taxes under the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939), pursuant

to the provisions of section 1426(1) (now section 3121(k)) of such Act. Thereafter, the organization filed returns and paid the taxes under the Federal Insurance Contributions Act in the mistaken belief that the waiver certificate which it had previously filed was valid. However, it was later determined by the District Director of Internal Revenue that such certificate was invalid for the reason that it had been concurred in by less than two-thirds of the individuals in the organization's employ at the time the waiver certificate was filed. A valid waiver certificate was thereafter filed on June 20, 1956, under section 3121(k) of the Act.

Under section 3121(k) of the Federal Insurance Contributions Act, any organization exempt from income tax under section 501(a) of the 1954 Code as an organization described in section 501(c)(3) may file a certificate certifying that it desires to have the insurance system established by title II of the Social Security Act extended to services performed by its employees, provided at least two-thirds of the employees, as computed at the time of filing the certificate, concur in such action. Such certificate is effective with respect to "wages" for services in "employment" performed by an employee whose signature appeared on the list filed by the organization or who became an employee of the organization after the calendar quarter in which the certificate was filed. Similar provisions are contained in section 1426(1) of the Federal Insurance Contributions Act, effective under the 1939 Code, with respect to organizations exempt from income tax under section 101(6) of the 1939 Code.

Section 403(a) of the Social Security Amendments of 1954, C. B. 1954–2, 603, at page 611, as amended by the Social Security Amendments of 1956, C. B. 1956–2, 1188, at page 1195, provides, in part, as follows:

> IN ANY CASE IN WHICH—(1) an individual has been employed at any time subsequent to 1950 and prior to the enactment of the Social Security Amendments of 1956, by an organization which is described in section 501(c)(3) of the Internal Revenue Code of 1954 and which is exempt from income tax under section 501(a) of such Code but which has failed to file prior to the enactment of the Social Security Amendments of 1956 a valid waiver certificate under section 1426(1)(1) of the Internal Revenue Code of 1939 or section 3121(k)(1) of the Internal Revenue Code of 1954;
>
> * * * * * * *
>
> the amount of such remuneration with respect to which such taxes have been paid shall, upon the request of such individual * * *, be deemed to constitute remuneration for employment * * *.

The purpose of section 403(a), *supra*, is to provide a means whereby an employee of an organization of the prescribed character may obtain retroactive social security coverage for certain periods after 1950 in situations where the organization had paid the taxes under the Federal Insurance Contributions Act in good faith but in the erroneous belief that it had waived its exemption from such taxes pursuant to the regular waiver procedure provided by section 1426(1) of the 1939 Code or section 3121(k) of the 1954 Code. Section 403(a) affords the only procedure whereby an employee may obtain retroactive coverage in such a situation inasmuch as the regular waiver procedure does not apply to past periods. Thus, an organization which believed it had filed a valid waiver certificate, but which had not actually done so, cannot correct its mistake for past periods by subsequently filing a

valid waiver certificate. Relief in such a situation may be obtained by the employee only if he meets the tests prescribed by section 403(a) of the Social Security Amendments of 1954, as amended, and complies with the regulations prescribed thereunder.

The specific question presented is whether the language of section 403(a) contained in the clause, "but which has failed to file prior to the enactment of the Social Security Amendments of 1956 a valid waiver certificate" precludes coverage of the employees of the instant organization for any period prior to the effective date of the waiver (July 1, 1956) which it filed on June 20, 1956. In the opinion of the Internal Revenue Service, the above quoted clause merely describes the situation which brought about a need for the relief provided for in section 403(a) and indicates the period within which that situation must be found to exist if the relief is to be available. It does not require as a condition to the relief that the mistake which gave rise to the situation in the first place remain uncorrected to the date of the enactment of section 403(a), *supra*. Thus, the fact that the organization filed a waiver certificate before the date of the enactment of the 1956 Amendments which is valid as to a subsequent period is wholly without significance in determining whether the relief provided for in section 403(a) is available in the case of such an organization.

In view of the foregoing, it is held that the valid waiver certificate filed by the instant organization on June 20, 1956, does not preclude the application of section 403(a) of the Social Security Amendments of 1954, as amended by the Social Security Amendments of 1956, to the employees of such organization.

---

26 CFR 31.3121(l)(1)-1: Agreements entered into by domestic corporations with respect to foreign subsidiaries. Rev. Rul. 58-14

A partnership, although the sole owner of one or more foreign corporations, does not qualify for the election provided by section 3121(1) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954). This section provides that a domestic corporation may, under certain specified conditions, elect to have the insurance system established by title II of the Social Security Act extended to certain employees of any one or more of its foreign subsidiaries. The term "corporation" as used in section 3121(1) of the Code includes associations, joint stock companies, and insurance companies, but does not include partnerships.

CHAPTER 23.—FEDERAL UNEMPLOYMENT TAX ACT

SECTION 3306.—DEFINITIONS

26 CFR 31.3306(a)-1: Who are employers.

A surety corporation which completed performance of a breached contract. See Rev. Rul. 58-26, page 354.

26 CFR 31.3306(b)–1: Wages.

Lockout benefits received by members and nonmembers of a labor union. See Rev. Rul. 58–139, page 14.

Tips or gratuities accounted for by an employee to the employer under the minimum wage act of a State. See Rev. Rul. 58–168, page 343.

---

26 CFR 31.3306(b)(1)–1: $3,000 limitation.

Wages paid by a predecessor employer which may be treated as having been paid by each of two successor-employers under section 3306(b)(1) of the Federal Unemployment Tax Act. See Rev. Rul. 58–80, page 345.

---

26 CFR 31.3306(c)(14)–1: Services of insurance agent or solicitor.

Services performed by agents in the sale of insurance. See Rev. Rul. 58–176, page 349.

Salesmen of general insurance on the industrial or debit plan remunerated solely on a commission basis. See Rev. Rul. 58–177, page 351.

---

26 CFR 31.3306 (i)–1: Who are employees.

A truck operator performing hauling services for a firm. See Rev. Rul. 58–46, page 347.

Status, for Federal employment tax purposes of dental hygienist performing services in the office of a dentist. See Rev. Rul. 58–268, page 353.

CHAPTER 24.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 3401.—DEFINITIONS

A truck operator performing hauling services for a firm. See Rev. Rul. 58–46, page 347.

Tips or gratuities accounted for by an employee to the employer under the minimum wage act of a state. See Rev. Rul. 58–168, page 343.

Fees paid to a dental hygienist for oral prophylaxis treatments given in the office of a dentist. See Rev. Rul. 58–268, page 353.

Bonuses paid to individuals by a baseball club for signing their first cointracts, which contain no provision requiring the performance of subsequent services, do not represent remuneration for services performed and, accordingly, do not constitute "wages" subject to the withholding of income tax under section 3402 of the Internal Revenue Code of 1954. However, bonuses paid to baseball players which are predicated on continued employment are subject to the withholding of income tax.

However, the bonus payments received by the baseball players under either of these circumstances are taxable as ordinary income in the taxable year in which received.

An inquiry has been received relative to the Collection of Income Tax at Sources on Wages (chapter 24, subtitle C, Internal Revenue Code of 1954) on bonuses paid by a baseball club to professional baseball players.

A baseball club pays two types of bonuses to baseball players. One type of bonus is paid to a new player solely for signing his first contract, without any requirement of subsequent service. This type of bonus is not contingent upon whether the player is retained by the club after a specified time. The second type of bonus is awarded as a consideration for the new player's signing his first contract, but the payment of a portion of such bonus is dependent upon subsequent service by the player or upon his being retained by the club after a specified date.

The questions presented relative to the treatment of the two types of bonuses for income tax withholding purposes and the answers thereto are set forth below, as follows:

Question 1. Is the first type of bonus, that is, the bonus paid to a new baseball player solely for signing his first contract, subject to the withholding of income tax?

Answer. Bonuses which are not predicated on continuing employment, made to new baseball players solely for signing their first contracts, do not represent remuneration for services performed and, accordingly, do not constitute wages subject to the withholding of income tax under section 3402 of the Internal Revenue Code.

Question 2. Does the above rule in answer to question 1 apply even in instances where it is provided that such bonus shall be paid in installments over a period of years, which means that some installments of the bonus may be paid at a time when the player has the status of an employee of the club?

Answer. The fact that a bonus is paid in installments over a period of years does not, in itself, establish such bonus as wages subject to the withholding of income tax.

Question 3. If the answer to question 2 is that the rule still applies where the bonus is paid in installments, does that rule continue to apply where there is a military service clause which provides for postponement of payment without introducing any contingency as to continued employment except for a requirement that the player "reports back in condition to play?"

Answer. If the military service clause contained in the bonus contract does not introduce any requirement as to continued employ-

ment, the presence of the clause in such contract does not alter the conclusion reached in answer to question 2 above.

Question 4. Can the rule stated with respect to a bonus payable solely upon signing a contract apply even where the contract provides also for an additional bonus contingent upon subsequent service and retention of the player beyond a specified date?

Answer. That portion of the bonus which is not predicated on continuing employment would not constitute taxable wages subject to the withholding of income tax. However, payments of wages and other payments, including bonuses, subsequently made under such contracts and predicated on continued employment are subject to the withholding of income tax under section 3402 of the Internal Revenue Code.

The bonus payments received by ballplayers under any of the circumstances set forth above are taxable to such individuals as ordinary income in the taxable year in which received. See Rev. Rul. 55–727, C. B. 1955–2, 25.

A surety corporation which completed performance of a breached contract. See Rev. Rul. 58–26, page 354.

Payments of benefits from trust to employees under supplemental benefit plan voluntarily adopted by employer. See Rev. Rul. 58–128, page 89.

Lockout benefits received by members and nonmembers of a labor union. See Rev. Rul. 58–139, page 14.

Remuneration received by agents in the sale of insurance. See Rev. Rul. 58–176, page 349.

Salesmen of general insurance on the industrial or debit plan remunerated solely on a commission basis. See Rev. Rul. 58–177, page 351.

Compensation to organizers of a corporation for services rendered prior to incorporation. See Rev. Rul. 58–269, page 344.

Payments by a labor union to a member after twenty-five years service for a particular company. See Rev. Rul. 58–277, page 41.

SECTION 3402.—INCOME TAX COLLECTED AT SOURCE

Amounts received under research fellowship grants. See Rev. Rul. 58–76, page 56.

26 CFR 31.3402(a)–1: Requirement of withholding. (Also Section 3121; 31.3121(a)(6)–1.) Rev. Rul. 58–113

Methods of computing the gross bonus payment, the income tax to be withheld, and the employee tax under the Federal Insurance Contributions Act, where the employer wishes to pay an employee a stated amount of take-home pay as a bonus and pay the taxes to be withheld on behalf of the employee with respect to the bonus.

The Internal Revenue Service has been requested to pass upon formulas submitted by employers in computing the gross amount of a bonus where the employer wishes to pay an employee a stated amount of take-home pay as a bonus and, to pay on the employee's behalf, the income tax required to be withheld under section 3402 of the Internal Revenue Code of 1954 and the employee tax under section 3102 of the Federal Insurance Contributions Act (chapters 24 and 21, respectively, subtitle C, Internal Revenue Code of 1954).

For purposes of income tax withholding, the term "wages" includes the amount paid by an employer on behalf of an employee (without deduction from the remuneration of, or other reimbursement from, the employee) on account of any tax imposed upon the employee. Section 31.3401(a)–1(b)(6) of the Employment Tax Regulations. For purposes of the tax under the Federal Insurance Contributions Act, the term "wages" does not include employee tax under the Act which is paid by the employer but does include the income tax to be withheld. Section 31.3121(a)(6)–1 of the regulations. Thus, the income tax required to be withheld under section 3402 of the Code and the employee tax imposed by the Federal Insurance Contributions Act must be included as "wages" in the income tax withholding computations. In computing the employee tax under the Federal Insurance Contributions Act, only the income tax to be withheld constitutes "wages" in addition to the amount of the net bonus.

The Internal Revenue Service does not prescribe formulas to be used in computing tax liability but will interpose no objection to the use of formulas so long as the statutory requirements are accomplished. If such a method of calculation is used and the employer wishes to absorb on behalf of his employees the income tax withholding with respect to bonus payments at the current (1957) minimum rate of 18 percent and/or the employee tax under the Federal Insurance Contributions Act at the current rate of 2¼ percent, the following computations suggested by the employer will be acceptable:

(1) Based upon the 2.25 percent rate under the Federal Insurance Contributions Act, the net bonus should be increased by 22.56 percent for income tax withholding and by 2.76 percent for the employee tax under the Federal Insurance Contributions Act, a total of 25.32 percent. The figure for income tax withholding is equal to 18 percent of the sum of the net bonus, the withholding tax to be paid by the employer on behalf of the employee, and the employee tax under the Federal Insurance Contributions Act to be paid by the employer. The figure for the employee tax under the Federal Insurance Contributions Act is equal to 2.25 percent of the sum of the net bonus and the withholding tax to be paid by the employer on behalf of the employee.

(2) If the employee is not subject to the taxes imposed by the Federal Insurance Contributions Act with respect to the bonus payment, but is subject to income tax withholding, the net bonus should be increased by 21.95 percent (a figure equal to 18 percent of the sum of the net bonus and the income tax withholding to be paid by the employer on behalf of the employee).

For purposes of illustration, assume that the employer wishes to give an employee a bonus of $100.00. If the employee is not subject to the Federal Insurance Contributions Act taxes with respect to the bonus, the gross earnings figure would be $121.95 and the employer would pay $21.95 in income tax withholding on behalf of the employee. If the employee is subject both to income tax withholding and to the Federal Insurance Contributions Act tax with respect to the bonus, the gross earnings figure would be $125.32, made up of $100.00 of net bonus, $22.56 of income tax withholding, and $2.76 of employee tax under the Federal Insurance Contributions Act. In addition to the latter two amounts ($22.56 and $2.76), the employer would also pay $2.76 of employer tax under the Federal Insurance Contributions Act.

Lump sum payment received by an employee for cancellation of an employment contract. See Rev. Rul. 58–301, page 23.

Amounts received by the recipient of an award which carried with it an appointment to an officially established position as a civil service employee of the United States Government. See Rev. Rul. 58–322, page 59.

SUBTITLE D.—MISCELLANEOUS EXCISE TAXES

CHAPTER 31.—RETAILERS EXCISE TAX

SUBCHAPTER A.—JEWELRY AND RELATED ITEMS

SECTION 4001.—IMPOSITION OF TAX

(Also Sections 4011, 4021, 4031.) Rev. Rul. 58–57

Periodic or occasional auction sales by the United States Customs Service and by the United States Postal Service to dispose of confiscated, unclaimed, or damaged jewelry, furs, toilet preparations, and luggage are not subject to the retailers excise taxes.

Advice has been requested whether the retailers excise tax applies to periodic or occasional auction sales by the United States Customs Service and the United States Postal Service of confiscated, unclaimed, forfeited, and damaged articles.

The United States Customs Service and the United States Postal Service acquire title to jewelry, furs, toilet preparations, luggage, etc., through failure or refusal of consignees to claim shipments, forfeited seizures, claims for merchandise damaged in transit, and various

other causes incidental to their functions as instrumentalities of the United States. This merchandise is periodically auctioned to the public for the sole purpose of disposing of it.

Sections 4001, 4011, 4021, and 4031 of the Internal Revenue Code of 1954 impose a tax upon jewelry and related items, furs, toilet preparations, and luggage, handbags, etc., respectively, sold at retail.

Section 4002 of the Code states, in part, that, for purposes of the tax on jewelry and related items imposed by section 4001 of the Code, the term "articles sold at retail" includes an article sold at retail by an auctioneer or other agent in the course of his business on behalf of a person who is not engaged in the business of selling like articles. In the case of articles so sold, the auctioneer or other agent shall be considered the "person who sells at retail." Section 4012(b) of the Code contains similar provisions regarding auction sales of furs.

Section 320.3(a) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that every person who sells at retail any article covered by these regulations, or leases such article, is liable for tax whether such sale or lease is made directly or through an agent. Section 320.1(b) of the regulations provides that the phrase "every person who sells at retail" means any person engaged in the business of selling articles to a purchaser at retail.

It is held that periodic or occasional auction sales by the United States Customs Service and by the United States Postal Service of jewelry, furs, toilet preparations, and luggage, which have been confiscated, forfeited, unclaimed, or damaged, are incidental to the conduct of the customs and postal service business and that such instrumentalities are not engaged in the business of selling at retail, and are not auctioneers or other agents selling articles on behalf of other persons as contemplated by sections 4002 or 4012(b) of the Code. Accordingly, neither the United States Customs Service nor the United States Postal Service is liable for the payment of the retailers excise tax in connection with such sales.

Rev. Rul. 58–102

A small metal ornament, in the shape of a Christmas tree, which is designed to be worn on the person for adornment is considered an article of jewelry and the sale thereof is subject to the retailers excise tax on jewelry and related items. A corsage or boutonniere of artificial flowers is not an article of jewelry and the sale thereof is not subject to the tax.

Advice has been requested whether the retailers excise tax imposed by section 4001 of the Internal Revenue Code of 1954 applies to sales of (1) a small metal ornament made in the shape of a Christmas tree and (2) a corsage or boutonniere consisting of artificial flowers made of fabrics or plastics.

The metal ornament made in the shape of a Christmas tree is approximately three inches high, two and one-fourth inches wide at the base, has various colored miniature bulbs on its front, and is equipped with a clasp for the purpose of attaching it to a lapel, dress, coat, or other wearing apparel. It was designed as a Christmas season decoration and may also be attached to Christmas wreaths and packages.

The corsage or boutonniere consists of artificial flowers of fabrics or plastics made to resemble natural flowers. The arrangement also contains artificial leaves and is equipped with a metal clasp for the purpose of attaching it to an article of wearing apparel.

Section 4001 of the ode imposes a tax upon certain articles sold at retail, including all articles commonly or commercially known as jewelry, whether real or imitation.

Section 320.30 of Regulations 51, made applicable to the 1954 Code by virtue of Treasury Decision 6091, C. B. 1954–2, 47, provides that the tax attaches to the sale by the retailer of all articles commonly or commercially known as jewelry, whether real or imitation, regardless of the substance of which made. Section 320.31 of Regulations 51 defines jewelry as follows:

> Jewelry in general includes articles designed to be worn on the person or apparel for the purpose of adornment and which in accordance with custom or ordinary usage are worn so as to be displayed, such as rings, chains, brooches, bracelets, cuff buttons, necklaces, earrings, beads, etc. The tax is imposed on the sale of any such articles at retail, regardless of the substance of which made and without reference to their utilitarian value or purpose, unless for a purpose specifically exempted by law.

Corsages and boutonnieres which are made of natural flowers do not fall within the classification of jewelry and are not subject to the retailers excise tax, even though they may be equipped with pins or clasps for attaching them to wearing apparel. The same conclusion must be reached with respect to corsages and boutonnieres made of fabrics or plastics in imitation of natural flowers. The term "imitation" means an artificial likeness of natural flowers in size, color and design. Since these corsages and boutonnieres are designed to be worn as substitutes for natural flowers, they obviously are not articles commonly or commercially known as jewelry.

Jewelry, on the other hand, which is made in a variety of styles, shapes and sizes, may include designs and patterns of flowers, trees, etc. Such articles are not made as, or regarded as, imitations of flowers, trees, etc., nor are they intended to be worn as substitutes for the natural objects. These articles fall within the classification of jewelry regardless of the material of which they are made.

Accordingly, it is held that a miniature Christmas tree made of metal is an article of costume jewelry and is subject to the tax when sold at retail, while a corsage or boutonniere consisting of artificial flowers made of fabrics or plastics is not taxable.

Rev. Rul. 58–182

> The retailers excise tax imposed by section 4001 of the Internal Revenue Code of 1954 applies to sales of articles of jewelry to the hostess of a "costume jewelry party" where she applies certain credits toward the purchase price, and the tax attaches to the total price for which the articles are sold. Where she purchases articles of jewelry at a discount, the tax attaches to the discounted price or to the amount actually required to be paid by the hostess for the articles.

Advice has been requested whether the retailers excise tax on jewelry and related items applies to sales of jewelry under the circumstances described below. If the tax applies, advice has further been requested as to the proper basis for computing the tax.

A company sells costume jewelry on a party plan whereby a prospective customer agrees to act as a hostess and invite other prospective customers to a "party" at her home for a demonstration of the company's merchandise. When the sales demonstration takes place in the hostess's home, the hostess receives a credit of one dollar for each guest who purchases jewelry at the demonstration, a credit of one dollar for each future party booked by the salesperson from among the other guests, and a credit of two dollars provided that her party is held within two weeks from the time the contract was made by the salesperson.

The credit accumulated by the hostess may be applied toward the regular purchase price of the jewelry she selects, and she pays the balance of the full dollar value of the item. If the hostess does not select an article of jewelry and apply her credit to the purchase price, she receives nothing for her services. If she has credit in excess of the retail selling price of the article of jewelry selected, she loses such credit. The credits cannot be redeemed for cash but can only be applied toward the purchase price of articles of jewelry.

In addition, the hostess is permitted to buy as many as three additional articles of jewelry at a 50 percent discount. However, she must purchase the jewelry at the time of her party, and, if she does not do so, she is not permitted to purchase the jewelry at the discount price at a future date.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax upon the sale at retail of jewelry and related items, and the tax attaches to the total price for which the articles are sold at retail. Section 320.1(f) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "sale" means an agreement whereby the seller transfers the property (that is, the title or the substantial incidents of ownership) in goods to the buyer for a consideration called the price, which may consist of money, services, or other things.

Where, as in the instant case, the hostess renders services for which she is compensated by the issuance of credits, it is held that the transfer of the property by the company to the hostess for the consideration of cash and the credit slips constitutes a sale at retail. Accordingly, the retailers excise tax imposed by section 4001 of the Code attaches to the total price for which the article of jewelry is sold. For example, where a hostess selects an article of jewelry which sells at retail for $15, and applies thereto a credit of $13 and pays the balance of $2, the tax is computed on $15, the total selling price of the jewelry.

Where the hostess is merely permitted to purchase taxable articles of jewelry at a discount because of the special relationships created between the hostess and the retailer, it is held that the retailers excise tax attaches to the discounted price or to the amount actually required to be paid by the hostess for the jewelry.

Rev. Rul. 58–196

The retailers excise tax on jewelry and related items, imposed by section 4001 of the Internal Revenue Code of 1954, applies to separate sales of wrist watch bands, bracelets, or straps, if such articles are made of, or ornamented, mounted, or fitted with precious metals or imitations thereof.

The Internal Revenue Service has been asked whether the retailers excise tax attaches to the sale of the following articles:

1. Wrist watch bands and bracelets made from stainless steel or other nonprecious metals.
2. Wrist watch bands on which the gold plating is less than one one-hundred thousanth of an inch in thickness.
3. Wrist watch bands on which the gold plating is one one-hundred thousandth of an inch or more in thickness.
4. Wrist watch bands, bracelets, or straps made of leather, plastic, cloth, or other such materials, when made:
   (a) without buckles;
   (b) with buckles made of nonprecious metals;
   (c) with buckles on which the gold plating is less than one one-hundred thousandth of an inch in thickness;
   (d) with buckles on which the gold plating is one one-hundred thousandth of an inch or more in thickness.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the retailer of jewelry and related items, including all articles commonly or commercially known as jewelry, whether real or imitation, and articles made of, or ornamented, mounted, or fitted with precious metals or imitations thereof. That section also enumerates watches, clocks, and cases and movements for watches and clocks, as articles which are subject to the tax.

Section 320.33 of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "precious metals" includes platinum, gold, silver, and other metals of similar or greater value and that the term "imitations thereof" includes platings and alloys of such metals. S.T. 935, C.B. 1948–2, 192, holds that articles, other than articles commonly or commercially known as jewelry, merely coated with a deposit of precious metal or an alloy of such metal which is less than one one-hundred thousandth of an inch in thickness, are not ornamented with a precious metal or imitation thereof.

Bands, bracelets, or straps which are designed for the purpose of holding a wrist watch are not considered articles commonly or commercially known as jewelry. However, wrist watch bands, bracelets, or straps which are made of, or ornamented, mounted, or fitted with precious metals or imitations thereof are taxable articles within the meaning of section 4001 of the Code. Such articles are considered to be ornamented when plated with a deposit of precious metal or an alloy of such metal if the plating is one one-hundred thousandth of an inch or more in thickness.

Accordingly, it is held that the retailers excise tax imposed by section 4001 of the Code will attach to the sale of items 3 and 4(d), but will not attach to the sale of items 1, 2, 4(a), 4(b), and 4(c) above when sold at retail as separate articles. However, where a wrist watch band, bracelet, or strap is sold on or with a wrist watch, the retailers excise tax will attach to the entire selling price of the watch and band, bracelet, or strap, regardless of the material of which made.

Rev. Rul. 58–197

The retailers excise tax imposed by section 4001 of the Internal Revenue Code of 1954 does not apply to the sale of a decedent's jewelry collection by an executor of the decedent's estate, provided neither the decedent nor the executor was engaged in the business of selling jewelry at retail.

The Internal Revenue Service has been asked whether the sale of a decedent's jewelry collection by an executor of the estate is subject to the retailers excise tax.

A valuable jewelry collection is included in a decedent's estate. The decedent was never engaged in the business of buying and selling jewelry but acquired this jewelry collection for her personal use. The executor, who is not engaged in the business of selling jewelry, sold this collection in liquidating the estate.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax upon the price for which jewelry and related items are sold at retail.

It is held that, under the circumstances described above, since neither the decedent nor the executor was engaged in the business of selling jewelry at retail, the sale of the jewelry collection for the purpose of liquidating the estate is in the nature of a private sale and, therefore, is not subject to the tax imposed by section 4001 of the Code. However, under the provisions of section 4002 of the Code, if the jewelry collection had been sold by an auctioner or other agent in the course of his business on behalf of the executor of the decedent's estate, the sale would be a sale at retail and, therefore, would be subject to the tax.

Rev. Rul. 58–213

The sale of an instrument consisting of a barometer, a thermometer, a hygrometer, and a clock mounted in the same casing, is considered to be a sale of a combination of a taxable clock and nontaxable articles. Accordingly, the retailers excise tax imposed by section 4001 of the Internal Revenue Code of 1954 is based on that portion of the retail sales price charged for the combination which is attributable to the clock.

Advice has been requested concerning the applicability of the retailers excise tax to the sale of an instrument consisting of a barometer, a thermometer, a hygrometer, and a clock mounted in the same casing and sold as a unit.

A retailer sells an instrument which consists of a barometer, a thermometer, a hygrometer, and an eight-day jeweled clock mounted in a walnut frame or casing. He sells the instrument at a total unit price.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax on the sale of watches and clocks at retail.

In the instant case, it is held that the sale of the instrument is a combination sale of a clock, a barometer, a thermometer, and a hygrometer. The sale is thus considered to be a sale of a taxable clock combined with nontaxable articles. Accordingly, the retailers excise tax imposed by section 4001 of the Code attaches to that portion of the retail sales price charged for the combination which is attributable to the clock. The taxable portion may be determined by applying to the retail sales price of the combination the ratio which the separate retail sales price of the taxable article bears to the sum of the retail

sales prices of both the taxable and nontaxable articles when sold separately at retail.

If one or more of the articles are not sold separately at retail and do not have established retail sales prices, the taxable portion may be determined from a comparison of the actual costs of the articles. Thus, if the cost of the jeweled clock represents one-half of the total cost of the clock, barometer, thermometer, and hygrometer, the tax will attach to one-half of the retail selling price of the instrument. The cost of the walnut frame or casting may be disregarded for the reason that such cost is proportionately allocable to both the taxable clock and the nontaxable articles and prorating such cost would not alter the ratio. The retailer's records should clearly show the breakdown of the retail sales prices or the respective costs of the articles; otherwise, the tax will attach to the total price charged for the complete instrument.

Rev. Rul. 58–311

Hair ornaments are subject to the retailers excise tax on jewelry and related items, imposed by section 4001 of the Internal Revenue Code of 1954, only if made of, or ornamented, mounted or fitted with precious metals or pearls, precious or semiprecious stones, or imitations of the foregoing.

Advice has been requested whether the retailers excise tax on sales of jewelry and related items applies to the sale at retail of the article described below.

A retailer sells a bobby pin with a miniature butterfly attached. The butterfly is made of nylon net and decorated with plastic glitter. The frame, body, and antenna of the butterfly are made of gold colored wire and thread.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax upon retail sales of jewelry and related items, including all articles commonly or commercially known as jewelry, whether real or imitation, and articles made of, or ornamented, mounted or fitted with precious metals or imitations thereof.

Section 320.31(a) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, states that jewelry in general includes articles designed to be worn on the person or apparel for the purpose of adornment and which in accordance with custom or ordinary usage are worn so as to be displayed, such as rings, chains, brooches, bracelets, cuff buttons, necklaces, earrings, beads, etc. The tax is imposed on the sale of any such articles at retail, regardless of the substance of which made and without reference to their utilitarian value or purpose, unless for a purpose specifically exempted by law.

Section 320.31(b) of the regulations states that jewelry also includes articles to be carried in the hand, or hung on the arm, or carried or worn on the person, whether in pocket or bag or under the outer garments, such as cigarette cases, eyeglass cases, pencils, powder boxes, garter buckles, canes, purses or handbags, if made of, or ornamented, mounted or fitted with, pearls, precious or semiprecious stones, or imitations thereof. Such articles are likewise subject to tax without regard to their utilitarian value or purpose.

Section 320.31(c) of the regulations states that for purposes of the tax, it is immaterial whether jewelry is real or imitation.

Section 320.33(a) of the regulations provides that the tax is imposed on the sale at retail of any article, as distinguished from those articles commonly or commercially known as jewelry as described in section 320.31, which are made of, or ornamented, mounted or fitted with, precious metals or imitations thereof.

It is held that hair ornaments are subject to the retailers excise tax, imposed on sales of jewelry and related items, only if made of, or ornamented, mounted or fitted with precious metals or pearls, precious or semiprecious stones, or imitations of the foregoing. See Revenue Ruling 178, C. B. 1953–2, 352, which relates to barrettes and combs so ornamented.

Accordingly, the bobby pin described above is not considered to be an article of jewelry within the meaning of section 4001 of the Code. The sale of such bobby pin, therefore, is not subject to the tax imposed by that section.

Rev. Rul. 58–330

Section 4001 of the Internal Revenue Code of 1954 imposes a tax on the sale at retail of several enumerated items, including watches, clocks, and cases and movements for watches and clocks. *Held*, a clock is subject to the tax when sold at retail, regardless of whether such clock is new, secondhand, or antique, or whether it is in working condition. Likewise, all cases and movements for clocks are taxable when sold separately at retail regardless of whether such cases or movements are new or used. Therefore, the sale of an antique clock to a purchaser for use rather than for resale is subject to the retailers excise tax, even though the clock may previously have been sold in a taxable transaction.

Whether the term "sold at retail" is equivalent to "sale for purposes other than resale". See Rev. Rul. 58–125, page 561.

Applicability of the statute of limitations to the tax due on jewelry and related items when not reported by a retailer who files a return on other retailers excise taxes. See Rev. Rul. 58–274, page 495.

SUBCHAPTER B.—FURS

SECTION 4011.—IMPOSITION OF TAX

Rev. Rul. 58–37

Information for use by retailers as a guide in determining their liability for the retailers excise tax on furs imposed by section 4011 of the Internal Revenue Code of 1954.

The Internal Revenue Service has been asked to publish information for use as a guide by retailers in determining their liability for the retailers excise tax on furs.

Section 4011 of the Internal Revenue Code of 1954 imposes a tax upon the sale at retail of articles made of fur on the hide or pelt, and articles of which such fur is the component material of chief value, but only if such value is more than three times the value of the next most valuable component material. Section 320.40 of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the tax is not confined to the sale of fur articles used as wearing apparel but applies to sales of any fur article suitable for any use, such as rugs, fur robes, etc. The tax does not apply to sales of raw fur.

It will be noted that there are two categories of articles which are subject to the tax, namely, (1) those *made of* fur on the hide or pelt, and (2) those of which fur on the hide or pelt is a *component material*, the value of which is more than three times the value of the next most valuable component material. In determining whether the sale of an article of which fur is a component material is subject to tax, the value of such fur at the time of assembly of the article must be compared to the value of each other single component, at such time. In comparing the value of the fur to the other components, all costs, including labor, of making or preparing a complete component should be considered. However, the cost of assembling the components into the finished article should not be considered. Where the value of the fur, as compared with the value of the other component materials in an article, is not such as to render the sale taxable, the retailer must establish that fact by maintaining adequate records or documentary evidence, such as a written statement obtained from the manufacturer or producer of the article, stating that the value of the fur at the time of assemblage of the article was not more than three times the value at such time of the next most valuable component material. In the absence of such records or documentary evidence, the tax must be paid with respect to the sale of such article at retail.

The Internal Revenue Service has received numerous inquiries concerning whether certain materials should be classified as "fur on the hide or pelt." The peltries of certain animals, with the hair wholly or partially intact, are well recognized as being "fur on the hide or pelt." There are other animals, however, such as certain types of sheep, whose hair is so fine that its natural tendency is to become matted or felted, so that in its natural condition it neither resembles fur nor is used as fur. Just before such sheep are slaughtered, the wool is closely sheared from the animal for use in weaving woolen fabrics. The resulting pelt, with the remaining short wool still having a matted or felted appearance, is known as "domestic type" shearling. The term "domestic type" includes sheepskin or lambskin of either domestic or foreign origin, such as sheepskin or lambskin from merino or crossbred sheep or lambs. Thus, the term "domestic type" refers to domesticated types of animals without regard to their place of origin.

The "domestic type" shearling described above is used extensively as linings in coats, gloves, and slippers. When used in this condition, it is not considered to be fur. However, there have been developed certain processes involving combing, "electrifying" with chemicals, washing, bleaching, dyeing, etc., whereby this "domestic type" shearling loses its felted appearance. The material thus processed is known

and sold commercially as fur under various names. Other animals, such as South American sheep, possess hair which grows in tight spirals and does not felt as readily as the hair of the "domestic type" animals. Accordingly, the pelts of such animals are known and sold commercially as fur without the extensive processing described above.

The list below is illustrative of the determinations which have been made by the National Office of the Service on questions of classification. The "taxable" column includes the materials which have been held to constitute "fur on the hide or pelt," while the "nontaxable" column includes materials which have been held not to constitute "fur on the hide or pelt."

TAXABLE	NONTAXABLE
Alpaca.	
Baum marten.	
Bear.	
Beaver.	
Bobcat.	
Broadtail.	
Buffalo.	
Bunny fur.	
Calfskin, with hair on.	
Caracal.	
Caribou hide, with hair on.	
	Chamois skins.
Cougar.	
Cowhide, with hair on.	
Coyote.	
Deer hides, with hair on.	
Doghide, with hair on.	
Ermine pelts or tails.	
Fox pelts or tails.	
Goatskins.	
Hair seal.	
Horsehide, with hair on.	
Iceland lambskin, whether in natural state, processed or dyed.	
Iceland sheepskin, whether in natural state, processed or dyed.	
Kidskin.	
Krimmer.	
Laskinlamb, whether in natural colors, processed or dyed.	
Lambskin of the so-called "domestic type" if electrified, dyed or otherwise processed to resemble fur.	
	Lambskin of the so-called "domestic type", in its natural condition.
Lion pelts.	
Marten.	
Mink pelts and tails.	
Moose hide.	
Mouton, whether in natural color or dyed.	
Muskrat.	
Nutria.	
	Nylon, even though processed and dyed to resemble fur.

TAXABLE	NONTAXABLE
Otter.	
Persian lamb.	
Pony.	
Rabbit.	
Raccoon pelts or tails.	
	Rayon, even though processed to resemble fur.
Reindeer hide, with hair on.	
Sable.	
Shearling of the so-called "domestic type" which has been electrified or otherwise processed to resemble fur.	
	Shearling of the so-called "domestic type" in its natural unprocessed condition.
Sheepskin of the so-called "domestic type" which has been electrified or otherwise processed to resemble fur.	
	Sheepskin of the so-called "domestic type" in its natural unprocessed condition.
Slink, with hair on.	
South American lambskin.	
South American sheepskin.	
Spanish lambskin.	
Squirrel.	
Tiger pelts.	
Wolf.	
Wolverine.	

The Service has received other inquiries concerning whether certain *articles* should be classified as articles *made of* fur on the hide or pelt, or as articles of which fur on the hide or pelt is a *component material.* Retail sales of articles of the first category are taxable without regard to the relative value of the fur, while articles of the second category are taxable only if the value of the fur component is more than three times the value of the next most valuable component. The list below is illustrative of the determinations which have been made on such questions.

ARTICLES MADE OF FUR	ARTICLES OF WHICH FUR IS A COMPONENT MATERIAL
Ascots, fur.	
Bags, fur.	
Belts, fur.	
	Belts, fur-trimmed.
Berets, fur.	
	Berets, fur-trimmed.
Boots, made entirely of fur.	
	Boots, fur-lined.
	Boots, fur, with leather soles.
Borders, fur.	
Boutonnieres, fur.	
Buttons, fur.	
Capes, fur.	
Caps, fur.	
	Caps, fur-trimmed or fur-lined.
Chokers, fur.	
Coats, fur.	

Articles Made of Fur	Articles of Which Fur is a Component Material
	Coats, fur-trimmed cloth.
	Coats, reversible, made of fur on one side and cloth on the other.
	Coats, fur-lined cloth.
Collars, fur, which can be worn separately or interchangeably with coats, suits or other garments.	
Cuffs, fur.	
Doll clothing, fur, such as booties, coats, etc.	
	Dress novelties, fur-trimmed.
Ear muffs, fur.	
Gloves, fur.	
	Gloves, fur-backed with palm of another material.
	Gloves, fur-lined.
Hats, fur.	
	Hats, fur-trimmed.
Head bands, fur.	
Lapels, fur.	
Lining, fur, when sold separately from the sale of a coat.	
Mittens, fur.	
	Mittens, fur-backed with palm of another material.
Muffs, fur.	
	Muffs, cloth, fur-trimmed.
Parkas, fur.	
	Parkas, fur-trimmed or fur-lined.
Piping, fur, sold separately.	
Play clothing, such as Davy Crockett fur hats.	
	Play clothing, such as fur-trimmed or fur-lined Davy Crockett hats, suits and jackets.
Rugs, fur, regardless of whether bound or lined.	
Scarves, fur.	
	Shakos, fur-trimmed.
Shoe dusting mitts.	
	Shoes, made partially of fur.
Skins, completely finished and mounted, such as those used in scarves.	
Sleeves, fur.	
Stoles, fur.	
	Slippers, fur-lined.
Striping, fur, sold separately.	
Tails, fur.	
	Toys or novelties made of fur and stuffed with other materials.
Turbans, fur.	
	Turbans, fur-trimmed.

For further guidance in determining the taxability of articles, see Mimeograph 6128, C. B. 1947–1, 154, Revenue Ruling 98, C. B. 1953–1, 424, Revenue Ruling 54–100, C. B. 1954–1, 245, and Revenue Ruling 56–291, C. B. 1956–1, 501.

The above classifications are not to be considered all-inclusive. They merely reflect determinations which have been made by the National Office of the Service. In any case where the classification of a particular material or article not listed above is in question, a specific ruling or determination thereon should be requested from the Service.

Regarding fur articles produced from pelts furnished by customers, section 4012 of the Code provides that where a person, who is engaged in the business of dressing or dyeing fur skins or of manufacturing, selling, or repairing fur articles, produces a taxable fur article from fur on the hide or pelt furnished, directly or indirectly, by a customer, and the article is for the use of, and not for resale by, such customer, the transaction shall be deemed to be a sale at retail and the person producing the article shall be deemed to be the person selling such article at retail for the purposes of the tax. The tax applicable to such transactions is to be computed upon the fair retail market value of the finished article, as determined by the Secretary of the Treasury or his delegate. Generally, the fair retail market value may be considered as the retail sales price for which the same or a similar finished article is sold by retailers generally in the ordinary course of the retail trade.

Taxable fur articles, such as collars, cuffs, lapels, buttons, borders, etc., may be produced by retail furriers in connection with the repairing, remodeling, or restyling of used fur garments. See S. T. 930, C. B. 1944, 607, which also holds that under such circumstances the tax attaches to that portion of the price charged for the entire job which is attributable to the fur article so produced, where any *complete garment* or *complete article* is produced (1) from fur, either *used* or *unused*, which is furnished by the furrier, or (2) from *unused* fur furnished by the customer. That ruling further holds, however, that the tax does not attach (1) where a complete garment or article is produced from *used* fur furnished by the customer, or (2) where fur, whether used or unused and whether furnished by the furrier or by the customer, is used in a repair, remodeling, or restyling operation in which *no complete garment or article* is produced.

Auction sales by the United States Customs Service and by the United States Postal Service of confiscated, unclaimed, or damaged furs. See Rev. Rul. 58–57, page 363.

Whether the term "sold at retail" is equivalent to "sale for purposes other than resale." See Rev. Rul. 58–125, page 561.

Applicability of the statute of limitations to the tax due on furs when not reported by a retailer who files a return on other retailers excise taxes. See Rev. Rul. 58–274, page 495.

SUBCHAPTER C.—TOILET PREPARATIONS

SECTION 4021.—IMPOSITION OF TAX

Rev. Rul. 58–38

Lists of articles which are taxable as toilet preparations under section 4021 of the Internal Revenue Code of 1954 and articles which are not taxable as toilet preparations within the purview of that section.

Mimeograph Coll. No. 5828, C. B. 1945, 438, superseded.

The Internal Revenue Service has been asked to publish, for use by retailers as a guide in determining their liability for the retailers excise tax on toilet preparations, an illustrative list of articles on which rulings of taxability or nontaxability have been issued.

Section 4021 of the Internal Revenue Code of 1954 provides:

There is hereby imposed upon the following articles sold at retail a tax equivalent to 10 percent of the price for which so sold—

Perfume.
Essences
Extracts.
Toilet waters.
Cosmetics.
Petroleum jellies.
Hair oils.
Pomades.
Hair dressings.
Hair restoratives.
Hair dyes.
Aromatic cachous.
Toilet powders.

Any other similar substance, article, or preparation, by whatsoever name known or distinguished; any of the above which are used or applied or intended to be used or applied for toilet purposes.

Section 320.50(a) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the tax applies to the sale by the retailer of the articles enumerated above and similar articles commonly or commercially known as toilet articles, which are used or applied, or intended to be used or applied, for toilet purposes. Any article advertised or held out for toilet purposes, or for any purpose for which the articles enumerated in the law are customarily used, will be subject to the tax regardless of the name by which it may be known or distinguished. The tax attaches to the sale by the retailer of any preparation which is used or applied or intended to be used or applied for toilet purposes or used in connection with the bath or care of the body, or applied to the clothing as a perfume or to the body as a toilet article. The fact that any particular product, preparation, or substance coming within the scope of the law may have, or be held out to have, a medicinal, stimulating, remedial, or curative value does not exempt it from the tax, if it is used, or held out for use, as an adjunct to the toilet or for toilet purposes.

Under the provisions of section 4022 of the Code, the tax on toilet preparations shall not apply to lotion, oil, powder, or other article intended to be used or applied only in the care of babies. Section 320.50(c) of the regulations provides that the determination of whether toilet articles are intended to be used or applied only in the care of babies will be made only by reference to the advertising with respect to, and the labeling contained on, the article. If an article is advertised and labeled as being for use in the care of babies and is not advertised or labeled as usable by persons other than babies

the article is exempt from tax even though the particular purchaser buys it for adult use. On the other hand, an article which is represented by advertising or labeling as fit for adult use, in addition to use in the care of babies, will not be exempt from tax even though sold to a purchaser who intends to use the article only in the care of babies.

There are listed below articles which the Internal Revenue Service has held to be toilet articles or preparations subject to tax when sold at retail. There are also listed articles which the Service has held not to be toilet articles or preparations within the meaning of the statute and therefore not subject to tax. The articles or preparations included in these lists should be considered illustrative instead of all-inclusive.

TAXABLE	NONTAXABLE
	Acne creams or lotions (if not recommended for toilet purposes).
After shave creams, lotions, or powders.	
Almond meal and paste.	
	Anointing oils (if advertised and labeled for use in care of babies only).
Anti-perspirants.	
	Antiseptics (if not recommended for toilet purposes).
Aromatic cachous (Sen-Sen).	
Astringents (after shave, anti-perspirants, etc.).	
Atomizers containing perfume and other taxable liquids.	
	Baby oils, powders, creams, lotions (if advertised and labeled for use in care of babies only).
Bandoline.	
Bath crystals.	
Bath milks.	
Bath oils.	
Bath powders.	
Bath salts.	
Bath tablets.	
Bay rum.	
Beauty creams, mask preparations, etc.	
Bleach creams and lotions (including freckle remover).	
Body powders (unless advertised or labeled for use in care of babies only).	
Bouquet liquids.	
Breath sweeteners (except candy, chewing gum, chlorophyll tablets and lozenges).	
Brilliantines.	
	Brushless shaving cream (if not recommended for use after shaving).
Bubble bath preparations.	
	Chlorophyll, in lozenge, tablet, or liquid form, to be taken internally.
Cleansing creams and lotions (including those for removing stains from the skin).	
Cocoa butter (if advertised or labeled for toilet purposes).	
Cold creams.	

TAXABLE	NONTAXABLE
Colognes.	
Compacts containing rouge or powder.	
Compact refills.	
	Corn or callous removers.
Cosmetics.	
Cosmetic stocking preparations.	
Cuticle softeners and removers.	
	Dandruff preparations or products used or intended for use as a remedy for, or as an application for relief from, dandruff (including the incidental elimination of dandruff scales or flakes), provided the labels, leaflets or other advertising relating thereto are so limited as to exclude any reference to the use of the preparations or products for toilet purposes (such as to improve one's personal appearance). Scalp lotions and scalp ointments, however, which are used or intended for use as a treatment for dry, oily or falling hair are taxable.
	Dentifrices.
Deodorants (even though having a medicinal or curative value, if advertised or labeled for use as a body deodorant).	
Deodorants (for use in closets, bureau drawers, etc., for imparting fragrance to clothing).	
	Deodorants (for use only for spraying rooms, bedding, or inside of automobiles).
Depilatories (except of the abrasive or mechanical type).	
Dusting powders (unless advertised or labeled for use in care of babies only).	
	Electric shaving preparations which serve the same functional purposes as lather or brushless shaving creams, provided they are not recommended for use after shaving or for other toilet purposes.
	Emery boards.
Essences and extracts, perfume.	
Eyebrow pencils.	
	Eye drops, eye lotions and eye washes (if not recommended for beautification of the eyes).
	Eyelash brushes.
	Eyelash combs.
	Eyelash curlers.
Eyelash mascara and eyelash and brow dyes.	
Eye shadows.	
Face creams.	
Face lotions, facial oils.	
Face packs.	
Face powders, in loose or cake form.	
	Facial tissues.
Fingerwave lotions.	
Floral essences.	

TAXABLE	NONTAXABLE
	Foot creams, balms, lotions, and powders for use in the treatment of tired, aching, burning or itching feet, or of skin irritations such as "athlete's foot," provided no claims or recommendations are made in advertising matter for use as deodorants, anti-perspirants, or for other toilet purposes.
Foundation makeup film.	
Freckle removers.	
Fullers earth (if recommended for toilet purposes).	
Glycerine and rose water.	
	Glycerine (if not recommended for toilet purposes).
Hair bleaches.	
Hair dressings.	
Hair dyes.	
Hair lotions.	
Hair oils.	
Hair pomades (regardless of whether they are colored or scented).	
Hair removers (except those of the abrasive or mechanical type).	
Hair restoratives.	
Hair sprays.	
Hair straighteners.	
Hair tints and rinses.	
Hair tonics.	
Hand creams.	
Hand lotions.	
Henna.	
Lavendar water.	
Leg makeup.	
Lip ices and salves (if colored or perfumed or if recommended for the prevention of chapped lips or for other toilet purposes).	
	Lip ices and salves (uncolored and unperfumed and recommended for use only after exposure).
Lip pomade.	
Lipsticks, lipstick refills.	
Liquid face powder.	
Liquid lip color.	
Liquid stockings.	
	Manicuring instruments.
Manicure preparations.	
Mascara.	
Massage creams.	
	Medicated preparations (if recommended only for relief of skin irritations and not for prevention of sunburn, chafing, etc.).
Mittens containing toilet powder.	
	Mosquito repellants (unless advertised as sunburn preventatives).
	Mouth washes (if not recommended for after shaving use or to sweeten the breath or other toilet purposes).
Mustache wax.	
Nail bleaches.	
Nail enamels.	
Nail enamel or polish removers.	

TAXABLE	NONTAXABLE
Nail lacquers.	
Nail polishes, paste, powder or liquid.	
Nail whitener.	
Olive oil (colored, or perfumed, or recommended for toilet purposes).	
Orange flower water.	
Oris root.	
Perfumes.	
Perfume ingredient kits (tax applicable to that portion of retail selling price which is allocable to the perfumery ingredients. Test tubes, droppers, etc., not taxable).	
Perfume novelties, containing perfume.	
Permanent waving creams, lotions, neutralizer.	
	Permanent waving curlers, caps, tissues.
Permanent waving kits (curlers, soap, nontaxable shampoos, caps, etc., in kits may be excluded in the computation of the excise tax if retailers records show comparative values of taxable and nontaxable articles in kit, based upon separate retail prices, or upon cost, if they are not actually sold separately).	
	Peroxide (if recommended only for use as an antiseptic or for medicinal purposes).
Peroxide (regardless of its strength, if recommended for use in bleaching the hair or for other toilet purposes).	
Petroleum jelly (if scent or color added).	
Plucking creams (for use in connection with plucking hair).	
Pore cleansers (other than soap).	
Powder bases (liquid and cream).	
	Powder puffs.
	Preparations compounded by druggists pursuant to bona fide prescriptions of physicians (except where the prescription, on its face, specifies that it is for toilet purposes).
	Preparations when recommended exclusively for use by morticians in preparing bodies for burial.
Protective creams (having toilet claims or used as skin creams or anti-perspirants).	
Rock salt bath crystals.	
	Reducing salts (unless perfumed or recommended for toilet purposes).
	Rose jars (if intended for use solely in scenting or perfuming the air of a room or home).
Rose water.	
Rouges.	
	Rubbing alcohol (if not scented or recommended for toilet purposes).

TAXABLE	NONTAXABLE
Sachets containing powder or aroma producing materials. When cases, for home storage of lingerie, handkerchiefs, hosiery, or gloves, contain sachets, only the sachets are taxable.	
Scalp lotions, scalp ointments, which are used or intended for use as a treatment for dry, oily or falling hair.	
Shampoos (containing 5% or less of saponaceous matter, regardless of advertising claims or other ingredients).	
	Shampoos (containing more than 5% of saponaceous matter and which are recommended only for cleansing purposes).
Shampoos (if recommended in advertising for conditioning, waving, straightening, bleaching, dyeing, tinting, or otherwise changing the natural appearance of the hair regardless of the saponaceous matter in the product).	
	Shampoos and other preparations recommended for use only on dogs, cats, and other pets.
	Shaving creams (whether brushless or lather), soaps, powders, or other preparations recommended solely for use in softening the beard preparatory to shaving. (Also see "Electric shaving preparations").
Shaving preparations which, in addition to use in softening the beard preparatory to shaving, are recommended for use as a skin conditioner, as an after shave lotion, or for any other toilet purposes.	
Skin balms, bleaches, creams, fresheners, lotions, oils, tonics, whiteners.	
	Smelling salts.
	Soaps, in cake, powder or liquid form.
	Sponges.
Stain removers, for use in removing stains from the hands or other parts of the body, unless the product contains more than 5 percent saponaceous matter.	
Styptics (if recommended for use as anti-perspirants or for other toilet purposes).	
	Styptics (in pencil, cream, powder or liquid form recommended for use only to stop the flow of blood from cuts in the skin).
Sun allergy cream (if recommended for use before exposure to sun to prevent sunburn).	
Sunburn preventatives — Suntan creams, lotions, oils, etc.	
Talcum powder (unless advertised or labeled for use in care of babies only).	
Texture creams.	

TAXABLE	NONTAXABLE
	Theatrical makeup: Such items as grease paints, clown white, nose putty, black wax, black face for minstrel makeup, and spirit gum are not taxable provided they are not advertised or sold for toilet purposes. However, face creams, toilet powders, lipsticks, rouges, eyebrow and eyelash mascara, eye shadow creams and other preparations which are commonly and commercially known and sold in the trade for toilet purposes are taxable, even though sold for use as theatrical makeup.
Tissue creams. Toilet ammonia. Toilet creams. Toilet lanolin. Toilet waters.	
	Toothbrushes. Toothpastes and toothpowders. Tooth stain removers. Toy makeup kits which contain only imitations of cosmetics or other toilet preparations. Tweezers.
Vanishing creams. Water softeners (perfumed or having toilet claims). Wave set (paste, powder or lotion). Witch hazel (regardless of purpose for which recommended). Wrinkle concealing preparations.	
	Zinc oxide (if not recommended for toilet purposes). Zinc stearate powder (if not recommended for toilet purposes).

Mimeograph Coll. No. 5828, C. B. 1945, 438, which contains a less extensive list of taxable articles, is hereby superseded.

Auction sales by the United States Customs Service and by the United States Postal Service of confiscated, unclaimed, or damaged toilet preparations. See Rev. Rul. 58–57, page 363.

Whether the term "sold at retail" is equivalent to "sale for purposes other than resale." See Rev. Rul. 58–125, page 561.

Taxability of elaborately designed cruets, vases, and decanters, in which toilet preparations are packaged and sold, see Rev. Rul. 58–146, page 387.

Applicability of the statute of limitations to the tax due on toilet preparations when not reported by a retailer who files a return on other retailers excise taxes. See Rev. Rul. 58–274, page 495.

SUBCHAPTER D.—LUGGAGE, HANDBAGS, ETC.

SECTION 4031.—IMPOSITION OF TAX

Rev. Rul. 58–183

Certain coin holders for use in holding coins for a particular purpose, such as for parking meters, are not purses within the meaning of section 4031 of the Internal Revenue Code of 1954 and, accordingly, are not subject to the retailers excise tax.

Advice has been requested whether the retailers excise tax on luggage, handbags, etc., applies to sales of certain coin holders which are designed for a particular purpose, such as holding coins to be used in parking meters or as street car or bus fares.

These coin holders are usually made of metal or a nonpliable plastic material and come in various shapes such as a bar, barrel, etc. They are designed to hold a specific number of coins of a particular denomination. Sometimes the coin holders have key chains attached.

Section 4031 of the Internal Revenue Code of 1954 imposes a retailers excise tax on the sale of luggage, handbags, etc., including purses, handbags, pocket books, wallets, billfolds, and card, pass, and key cases. Section 320.60(e) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the terms "purses," "handbags," "pocketbooks," "wallets," "billfolds," and "card, pass, and key cases" to include receptacles commonly and commercially known and sold as such, regardless of design, size or materials from which made or the purpose for which they are to be used.

It is held that coin holders of the type described above, which are not suitable for use as purses, are not purses within the meaning of section 4031 of the Code and are not subject to the tax imposed thereunder. While "key cases" are embraced within section 4031 of the Code, this term is not considered to include key chains and such chains are not taxable under that statute.

See Revenue Ruling 56–274, C. B. 1956–1, as to taxability of a small plastic receptacle, which has a magnetized top for attachment to the dashboard of an automobile.

Rev. Rul. 58–198

A so-called "insurance card folder" which is suitable for use in carrying cards and passes, is subject to the retailers excise tax on luggage, handbags, etc., imposed by section 4031 of the Internal Revenue Code of 1954.

Advice has been requested whether the retailers excise tax on luggage, handbags, etc., applies to sales of so-called "insurance card folders."

The "insurance card folder" consists of a piece of imitation leather which when folded in half measures approximately four and one-half inches by two and seven-eighths inches and contains two full-length inside pockets opening along the center fold. The top sides of the pockets are made of stiff transparent cellophane.

Section 4031 of the Internal Revenue Code of 1954 imposes a tax upon luggage, handbags, etc., including wallets, billfolds, and card, pass, and key cases.

It is held that, since the "insurance card folder" described above is made with pockets that are suitable for use in carrying passes and cards, it is a card or pass case within the meaning of section 4031 of the Code. Therefore, retail sales of this article are subject to the tax imposed by that section.

Rev. Rul. 58–199

Sales of shoe mittens designed for the purpose of covering shoes to prevent soiling other clothing or luggage lining while packed for travel are subject to the retailers excise tax on luggage, handbags, etc., imposed by section 4031 of the Internal Revenue Code of 1954.

Advice has been requested whether sales of so-called "shoe mittens" are subject to the retailers excise tax on luggage, handbags, etc.

A retailer sells shoe mittens made of knitted washable cotton yarn which fit over shoes as a protective covering for the purpose of preventing soiling of clothing or luggage lining with which the shoes may come in contact when packed for traveling.

Section 4031 of the Internal Revenue Code of 1954 imposes a tax upon the retail sale of all cases, bags, and kits (without regard to size, shape, construction, or material from which made) for use in carrying toilet articles or articles of wearing apparel.

Shoes are articles of wearing apparel. Therefore, it is held that shoe mittens, designed for the purpose of covering shoes to prevent the soiling of other clothing and luggage lining when packed for travel, come within the classification of cases, bags, and kits for carrying articles of wearing apparel within the meaning of section 4031 of the Code. Accordingly, sales of shoe mittens are subject to the retailers excise tax imposed by section 4031 of the Code, regardless of the material from which such mittens are made.

(Also Section 4051.) Rev. Rul. 58–249

Rain hoods are not taxable articles for purposes of any of the retailers excise taxes. However, plastic cases designed to carry the rain hoods are cases for carrying wearing apparel and are subject to the retailers excise tax on luggage imposed by section 4031 of the Internal Revenue Code.

Advice has been requested concerning the applicability of the retailers excise tax to sales of a rain hood and a small plastic case which is designed for carrying the rain hood. The rain hood is made of plastic which is permanently pleated so that it may be folded easily to fit into the case.

Section 4031 of the Internal Revenue Code of 1954 provides that a tax shall be imposed on the sale at retail of any case (without regard to size, shape, construction, or material from which made) for use in carrying articles of wearing apparel.

The rain hoods are not taxable articles for purposes of any of the retailers excise taxes. However, since the cases for the rain hoods are specifically designed and used for carrying articles of wearing apparel, they are subject to the retailers excise tax on luggage.

Where the taxable case and the nontaxable rain hood are sold at retail in combination, the tax applies only to that portion of the retail price charged for the combination which is attributable to the taxable case itself. If the case and the rain hood have separate selling prices, the taxable portion of the combination may be determined by applying to the retail selling price of the combination the ratio which the separate retail selling price of the case bears to the sum of the retail selling prices of both the taxable and nontaxable articles. Where either of the articles is not sold separately at retail and does not have an established retail sales price, the taxable portion of the combination is to be determined by a comparison of the cost of the taxable article to the sum of the costs of the taxable and nontaxable articles. Accordingly, if the cost of the case represents one-tenth of the cost of both articles, the tax applies to one-tenth of the tax-excluded retail selling price of the combination.

Rev. Rul. 58–331

Eyeglass cases made of beads, designed for use only in carrying eyeglasses, and cigarette cases made of beads, designed for use only in carrying one pack of cigarettes, are not considered suitable for carrying toilet articles or articles of wearing apparel and therefore are not subject to the retailers excise tax on luggage, handbags, etc., imposed by section 4031 of the Internal Revenue Code of 1954.

Advice has been requested whether the retailers excise tax on luggage, handbags, etc., applies to sales of eyeglass cases and cigarette cases made of beads.

An eyeglass case, made of black beads, measures approximately three inches by six inches with an open top. Another eyeglass case is made of white beads with a colored bead design on the the front, measures three and one-half inches by seven inches, and has a gold colored frame and closure. The cigarette case, designed for holding one package of cigarettes, is also made of beads and is approximately two and one-half inches by four inches in size with a flap and snap closure.

Section 4031 of the Internal Revenue Code of 1954 imposes a tax upon retail sales of luggage, handbags, etc., including cases, bags, and skits (regardless of size, shape, construction, or material from which made) for use in carrying toilet articles or articles of wearing apparel.

In the instant case, the eyeglass cases are designed for use only in carrying eyeglasses and the cigarette case is designed only for the purpose of carrying one pack of cigarettes. Neither of the articles is adaptable for any other purpose, such as carrying toilet articles or articles of wearing apparel. Accordingly, it is held that eyeglass cases and cigarette cases of the type described above are not subject to the tax imposed by section 4031 of the Code.

However, if the frame, closure, or any other part of the eyeglass cases or cigarette cases is made of gold or other precious metal or is plated with such metal or an alloy thereof to a thickness of one one-hundred-thousandth of an inch or more, it is an article ornamented, mounted, or fitted with a precious metal or imitation thereof within the meaning of section 4001 of the Code and is subject to the retailers excise tax on jewelry and related items when sold at retail. Eyeglass

and cigarette cases would also be subject to the tax if they are ornamented, mounted or fitted with pearls, precious or semiprecious stones, or imitations thereof.

Auction sales by the United States Customs Service and by the United States Postal Service of confiscated, unclaimed, or damaged luggage, handbags, etc. See Rev. Rul. 58–57, page 363.

Whether the term "sold at retail" is equivalent to "sale for purposes other than resale." See Rev. Rul. 58–125, page 561.

Applicability of the statute of limitations to the tax due on luggage, handbags, etc., when not reported by a retailer who files a return on other retailers excise taxes. See Rev. Rul. 58–274, page 495.

SUBCHAPTER E.—SPECIAL FUELS

SECTION 4041.—IMPOSITION OF TAX

Rev. Rul. 58–169

The retailers excise tax on special fuels, imposed by section 4041 of the Internal Revenue Code of 1954, does not apply to retail sales of diesel fuel which is delivered into a container other than the fuel supply tank of a diesel-powered highway vehicle, where the customer states that the fuel is for use as a weed killer.

Advice has been requested as to the applicability of the retailers excise tax on special motor fuels to retail sales of diesel fuel sold to a customer who furnishes a container for carrying the fuel and who states that the fuel is for use as a weed killer.

Section 4041(a) of the Internal Revenue Code of 1954 imposes a tax upon any liquid, other than gasoline, sold by any person to an owner, lessee, or other operator of a diesel-powered highway vehicle, for use as a fuel in such vehicle, or used by any person as a fuel in a diesel-powered highway vehicle.

Section 324.21 of Regulations 119, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides, in part, that the sale of diesel fuel is taxable when the fuel is delivered into the fuel supply tank of a diesel-powered highway vehicle or, when not so delivered, the customer indicates in writing at the time of the sale that the entire quantity of the diesel fuel is for use as a fuel in diesel-powered highway vehicles. The regulations further provide that if such a written statement is not furnished by the vendee, he shall be liable for the tax on that quantity of the liquid which is used by him as fuel in a diesel-powered highway vehicle, or which is sold by him in a taxable transaction.

It is held that, where diesel fuel is sold and delivered into a container other than the fuel supply tank of a diesel-powered highway

vehicle, and the vendee does not furnish the vendor a written statement that the liquid is for use as a fuel in a diesel-powered highway vehicle, the retailers excise tax imposed by section 4041 of the Code does not attach to that sale of such liquid. Therefore, sales of diesel fuel, as described above, are not subject to the tax.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO RETAILERS TAX

SECTION 4051.—DEFINITION OF PRICE

(Also Section 4021.) Rev. Rul. 58–146

Elaborately designed cruets, vases, and decanters, in which toilet preparations are packaged and sold, are considered to be containers within the meaning of section 4051 of the Internal Revenue Code of 1954, even though the containers are also suitable for reuse other than for holding toilet preparations.

Advice has been requested regarding the applicability of the retailers excise tax to cruets, vases, and decanters, which are used to hold toilet preparations when sold but which may be reused by the purchaser for other purposes.

Certain toilet preparations are sold packaged in various types of cruets, vases, and decanters, which are very elaborately designed and which may be reused as bud and flower vases, lamp stands, or wine decanters, thereby creating an additional inducement to purchase the toilet preparations. The price for these toilet preparations would be considerably reduced if they were packaged in ordinary bottles, plastic bags, paper boxes, or cans.

Section 4021 of the Internal Revenue Code of 1954 imposes a tax on toilet preparations when sold at retail. Section 4051 of the Code provides in part, that for tax computation purposes there must be included in the price of an article so sold any charges for coverings and containers of whatever nature and any charges incident to placing an article in condition packed ready for shipment.

In the instant case, the cruets, vases, and decanters are used for the purpose of containing the toilet preparations for sale. Therefore, it is held that, under such circumstances, the cruets, vases, and decanters are containers for toilet preparations within the meaning of section 4051 of the Code. The fact that the cruets, vases, and decanters may, after they have served as containers for the toilet preparations, be used for some other purpose is not material. Accordingly, the retailers excise tax imposed by section 4021 of the Code attaches to the entire price for which the toilet preparations and containers are sold at retail.

Applicability of the retailers excise tax where a nontaxable rain hood is sold in combination with a taxable carrying case. See Rev. Rul. 58–249, page 384.

SECTION 4053.—COMPUTATION OF TAX ON INSTALLMENT SALES, ETC.

Rev. Rul. 58–283

Where articles subject to the retailers excise tax are sold under installment sale contracts and thereafter the retailer sells the accounts to a third party, the retailer becomes liable, at the time of the sale of the accounts, for tax based upon the entire balance due under the contracts. However, if the retailer elects to turn the accounts over to a collection agency, the tax becomes due on the gross amounts collected by the agency and is payable by the retailer for the quarter during which such collections are effected.

The Internal Revenue Service has been requested to explain the retailers excise tax consequences of selling installment sale contracts as contrasted to collecting those accounts through collection agencies.

Articles subject to the retailers excise tax are sold by a retail dealer under contracts which provide that the price shall be paid by installments and that title to the articles so sold shall remain in the dealer until all installments are paid. Thereafter, the retailer may (1) collect the installment payments himself, (2) sell the accounts, usually at a discount, to a third party, or (3) turn the accounts over to an agency for collection under a percentage-fee arrangement. The excise tax consequences will vary, depending upon the way in which the retailer chooses to handle the accounts.

Sections 4001, 4011, 4021, 4031 of the Internal Revenue Code of 1954 impose upon certain articles when sold at retail a tax based on the price for which sold. Section 4053 of the Code provides, in part, that, in the case of a contract for the sale of an article wherein it is provided that the price shall be paid by installments and title to the article sold does not pass until a future date, there shall be paid upon each payment with respect to the article that portion of the total tax which is proportionate to the portion of the total amount to be paid represented by such payment.

Section 320.4 of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides, in part, that in general the retailers excise tax attaches when the title to the article sold passes from the retailer to the purchaser. Section 4053 of the Code is in the nature of a relief provision applicable only in certain specified situations. While it does not affect the general rule that liability for the tax attaches when the sale of the article is made, its effect is to postpone the time for payment of the tax until such time as installments are received by the retailer from his vendee. The applicability of the section is contingent, however, upon the continued existence of the conditions which brought it into play in the first instance. Thus, so long as the retailer continues to receive the payment of the purchase price periodically in installments under the contract, he is liable for a proportionate tax based upon the installments received.

Therefore, it is held that if the retailer sells the accounts and receives payment therefor, either in whole or in part, the relief provided in section 4053 of the Code ceases to be effective. The retailer may no longer postpone payment of the balance of the tax due based upon the entire amount outstanding in the accounts. The tax is then subject to payment for the quarter in which the accounts were sold.

It is further held that, where the retailer elects to turn the accounts over to an agency for collection under a percentage-fee arrangement, such a situation does not constitute a sale of the accounts. Accordingly, under section 4053 of the Code, the retailer is liable for tax on the amounts collected from his vendees by the agency on his behalf at the time collections are effected. The tax is based upon the gross amounts collected from the retailer's vendees, with no exclusion from the tax base for any fees or commissions paid to, or retained by, the agency. See Revenue Ruling 56–412, C. B. 1956–2, 951, which holds that an amount retained by a collection agency as a charge for collecting for a retailer the balance due on credit sales does not constitute a bona fide discount, rebate, or allowance within the meaning of section 6416 of the Code.

SECTION 4055.—STATE AND LOCAL GOVERNMENT EXEMPTION

(Also Sections 4224, 4292.) Rev. Rul. 58–156

Certain state associations of municipalities, composed of towns and cities of their respective states, are instrumentalities of political subdivisions of those states and, therefore, come within the scope of the exemptions from certain excise taxes provided by sections 4055, 4224, and 4292 of the Internal Revenue Code of 1954.

The Internal Revenue Service has been asked whether various state associations of municipalities come within the scope of the exemptions from certain Federal excise taxes provided with respect to transactions with states and their political subdivisions.

Many state associations of municipalities are voluntary organizations composed of towns and cities of their respective states. Their activities, facilities, and services include research, information, reference library, bulletins, magazines, and training meetings on behalf of the member municipalities. Any municipality may become a member upon application and payment of the association's dues, the amount of which is based on the applicant's population. Such dues paid by the municipalities are the basic financial support of the association.

Sections 4055 and 4224 of the Internal Revenue Code of 1954 provide that the retailers and manufacturers excise taxes will not apply to the sale of any article for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia.

Section 4292 of the Code provides that no tax shall apply to payments received for communication and transportation services and facilities furnished to the government of any State, Territory of the United States, or to any political subdivision of the foregoing, or the District of Columbia. That section also provides that the tax shall not be imposed upon amounts paid for the transportation of property to or from such governmental units.

These state and local governmental exemptions apply to the Federal excise taxes tabulated below along with the applicable sections of the regulations which prescribe the manner of establishing the right to the exemptions. Those regulations issued under the 1939 Code have been

made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47. They are as follows:

Tax	Exemption section of Code	Applicable regulations
(1) Retailers	Sec. 4055	Regs. 51, Sec. 320.20 Regs. 119, Sec. 324.30
(2) Manufacturers	Sec. 4224	Regs. 44, Sec. 314.24 Regs. 46 Sec. 316.24
(3) Communications	Sec. 4292	Regs. 42, Sec. 130.44
(4) Transportation of persons	Sec. 4292	Sec. 42.4292–1 of the Facilities and Services Excise Tax Regulations
(5) Transportation of property	Sec. 4292	Regs. 113, Sec. 143.24

It is held that state associations of municipalities, as described above, are instrumentalities of political subdivisions of their respective states and, therefore, come within the scope of the exemptions set forth above.

Whether the North Jeffco Metropolitan Recreation District of Colorado comes within the scope of the exemptions relating to state and local governmental units. See Rev. Rul. 58–59, page 428.

Whether the Connecticut River Valley Flood Control Commission comes within the scope of exemptions from certain Federal excise taxes provided with respect to transactions with states and other local governmental units. See Rev. Rul. 58–61, page 456.

CHAPTER 32.—MANUFACTURERS EXCISE TAXES

SUBCHAPTER A.—AUTOMOTIVE AND RELATED ITEMS

PART I.—MOTOR VEHICLES

SECTION 4061.—IMPOSITION OF TAX

Rev. Rul. 58–15

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of automobile truck chassis, automobile truck bodies, automobile bus chassis, automobile bus bodies, truck and bus trailer and semitrailer chassis, truck and bus trailer and semitrailer bodies, and tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer. A company manufactures a tank on trailing wheels for storage of bituminous material. The tank is specifically designed to be transported only when empty and a structural failure would result if transported with a full or partial load of bituminous material. The trailing wheels are only used to transport the tank from job to job

and once on the job adjustable screw jacks support the entire weight of the tank and contents. When loaded, the tank's weight is far in excess of the weight limitations applicable to vehicles operating on the highway. *Held*, since the storage tank on trailing wheels is not intended for or capable of transporting property over the highways, it is not a taxable motor vehicle article within the meaning of section 4061(a)(1) of the Code and is not subject to the manufacturers excise tax imposed by that section.

(Also Sections 4063, 4220, 6416.) Rev. Rul. 58–32

The manufacturers excise tax on motor vehicles imposed by section 4061(a) of the Internal Revenue Code of 1954 applies to sales of funeral coaches and ambulances which are manufactured by converting regular passenger automobiles purchased on a tax-paid basis. The manufacturer of the coaches and ambulances may claim a credit or refund of the tax paid by the original manufacturer of the chassis, bodies, or other automobile parts used in the manufacture of the coaches and ambulances. On the other hand, the chassis, bodies, and parts could be purchased tax-free for use in the further manufacture of the coaches and ambulances.

Advice has been requested whether the manufacturers excise tax on motor vehicles applies to sales of funeral coaches and ambulances made from regular passenger automobile chassis, or from complete passenger automobiles, purchased on a tax-paid basis.

X company purchases regular passenger automobile chassis, each of which it lengthens sufficiently to accommodate a complete funeral coach or ambulance body of its own manufacture. *X* company sells the completed vehicle.

Y company purchases a regular two-door sedan and lengthens it sufficiently to convert it into a funeral coach or ambulance. This is accomplished by cutting both the body and the chassis and inserting the necessary parts and materials.

Section 4061(a) of the Internal Revenue Code of 1954 imposes a tax upon automobile and/or truck bodies and chassis, and other enumerated motor vehicle articles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof) sold by the manufacturer, producer, or importer. Section 4061(b) imposes a tax upon parts or accessories (other than tires and inner tubes and other than automobile radio and television sets) for any of the articles enumerated in subsection (a) sold by the manufacturer, producer, or importer. Section 4063(b) permits the tax-free sale of bodies to manufacturers of automobile trucks or other automobiles.

Section 4220 provides exemption for sales or resales to manufacturers, as follows:

Under regulations prescribed by the Secretary or his delegate, no tax under this chapter [chapter 32] shall be imposed with respect to the sale of—

(1) any article (other than an automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4111, a radio or television component taxable under section 4141, or a camera lens taxable under section 4171)—

(A) for use by the vendee as material in the manufacture or production of, or as a component part of, an article enumerated in this chapter; or

(B) for resale by the vendee for such use by his vendee, if such article is in due course so resold; or

(2) an automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4111, a radio or television component taxable under section 4141, or a camera lens taxable under section 4171—

(A) for use by his vendee as material in the manufacture or production of, or as a component part of any article; or

(B) for resale by the vendee for such use by his vendee, if such article is in due course resold.

For the purposes of this chapter, the manufacturer or producer to whom an article is sold under paragraph (1)(A) or (2)(A) or resold under paragraph (1)(B) or (2)(B) shall be considered the manufacturer or producer of such article. The provisions of paragraph (1) and (2) shall not apply with respect to tires, inner tubes, or automobile radio or television receiving sets taxable under section 4141.

Under the provisions of section 6416(b)(3) of the Code, if a manufacturer purchases an automobile chassis or body, on which the manufacturers excise tax has been paid, and uses it in the manufacture of another article on which the manufacturers excise tax has been paid or which has been sold free of tax by virtue of section 4220 or 4224, relating to tax-free sales, the tax paid by the original manufacturer of the chassis or body may be credited or refunded to the purchasing manufacturer. Similarly, if a manufacturer purchases automobile parts or accessories, on a tax-paid basis, and uses them in the manufacture of any taxable or nontaxable article, the tax paid by the manufacturer of the parts or accessories may be credited or refunded to the purchasing manufacturer.

The conversion of a passenger automobile chassis to a chassis suitable for use in making a funeral coach or ambulance, as in the case of *X* company, is considered to be an act of further manufacture, since a new and different chassis is the result of such conversion. Likewise, the conversion of a regular passenger automobile to a funeral coach or ambulance, under the circumstances in the case of *Y* company, is an act of further manufacture on both the passenger automobile chassis and the body.

Accordingly, it is held that, under the circumstances described, both *X* company and *Y* company are manufacturers of automobile trucks or other automobiles, that their sales of the funeral coaches are subject to the manufacturers excise tax on motor vehicles imposed by section 4061(a)(1) of the Code, and that their sales of ambulances and combination funeral coaches and ambulances are subject to the manufacturers excise tax imposed by section 4061(a)(2).

It is further held that where the chassis, bodies, and/or parts used in the conversion were purchased on a tax-paid basis, the manufacturer of the funeral coaches or ambulances is entitled, under the provisions of section 6416(b)(3) of the Code, to claim a credit or refund of an amount equal to the tax paid by the original manufacturer on such chassis, bodies, or parts. However, under the provisions of section 4063(b) of the Code, either manufacturer *X* or manufacturer *Y* may purchase automobile bodies on a tax-free basis. Furthermore, under the provisions of section 4220 of the Code, the chassis, bodies, or parts for use in the manufacture of the funeral coaches or ambulances may be purchased on a tax-free basis.

It was the former position of the Internal Revenue Service that the lengthening or conversion of an automobile chassis under cir-

cumstances similar to those described above did not constitute further manufacture. Therefore, to the extent that this Revenue Ruling holds such lengthening or conversion of chassis to be further manufacture, it will not, under the authority contained in section 7805(b) of the Code, be applied to sales prior to April 1, 1958, of automobile chassis so converted. However, since the conclusion set forth above with respect to the conversion of one type of automobile body into another type of body does not represent a change in the position of the Service, this nonretroactive application will have no effect on the taxability of sales of bodies so converted.

Rev. Rul. 58–71

The manufacturers excise tax on motor vehicles, imposed by section 4061(a) of the Internal Revenue Code of 1954, does not apply to a specially constructed motor truck snow plow which is not designed or adapted for the transportation of persons or property on the highway.

Advice has been requested concerning the applicability of the manufacturers excise tax to sales of a heavy duty "four wheel steer" motor truck designed exclusively for rotary snow plow service.

The vehicle is equipped with extra heavy front springs to accomodate the weight of the rotary plow which is mounted on the front of the vehicle. The vehicle is also equipped with a special large reduction auxiliary gear box providing for a low speed of less than one mile per hour. A special rear drive steering axle enables the vehicle to turn in a very small radius and also to drive at an angle, or oblique. Since this truck is of such an unusual design, it is considered to be impractical and dangerous for highway use.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of motor vehicle chassis and bodies, including automobile truck chassis and automobile truck bodies. Section 4061(b) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories (with certain exceptions not here material) for any of the articles enumerated in section 4061(a).

Since the chassis described above is designed and equipped for the exclusive purpose of accommodating the needs of the rotary snow plow, it is held not to be designed or adapted for the transportation of persons or property on the highway and, accordingly, not to be a taxable chassis within the meaning of section 4061(a)(1) of the Code. However, a truck chassis which is designed primarily for such highway use is subject to the manufacturers excise tax when sold or used by the manufacturer, despite the fact that a snow plow may be mounted on such chassis.

Rev. Rul. 58–72

A vacuum cleaner, which is primarily designed and adapted for use in automobiles and works only on the battery current of such vehicles, is an automobile accessory within the meaning of section 4061(b) of the Internal Revenue Code of 1954. Therefore, sales of

such vacuum cleaners by the manufacturer, producer or importer thereof are subject to the tax imposed by that section.

(Also Sections 4071, 4111, 4121, 4131, 4141, 4151, 4161, 4171, 4181, 4191, 4201, 4211.) Rev. Rul. 58–103

A United States Armed Forces disciplinary barracks manufactures and sells to the general public articles of the type which are subject to the manufacturers excise tax. The proceeds from the sale of such articles may be used in furnishing equipment, supplies, or services which contribute to the welfare and morale of the prisoners. *Held*, since the statute contains no provisions for exempting from tax sales by the United States or its instrumentalities, the disciplinary barracks is liable for the manufacturers excise tax on all sales of taxable articles of its manufacture.

Rev. Rul. 58–104

The manufacturing excise tax on automobile parts or accessories applies to the manufacturer's sale of a rubber flange strip and a rubber or plastic ring especially designed and adapted to be used on the wheels or tires of the motor vehicle articles enumerated in section 4061(a) of the Internal Revenue Code of 1954.

Advice has been requested whether the manufacturers excise tax on automobile parts or accessories applies to sales of a rubber rim flange strip which may be inserted between a rim and a worn tubeless tire for restoring the sealing qualities of the tire. Advice has also been requested concerning the taxability of sales of a white or colored ring, or disc, of rubber or plastic which is used to transform the appearance of a tire. This ring is manufactured in one model which may be glued to the wall of the tire. Another model may be "snapped on" by means of a small flap between the tire and the rim.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax on the manufacturer's sale of parts or accessories (other than tires and inner tubes and automobile radio and television receiving sets) for the motor vehicle articles enumerated in section 4061(a).

Section 316.55(a) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "parts or accessories" for a taxable motor vehicle article includes

(1) any article the primary use of which is to improve, repair, replace or serve as a component part of such vehicle or article, (2) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, or (3) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use. However, such term does not include tires, inner tubes, or automobile radio or television receiving sets, since these articles are expressly excluded by the statute from the tax on parts or accessories.

Accordingly, it is held that a rubber rim flange strip and a rubber or plastic ring especially designed and adapted to be used on the wheels or tires of the motor vehicle articles enumerated in section 4061(a) of the Code are subject to the manufacturers excise tax on automobile parts or accessories when sold by the manufacturer, pro-

ducer, or importer. The manner in which these articles are held in place has no effect on their taxability.

(Also Sections 4071, 4111, 4121, 4131, 4141, 4151, 4161, 4171, 4181, 4191, 4201, 4211.) Rev. Rul. 58-134

Where a corporation owns patents under which a taxable article is fabricated by another company for it, the corporation is the manufacturer of the article for purposes of the manufacturers excise taxes.

The Internal Revenue Service has been requested to determine, under the circumstances below, which company is the manufacturer or producer of an automobile part or accessory for the purposes of the manufacturers excise tax.

M corporation is the owner of a patent on a certain automobile part or accessory. It entered into an agreement with *N* company under which *N* company has been granted manufacturing rights to fabricate the article under the patent to *M* corporation's order. *N* company furnishes all materials and labor and packs the completed article. If *N* company is unable to meet *M* corporation's requirements, *M* may have additional articles fabricated by other companies. *N* company is permitted to produce articles in excess of *M* corporation's requirements and has been assigned the exclusive right to sell such excess articles to companies other than *M*. However, *N* company's sales of the excess articles must be made within a certain territory designated by *M*. There are no financial or other relationships between the two companies except those arising out of the agreement itself.

Section 316.4(a) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47, defines the term "manufacturer" to include a person who produces a taxable article from scrap, salvage or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles. Section 316.4(b) provides that, under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes material and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

Generally where a company not only owns the patents under which a taxable article is fabricated by another company, but also exercises control as to the amounts to be so fabricated and has exclusive rights to the output, and where the fabricator is not free to sell elsewhere, the company owning the patents is considered to be the manufacturer for purposes of the manufacturers excise tax. See *Polaroid Corporation v. United States*, 235 F. 2d 276, cert. den. 352 U. S. 953.

Based on the facts and circumstances of the present case, it is held that (1) where *N* company fabricates the automobile part or accessory for *M* corporation to *M's* order, *M* controls the output of *N* company to the extent that *M* has the exclusive or first right to the output, and *N*, the fabricator, is not free to sell the product elsewhere, with the

exception of sales in the assigned territory mentioned above, *M* corporation is considered to be the manufacturer of all those parts and accessories which it takes from *N* company's output and is liable for the manufacturers excise tax on its sales of such parts or accessories; and (2) where, under the agreement with *M*, *N* company is assigned the exclusive right to sell the excess of its output over *M's* requirements within a specific territory, *N* company, as the fabricator and also the company which actually makes the sales and collects the royalties thereon for transmission to *M*, is considered to be the manufacturer and liable for the tax on all sales of its additional output of automobile parts and accessories.

Rev. Rul. 58–147

Sales by the manufacturer of automobile radiator cores which are primarily designed for use on taxable motor vehicles are subject to the manufacturers excise tax imposed by section 4061(b) of the Internal Revenue Code of 1954. S. T. 448, C. B. III–1, 462 (1924), issued under a provision of law later repealed, is not determinative under present law.

Advice has been requested whether automobile radiator cores are subject to the manufacturers excise tax on automobile parts or accessories. The basis for the request is that S. T. 448, C. B. III–1, 462 (1924), holds that radiator cores are not subject to the tax when sold separately.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories for the motor vehicle articles enumerated in section 4061(a) of the Code. Section 316.55 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "parts or accessories" for an automobile truck or other automobile chassis or body includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or articles, (2) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

S. T. 448 was issued under regulations which were based upon a provision of law which later was repealed. Consequently, that ruling is not determinative under present law, even though it has not been specifically revoked.

At the present time, radiator cores are manufactured in specific sizes and shapes and are designed and identified for use on specific motor vehicles. Therefore, it is held that radiator cores which are primarily designed for use on taxable motor vehicles are parts or accessories for such vehicles within the meaning of section 4061(b) of the Code. Accordingly, sales of such radiator cores by the manufacturer thereof are subject to the manufacturers excise tax imposed by that section.

Because the position of the Internal Revenue Service has not been consistent with the conclusion set forth above, and under the authority contained in section 7805(b) of the Code, the conclusion of this Revenue Ruling will not be applied to sales made prior to June 1, 1958.

Rev. Rul. 58–148

A company manufactures a small framed mirror with a tiny flashlight installed in the center of the frame. It is equipped with two spring steel clips. It is sold for, and is particularly adapted for, attachment to an automobile sun visor for use after dark as a combination flashlight-mirror. It is also sold for possible use under certain conditions in the home. *Held*, since the flashlight-mirror combination is primarily designed and adapted for attachment to the sun visor of an automobile, it is an automobile accessory within the meaning of section 4061(b) of the Internal Revenue Code of 1954. Accordingly, the manufacturers excise tax imposed by that section of the Code applies to the sale of such article by the manufacturer, producer, or importer.

Rev. Rul. 58–170

Trailer hitches designed to be installed on automobiles for the purpose of towing trailers over the highway constitute parts or accessories for automobiles and sales thereof are subject to the manufacturers excise tax imposed by section 4061(b) of the Internal Revenue Code of 1954. The tax applies whether such hitches are designed for towing house trailers which are not taxable or for towing the type of trailers taxable under section 4061(a) of the Code.

Advice has been requested concerning the applicability of the manufacturers excise tax on automobile parts or accessories to the sale of two types of trailer hitches designed to be installed on automobiles for the purpose of towing trailers over the highway. One type of hitch is designed for towing house trailers, which are not taxable, while the other is designed for towing trailers of the type subject to the manufacturers excise tax.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer of parts or accessories (other than tires and tubes and other than automobile radio and television receiving sets) for any of the articles enumerated in section 4061(a) of the Code.

It is held that trailer hitches designed to be installed on automobiles for the purpose of towing trailers over the highway are parts or accessories for automobiles within the meaning of section 4061(b) of the Code and sales thereof by the manufacturer are subject to the tax imposed by that section. The tax applies whether such hitches are designed for towing house trailers which are not taxable or for towing trailers of the type taxable under section 4061(a) of the Code.

In the past, the position of the Internal Revenue Service relating to trailer hitches primarily designed for towing house trailers which are not taxable has not been consistent with the position set forth herein; therefore, under the authority of section 7805(b) of the Code, this ruling, insofar as it relates to those particular hitches, will be applied without retroactive effect as to sales made prior to July 1, 1958.

Rev. Rul. 58–184

Since there is no statutory provision authorizing exemption, the manufacturers excise tax applies to the sale of an automobile purchased by a veteran with funds made available by Public Law 187, 82nd Congress.

Advice has been requested whether the manufacturers excise tax applies to the sale of an automobile purchased by a veteran under the provisions of the Act of October 20, 1951, Public Law 187, 82nd Congress, 65 Stat. 574, 38 U. S. C. 252.

Section 4061(a)(2) of the Internal Revenue Code of 1954 imposes a tax on the sale of automobiles by manufacturers, producers, or importers thereof. Public Law 187 provides that the Administrator of Veterans' Affairs is authorized and directed, under such regulations as he shall prescribe, to provide or assist in providing, for any veteran described therein, an automobile or other conveyance by paying not to exceed $1,600 on the purchase price. Public Law 187 does not provide an exemption from the manufacturers excise tax on sales of automobiles for this purpose. Furthermore, there is no provision of the Internal Revenue Code which would authorize exemption of such sale.

Since there is no statutory provision authorizing exemption, it is held that the manufacturers excise tax applies to the sale of an automobile purchased by a veteran with funds made available by Public Law 187.

Rev. Rul. 58–185

Special controls which enable physically handicapped persons to drive an automobile constitutes parts or accessories for automobiles within the meaning of section 4061(b) of the Internal Revenue Code of 1954 and are subject to the manufacturers excise tax upon their sale by the manufacturer.

Advice has been requested whether special controls which enable physically handicapped persons to drive an automobile are subject to the tax on automobile parts and accessories.

A company manufactures special controls which attach to the steering wheel and pedals of an automobile in such a manner as to enable physically handicapped persons to drive the automobile.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories (other than tires and inner tubes and other than automobile radio and television sets) for any of the articles enumerated in section 4061(a) of the Code. Section 316.55 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 57, defines the term "parts or accessories" for an automobile truck, or other automobile chassis or body, as including any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, and also including any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

Therefore, it is held that, in the absence of a statutory exemption, special controls which enable physically handicapped persons to drive an automobile are parts or accessories within the meaning of section 4061(b) of the Code. Accordingly, such special controls are subject to the manufacturers excise tax upon their sale by the manufacturer.

Rev. Rul. 58-200

Electrically-driven or gasoline-powered miniature vehicles which resemble automobiles or automobile trucks, but which are designed for use by children and are not adaptable for street or highway use, are not subject to the manufacturers excise tax imposed by section 4061(a) of the Internal Revenue Code of 1954. Likewise, the tax imposed by section 4061(b) does not apply to separate sales, for repair or replacement purposes, of parts or accessories which are usable *only* in such nontaxable miniature vehicles.

Advice has been requested whether the manufacturers excise tax applies to sales of (1) miniature vehicles which resemble automobiles or automobile trucks, but which are designed for use by children, and (2) repair and replacement parts or accessories for these vehicles.

The miniature vehicles are designed as (1) midget commercial trucks (2) a so-called "quarter midget" racing care for use only on a specially built race track, and (3) a scale miniature of a standard make automobile. The vehicles are manufactured in both electrically-driven and gasoline-powered models; have steel chassis, fiber glass or plastic bodies, pneumatic or semipneumatic tires; and, with the exception of the racing car, attain maximum speeds of from five to twelve miles per hour. The vehicles are designed to accommodate children from four to fourteen years of age, are not adaptable for street or highway use, and cannot meet equipment requirements for such use.

Section 4061(a) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of motor vehicles, including automobiles and automobile trucks. Section 4061(b) of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of parts and accessories (other than tires and tubes and other than automobile radio and television receiving sets) for any of the articles enumerated in section 4061(a).

Since the above-described vehicles are designed for the use of children, are not adaptable for street or highway use, and cannot meet equipment requirements for such use, it is held that the vehicles are not automobiles or automobile trucks within the meaning of section 4061(a) of the Code. Accordingly, sales of the vehicles by the manufacturer thereof are not subject to the manufacturers excise tax imposed by that section.

Separate sales of parts or accessories for repair or replacement purposes are likewise not subject to the manufacturers excise tax on parts or accessories if they are usable only in such nontaxable vehicles. However, separate sales of parts or accessories, which are used in the vehicles for repair or replacement purposes, are properly subject to the tax if they are also usable in vehicles which are taxable under section 4061(a) of the Code.

Rev. Rul. 58-214

A self-propelled line marking machine which is designed for use in painting guide lines on highways, streets, parking lots, airports, playgrounds, etc., is not a taxable motor vehicle within the meaning of section 4061(a) of the Internal Revenue Code of 1954.

Advice has been requested whether the manufacturers excise tax on motor vehicles applies to sales by the manufacturer of a line marking machine which is designed for use in painting guide lines on highways, streets, parking lots, airports, playgrounds, etc.

The machine consists primarily of an engine for driving a compressor and propelling the machine, a paint tank, air actuated spray guns, and necessary controls. It is equipped with a steel platform upon which a person may stand to steer the vehicle and operate the paint equipment controls. The machine uses 4.00 x 8 pneumatic rubber tires which have an overall diameter of sixteen inches. The normal speed for painting is from three to six miles per hour. The machine does not have head lights or tail lights.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of certain motor vehicle articles, including truck chassis and truck bodies. Section 4061(a)(2) imposes a tax upon automobile chassis and bodies other than those taxable under paragraph (1).

It is held that the above described line marking machine is not a taxable motor vehicle within the meaning of section 4061(a) of the Code. Accordingly, sales of the machine by the manufacturer, producer, or importer thereof are not subject to the manufacturers excise tax imposed by that section.

Rev. Rul. 58–284

A certain three-wheel automotive vehicle designed for use in the delivery and collection of mail is an automobile truck within the meaning of section 4061(a)(1) of the Internal Revenue Code of 1954. Sales of this vehicle by the manufacturer thereof are subject to the manufacturers excise tax imposed by that section.

Advice has been requested whether the manufacturers excise tax applies to sales of the three-wheel automotive vehicle described below.

The vehicle is designed for use in the delivery and collection of mail. The vehicle has one front wheel and two rear wheels which are axle driven by a nine horsepower gasoline engine through a propeller shaft and automotive type differential. The body is of reinforced plastic or aluminum. It consists of a driver's compartment and a mail compartment capable of accommodating a minimum of 40 cubic feet of mail. There is no door frame or body side members to interfere with ready entrance or exit from the vehicle. The vehicle is equipped with a head lamp, a tail lamp, directional signals, one seat, brake, clutch, and accelerator foot pedals. It may be equipped for steering either by handle bars or a steering wheel. The maximum gross weight of the vehicle is 1,450 pounds when loaded with 500 pounds of cargo and the driver, and the maximum speed attainable is 35 miles per hour.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of automobile truck chassis, automobile truck bodies, automobile bus chassis, automobile bus bodies, truck and bus trailer and semitrailer chassis, truck and bus trailer and semitrailer bodies, and tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.

Based on the facts stated above, it is held that the vehicle has the characteristics of an automobile truck within the meaning of section 4061(a) of the Code. Accordingly, sales by the manufacturer of this vehicle are subject to the manufacturers excise tax imposed by that section.

Rev. Rul. 58–285

A company manufactures electric immersion heaters which are designed to operate on automobile electrical current. Each heater is equipped with a cord and a plug which may be inserted into the cigarette lighter outlet in an automobile. They are sold for use in warming liquids while traveling in automobiles or other motor vehicles, such as, for example, by immersion of the heating element in a cup of water for the preparation of an "instant" beverage. *Held*, since these immersion heaters are primarily designed and adapted for use in automobiles, the manufacturer's sales thereof are subject to the manufacturers excise tax imposed upon automobile parts or accessories by section 4061(b) of the Internal Revenue Code of 1954.

Rev. Rul. 58–297

Used automobiles of foreign manufacture are imported and sold in this country. The importer's sales of the used automobiles constitute the initial sales of the automobiles within the United States. *Held*, the manufacturers excise tax on automobiles sold by the manufacturer, producer, or importer thereof, imposed by section 4061 of the Internal Revenue Code of 1954, applies to the importer's sales of the automobiles. It is immaterial that the vehicles had been used prior to their importation.

Rev. Rul. 58–332

A self-powered grain or feed loader-unloader is not an automotive part or accessory within the meaning of section 4061(b) of the Internal Revenue Code of 1954 and sales thereof are not subject to the manufacturers excise tax. Similarly, a one-wheel trailer which merely serves as a mounting for the loader-unloader is not subject to the manufacturers excise tax.

Advice has been requested concerning the applicability of the manufacturers excise tax to sales of a grain or feed loader-unloader and a one-wheel trailer upon which it may be mounted.

The loader-unloader is completely self-powered and self-contained. It is designed so that it may be installed in a semitrailer van of the commercial freight hauling type for use in loading and unloading grains, feeds, etc., into and out of the van. Or it may be installed at a permanent location at a farm, mill, or anywhere else where loading and unloading of grain and feed is desired. Some of these loader-unloaders are placed upon a special one-wheel trailer which simply provides mobility and ease of transportation when attached to a towing vehicle. Such trailer only carries the loader-unloader, that is, no other goods or materials to be carried in the towing vehicle can be transported upon the trailer. The loader-unloader does not in any manner assist the movement of the trailer or towing vehicle, nor does it improve the means of transportation in any way. It is never used while in transit.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of automobile truck chassis, automobile truck bodies, automobile bus chassis, automobile bus bodies, truck and bus trailer and semitrailer chassis, truck and bus trailer and semitrailer bodies, and tractors of the kind

chiefly used for highway transportation in combination with a trailer or semitrailer (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof).

Section 4061(b) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories, with certain exceptions not here material, for any of the articles enumerated in section 4061(a) of the Code.

It is held that since the loader-unloader is self-powered and may be operated in the various places stated, as well as in trucks and trailers, it is an article susceptible of general use and not an automotive part or accessory within the meaning of section 4061(b) of the Code.

It is further held that the special one-wheel trailer, on which the loader-unloader rests, is only a mounting for the loader-unloader and, therefore, is not a taxable article within the meaning of section 4061 (a)(1) of the Code. Accordingly, sales of these articles are not subject to the manufacturers excise tax.

For determination of whether credit or refund of manufacturers excise taxes is available to an exporter of a truck chassis and body combination, see Rev. Rul. 58–216, page 489.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

SECTION 4063.—EXEMPTIONS

Further manufacture of passenger automobile chassis and bodies into funeral coaches, ambulances, and combination funeral coach and ambulance. See Rev. Rul. 58–32, page 391.

PART II.—TIRES AND TUBES

SECTION 4071.—IMPOSITION OF TAX

(Also Section 6416.) Rev. Rul. 58–105

No credit or refund of the manufacturers excise tax imposed by section 4071 of the Internal Revenue Code of 1954 is allowable where tax-paid tread rubber is damaged or destroyed in the recapping or retreading process, or as a result thereof.

Advice has been requested whether a credit or refund of the manufacturers excise tax is allowable where tax-paid tread rubber is subsequently damaged or destroyed under the circumstances described below.

A manufacturer sells tread rubber on a tax-paid basis for use by the vendee in the recapping or retreading of tires of the type used on highway vehicles. During the recapping or retreading process, the tread rubber is lost through unavoidable means. For example, a tire "blows up" in the recapping mold, or a recapping fails after being put into use and has to be adjusted.

Section 4071 of the Internal Revenue Code of 1954, as amended by the Highway Revenue Act of 1956, Public Law 627, 84th Cong., 70 Stat. 387, C. B. 1956–2, 1150, imposes a tax on tread rubber sold by the manufacturer, producer, or importer.

Section 4073(c) of the Code provides that the tax imposed by section 4071 on sales of tread rubber shall not apply to tread rubber sold by the manufacturer, producer, or importer, to any person for use by such person otherwise than in the recapping or retreading of tires of the type used on highway vehicles.

Section 6416(b)(2)(M) of the Code provides, in part, that credit or refund of tax paid on tread rubber under section 4071 shall be made where such tread rubber is used or resold for use otherwise than in the recapping or retreading of tires of the type used on highway vehicles.

The tax on tread rubber imposed by section 4071 of the Code attaches at the time of sale by the manufacturer, producer, or importer, unless the exemption provided under section 4073(c) of the Code applies. The subsequent loss of tax-paid tread rubber does not constitute a *use* of the rubber "otherwise than in the recapping or retreading of tires of the type used on highway vehicles" as contemplated by section 6416(b)(2)(M) of the Code. There is no other provision whereby a credit or refund may be allowed for the tax paid on the scale of tread rubber because such tax-paid rubber is damaged in the recapping or treading process.

Accordingly, it is held that no credit or refund may be allowed for manufacturers excise tax paid on the sale of tread rubber where such tax-paid rubber is damaged or destroyed in the recapping or retreading process, or as a result thereof.

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is produced under patented rights. See Rev. Rul. 58–134, page 395.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

PART III.—PETROLEUM PRODUCTS

Subpart A.—Gasoline

SECTION 4081.—IMPOSITION OF TAX

Rev. Rul. 58–201

There are no provisions in the Internal Revenue Code of 1954 which would permit gasoline to be sold subject to tax at the rate of two cents a gallon. Therefore, sales of aviation gasoline are subject to tax at the rate of three cents a gallon.

Advice has been requested whether the increase in the tax rate on gasoline from two cents a gallon to three cents a gallon, effective July 1, 1956, applies to sales of aviation gasoline, grades 80–87, 91–100, and 100–130 octane.

Section 4081(a) of the Internal Revenue Code of 1954, as amended by the Highway Revenue Act of 1956, P. L. 627, 84th Cong., 70 Stat. 387, C.B. 1956–2, 1150, imposes a manufacturers excise tax at the rate of three cents a gallon on gasoline sold by the producer or importer thereof, or by any producer of gasoline. Prior to the enactment of the Highway Revenue Act of 1956, gasoline was subject to tax at the rate of two cents a gallon.

While under certain conditions diesel fuel and special motor fuels are sold subject to the retailers excise tax imposed by section 4041 of the Code at the rate of two cents a gallon, there are no provisions in the Code which would permit gasoline to be sold subject to the manufacturers excise tax at the rate of two cents a gallon. Accordingly, it is held that sales of aviation gasoline by the producer or importer thereof, or by any producer of gasoline, is subject to tax at the rate of three cents a gallon. However, insofar as applicable to this situation, section 6421(a) of the Code provides, in part, that the ultimate purchaser is entitled to a payment equal to one cent for each gallon of gasoline which is purchased on or after July 1, 1956, and which is used *otherwise* than as a fuel in a highway vehicle which (at the time of such use) is registered, or is required to be registered, for highway use under the laws of any state or foreign country.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

SECTION 4083.—EXEMPTION OF SALES TO PRODUCER

Rev. Rul. 58–286

The exemption provided by section 4083 of the Internal Revenue Code of 1954 does not apply to sales of gasoline to dealers in crude oil or to producers of crude oil who do not qualify as producers of gasoline as defined in section 4082(a) of the Code. Accordingly, such sales of gasoline by producers thereof are subject to the manufacturers excise tax imposed by section 4081 of the Code.

Advice has been requested whether the manufacturers excise tax is applicable to sales of gasoline when sold by the producer to dealers in crude oil or to producers of crude oil.

Situation 1. A dealer in crude oil purchases natural gasoline from a producer thereof. The dealer mixes such gasoline with the crude oil, which results in a crude oil having a higher gasoline content. The dealer then sells such crude oil to various refineries.

Situation 2. A producer of crude oil purchases natural and casinghead gasoline from a producer thereof for the purpose of injecting such products into his oil producing wells, where they act as a solvent to dissolve the asphalt and paraffin residue which obstructs the flow

of oil from the wells. Thus, the gasoline loses its identity, as such, when blended with the crude oil.

Section 4081 of the Internal Revenue Code of 1954 imposes a tax on gasoline sold by the producer or importer thereof, or by any producer of gasoline. Section 4082(a) of the Code defines the term "producer" to include a refiner, compounder, or blender, and a dealer selling gasoline exclusively to producers of gasoline, as a producer. Section 4083 of the Code provides that, under regulations prescribed by the Secretary of the Treasury or his delegate, the tax imposed by section 4081 shall not apply in the case of sales of gasoline to a producer of gasoline.

In the first situation described above, the purchaser of the gasoline is a dealer selling crude oil and not "a dealer selling gasoline exclusively to producers of gasoline." Therefore, he does not qualify as a producer of gasoline, as defined by section 4082(a) of the Code, for purposes of the exemption provided by section 4083 of the Code. Accordingly, it is held that sales of gasoline by the producer thereof to such a dealer in crude oil are subject to the manufacturers excise tax imposed by section 4081 of the Code.

In the second situation described above, the purchaser of the gasoline is a producer of crude oil and, therefore, does not qualify as a producer of gasoline as defined by section 4082(a) of the Code. There is no provision that sales of gasoline may be made tax-free for use in the production of crude oil. Therefore, it is held that such sales by a producer of gasoline are subject to the manufacturers excise tax imposed by section 4081 of the Code.

Subpart B.—Lubricating Oil

SECTION 4091.—IMPOSITION OF TAX

Rev. Rul. 58-16

Manufacturers or producers of castor oil may sell such oil for nonlubricating purposes tax-free without obtaining exemption certificates from the purchasers; however, they must pay the tax imposed by section 4091 of the Internal Revenue Code of 1954 with respect to any such oil which may actually be sold for lubricating purposes.

The Internal Revenue Service has been asked whether manufacturers or producers of castor oil may sell such oil for nonlubricating purposes without obtaining from the purchasers the exemption certificates which are normally required when lubricating oil is sold for nonlubricating purposes.

In recent years, the use of castor oil as a lubricating oil has declined to the point where less than one-half of one percent of such oil is being sold for lubricating purposes. Approximately 99½ percent of all castor oil produced and sold in the United States is used in sulfonation, plasticizers, hydraulic fluids (brakes and shock absorbers), paints, varnishes, synthetic resins, lacquers, cosmetics, pharmaceuticals, calks, adhesives, inks, carbon paper, disinfectants, and chemical processing.

Section 4091 of the Internal Revenue Code of 1954 imposes a tax upon lubricating oils sold by the manufacturer or producer thereof.

Section 314.43(a) of Regulations 44, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that no tax attaches where oil is sold by the manufacturer direct to a person who uses it for nonlubricating purposes, provided the manufacturer has definite knowledge, prior to or at the time of sale, that the product is purchased for such purposes, and he obtains from such person a certificate of nonlubricating use in the form prescribed by that section. No sale of oil may be made tax free by the manufacturer to a dealer for resale for a nonlubricating purpose even though it is known at the time of sale that the oil will be so resold.

It is held that, since castor oil is seldom used for lubricating purposes even though it has qualities which make it capable of being used for such purposes, it may be sold free of the tax imposed by section 4091 of the Code for nonlubricating purposes without the necessity of obtaining exemption certificates usually required with such sales, provided, however, that the manufacturers of the product shall account for and pay the tax with respect to any such oil which may actually be sold for lubricating purposes. A complete record of all sales of such castor oil must be retained by the manufacturer or producer thereof for a period of at least four years and be kept available for inspection by representatives of the Internal Revenue Service.

Rev. Rul. 58–81

The manufacturers excise tax on lubricating oils, imposed by section 4091 of the Internal Revenue Code of 1954, applies to sales of oil by the manufacturer or producer thereof for use in cooling saws.

Advice has been requested whether the manufacturers excise tax on lubricating oil applies to sales of oil by the manufacturer thereof for use in cooling saws. The oil permits the saw teeth to pass through lumber with less difficulty.

Section 4091 of the Internal Revenue Code of 1954 imposes a tax on lubricating oils sold by the manufacturer or producer. Section 314.40 of Regulations 44, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "lubricating oils" includes all oils, regardless of their origin, which are sold as lubricating oils and all oils which are *suitable for use as a lubricant.* Section 314.43(a) of the regulations provides that no tax attaches where oil is sold by the manufacturer direct to a purchaser who uses it for nonlubricating purposes.

In permitting the saw teeth to pass through lumber with less difficulty, the oil is used, in part, for lubricating purposes. Accordingly, it is held that the manufacturers excise tax imposed by section 4091 of the Code applies to sales of oil by the manufacturer or producer thereof for use in cooling saws.

Rev. Rul. 58–106

The manufacturers excise tax on lubricating oil, imposed by section 4091 of the Internal Revene Code of 1954, does not apply to a grease product, even though its consistency is altered by the addition of a solvent which quickly vaporizes upon application of the grease product to gears or other machine parts by spraying, brushing, or swabbing.

Advice has been requested whether the manufacturers excise tax on lubricating oil applies to the sale of a nontaxable grease product whose consistency is altered by the addition of a solvent.

An oil company manufactures a grease product which contains oil and which is of an unworked consistency of less than 360 penetration units. However, before the grease is drawn from the production vessel into containers for shipment, a solvent is added to alter its consistency. The solvent renders the grease sufficiently fluid to enable its application to gears and other machine parts by spraying, brushing, or swabbing. After the application, the solvent quickly vaporizes, leaving only a film of grease of the consistency existing prior to the introduction of the solvent. The solvent itself has no lubricating value and if it did not evaporate would render the grease useless as a lubricant.

Section 4091 of the Internal Revenue Code of 1954 imposes a tax on lubricating oils sold by the manufacturer or producer thereof. Section 314.40(b) of Regulations 44, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 57, provides that the term "lubricating oils" does not include products of the type commonly known as grease. Oleaginous substances which are classed as grease and which contain oil are not subject to the tax when of a worked consistency of less than 390 penetration units, or an unworked consistency of less than 360 penetration units, by the method of test of the American Society for Testing Materials D–217–33–T.

The mere addition to a nontaxable grease product of a solvent which quickly vaporizes upon application, under the circumstances described above, would not change the classification of the product to taxable "lubricating oils," even though the consistency of the nontaxable grease product is altered by the addition of the solvent. Accordingly, it is held that the manufacturers excise tax on lubricating oils, imposed by section 4091 of the Code, does not apply to such a grease product sold by the manufacturer.

SUBCHAPTER B.—HOUSEHOLD TYPE EQUIPMENT, ETC.

PART I.—REFRIGERATION EQUIPMENT

SECTION 4111.—IMPOSITION OF TAX

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is produced under patented rights. See Rev. Rul. 58–134, page 395.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

PART II.—ELECTRIC, GAS AND OIL APPLIANCES

SECTION 4121.—IMPOSITION OF TAX

Rev. Rul. 58–48

A rug cleaning attachment, which is a specially designed accessory for an electric floor polisher, is subject to the manufacturers excise tax imposed by section 4121(a) of the Internal Revenue Code of 1954 when sold by the manufacturer on or in connection with the sale of a household type electric floor polisher.

The Internal Revenue Service has been asked whether a rug cleaning attachment for an electric floor polisher is subject to the manufacturers excise tax imposed by section 4121(a) of the Internal Revenue Code of 1954.

A company, which manufactures a household type electric floor polisher, also manufactures a rug cleaning attachment which is a specially designed accessory for use with the floor polisher. The floor polisher is a complete functionable article in itself to be used for polishing, scrubbing, and general maintenance of all kinds of surfaces. By removing the brushes from the floor polisher and affixing the rug cleaning attachment, the user is able, with the aid of commercial cleaning products, to clean rugs without removing them from the floor.

Section 4121(a) of the Code imposes a tax upon sales by the manufacturer of household type electric floor polishers and waxers, including parts or accessories therefor sold on or in connection with the sale thereof.

It is held that where a manufacturer sells a complete taxable article, such as a household type electric floor polisher, together with specially designed accessories, the tax imposed by section 4121(a) of the Code applies to the manufacturer's sale of the combination, even though he invoices the accessories separately.

Whether parts or accessories are sold in connection with the sale of a taxable article or separately is a question of fact which must be decided in each instance on the basis of all surrounding circumstances. As stated above, the statute imposes a tax upon the sale by the manufacturer. Therefore, the Service must be guided by the facts surrounding the manufacturer's sale and cannot look to the retailer or ultimate consumer as to the purpose for which certain parts or accessories are purchased.

Rev. Rul. 58–58

The manufacturers excise tax on household type electric, gas, and oil appliances, imposed by section 4121 of the Internal Revenue Code of 1954, does not apply to the sale by the manufacturer of a hand and face dryer which is designed to be used primarily in commerical and industrial establishments.

Advice has been requested whether the manufacturers excise tax on electric, gas, and oil appliances applies to the sale by the manufacturer of a hand and face dryer.

A company manufactures an electrically operated hand and face dryer which is designed to be permanently mounted on a wall. The

dryer is enclosed in a cast aluminum cabinet with airflow outlets through which heated air is channeled to dry hands and face. An adjustable timer cuts off the dryer at any desired limit. These dryers are used primarily in the washrooms of commercial and industrial establishments.

Section 4121(a) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated electric, gas, and oil appliances of the household type (including in each case parts or accessories therefor sold on or in connection with the sale thereof). Included in the articles enumerated are electric air heaters (not including furnaces).

It is held that the hand and face dryer described above is not considered to be an electric air heater of the household type or an appliance of the household type within the meaning of section 4121 of the Code. Accordingly, the sale by the manufacturer of such an article is not subject to the manufacturers excise tax on electric, gas, and oil appliances of the household type.

Rev. Rul. 58–115

Quick recovery type electric water heaters, designed for use in homes, which operate on one element at a time not exceeding 7,500 watts, are electric water heaters of the household type and are subject to the manufacturers excise tax imposed by section 4121(a) of the Internal Revenue Code of 1954.

Rev. Rul. 54–386, C. B. 1954–2, 414, amplified.

Advice has been requested whether electric water heaters, designed for use in homes, with two heating elements aggregating over 7,500 watts, are considered to be electric water heaters of the household type.

A company manufactures so-called "quick recovery" type electric water heaters with an upper and a lower heating element, each having a wattage of 4,500 (4½ KW), or an aggregate wattage of 9,000 (9 KW). The heaters are equipped with an interlocking control so that only the upper element is energized until the water in the top of the tank reaches the temperature set in the upper thermostat, at which time the upper element shuts off automatically and the lower element is energized to heat the water in the lower part of the tank.

Section 4121(a) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of various electric, gas, or oil appliances of the household type (including in each case parts or accessories therefor sold on or in connection with the sale thereof). Included in the enumeration of articles are electric, gas, or oil water heaters.

Revenue Ruling 54–386, C. B. 1954–2, 414, holds that an electric water heater with heating elements aggregating wattages not exceeding 7,500 (7½ KW) is a heater of the household type, unless the heater, by reason of other features of design and construction is primarily adaptable for purposes other than household use. In reaching that conclusion, the Internal Revenue Service contemplated electric water heaters which are designed to operate at wattages not exceeding 7,500 (7½ KW).

The so-called "quick recovery" type electric water heaters described above are designed to operate on one heating element not exceeding 7,500 watts, although the aggregate wattages of the upper and lower heating elements, if energized at the same time, would exceed 7,500. Accordingly, it is held that an electric water heater which is equipped with an interlocking control, or is so designed by the manufacturer that such a control may readily be installed, for operation on one element not exceeding 7,500 watts, is an electric water heater of the household type. Therefore, the sale by the manufacturer, producer, or importer of such an electric water heater is subject to the manufacturers excise tax on electric, gas, or oil appliances, imposed by section 4121(a) of the Code. [See Rev. Rul. 58–519, I. R. B. 1958–42, 28.]

Revenue Ruling 54–386, *supra*, is hereby amplified.

Rev. Rul. 58–116

Section 4121(a) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of various articles of electric, gas, and oil appliances of the household type (including in each case parts or accessories therefor sold on or in connection with the sale thereof). Included in the enumeration of articles are "electric air heaters (not including furnaces)." *Held*, electric hair dryers are not considered to be electric air heaters as contemplated by section 4121(a) of the Code. Accordingly, the tax imposed by that section does not apply to sales of electric hair dryers, regardless of whether such dryers are of the portable type or where they are used.

Rev. Rul. 58–186

The manufacturer of a power lawn mower also produces a "sulky," which is a four-wheel cart having a seat and its own engine. The "sulky," when attached to the power lawn mower, can be used as a riding mower, in which event the mower and "sulky" are both powered by their own individual engines. Other equipment, such as a grass sower, fertilizer attachment, lawn roller, etc., can also be used with the "sulky." *Held*, the "sulky" is not a part or accessory for a power lawn mower. Accordingly, sales of the "sulky" by the manufacturer are not subject to the manufacturers excise tax on power lawn mowers imposed by section 4121(a) of the Internal Revenue Code of 1954 regardless of whether it is sold separately or on or in connection with the sale of a power lawn mower, provided it is billed separately on the manufacturer's invoice or the price thereof can be readily determined from his records.

Rev. Rul. 58–298

The purpose for which an electric direct motor-driven fan, other than a desk, bracket, or pedestal type, is actually designed, rather than the blade diameter, is the decisive factor in determining its taxability. Accordingly, such a fan that is designed and adapted for air circulating purposes in the home is a nonindustrial type of circulator which is subject to the manufacturers excise tax imposed by section 4121(b) of the Internal Revenue Code of 1954, irrespective of the diameter of the fan blades.

Where an electric direct motor-driven fan of the desk, bracket, or pedestal type is also designed for use as a window exhaust or intake ventilating fan, such fan is subject to the manufacturers excise tax imposed by section 4121(b) of the code, regardless of the size of the blade diameter. Stand attachments and panels for use with this type of fan are considered accessories for such fan and are taxable when sold on or in connection therewith. No tax is due on the separate sales of these accessories.

Advice has been requested whether the manufacturers excise tax applies to certain electric motor-driven fans described below.

(1) A company produces an electric direct motor-driven fan which is portable, is equipped with a handle, and has a blade of 20 inches in diameter. The fan has no pedestal or bracket and is not adapted for use on a desk, but is designed and adapted for air circulating purposes in the home.

(2) Another company produces an electric motor-driven fan which has a handle attached and may be used on a desk, on a table, or on the floor. This fan may be used in the same locations with a low stand attachment that permits it to be tilted. It also may be used with a high stand attachment that permits it to be raised, tilted and rolled. In addition to these stands, there is a third optional accessory consisting of panels which permit insertion of the basic fan in a window so that it may be used as an exhaust or intake ventilating fan.

Section 4121(b) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of electric direct motor-driven fans and air circulators not of the industrial type.

Section 316.110(b) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides in part:

The following list is illustrative of the direct motor-driven fans and air circulators which are of the nonindustrial type and therefore subject to tax:

Ceiling fans of the wood blade type (regardless of whether the blades are made of wood or other material).

Hassock type radial discharge fans and air circulators and modifications thereof, regardless of blade diameter.

Exhaust or intake ventilating fans of the household type for use in window or attic.

Exhaust or intake ventilating fans of the household kitchen type (built-in wall and built-in ceiling types).

Desk, bracket, and pedestal type fans and air circulators with blade diameter of 16 inches and less.

As stated in the regulations, the list is merely illustrative. Such list was not intended to include every possible type of taxable fan or air circulator. Thus, the items in the list are intended to provide merely a description of several types of fans which normally are classified as nonindustrial types and such list should not be construed to denote qualifying standards such as shape, size, etc.

The Code imposes the tax on nonindustrial type fans and air circulators without qualification. In other words, once a fan or air circulator is determined to be designed or adapted primarily for nonindustrial use, its characteristics or the size of its blade diameter is not a decisive factor in determining the taxability of the fan, unless it is of the desk, bracket, or pedestal type.

It is held, therefore, that the purpose for which a fan or air circulator, other than a desk, bracket, or pedestal type, is actually designed is the decisive factor in determining its taxability, without re-

gard to the blade diameter. Accordingly, the electric fan described in (1) above is a nonindustrial type of fan designed and adapted for air circulating purposes in the home, and sales thereof are subject to the manufacturers excise tax imposed by section 4121(b) of the Code, irrespective of the size of the blade diameter.

It is further held that an electric direct motor-driven fan which may be used on a desk, on a table, or on the floor, but which also is designed for use as a window exhaust or intake ventilating fan, is subject to the tax imposed by section 4121(b) of the Code. Accordingly, the electric fan described in (2) above, although of the desk, bracket or pedestal type, is also adaptable for use as a window exhaust or intake ventilating fan and is, therefore, subject to the tax, irrespective of the size of the blade diameter. Stand attachments and panels for use with this type of fan are considered accessories of such fan and are taxable when sold on or in connection therewith. No tax is due on the separate sales of these accessories.

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is produced under patented rights. See Rev. Rul. 58–134, page 395.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

PART III.—ELECTRIC LIGHT BULBS

SECTION 4131.—IMPOSITION OF TAX

Rev. Rul. 58–35

Sales of "glow lamps" designed for use as prayer lights, night lights, sick room lights, and other lights for subdued illumination are subject to the manufacturers excise tax imposed by section 4131 of the Internal Revenue Code of 1954.

Advice has been requested whether the sales of certain "glow lamps" are subject to the manufacturers excise tax on electric light bulbs.

The "glow lamps" are gaseous discharge type bulbs which generate a very soft light. The purpose of the bulb is to provide a soft nonirritating light for use as prayer lights for religious purposes, night lights for children, sick room lights, and lights for subdued illumination.

Section 4131 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of electric light bulbs and tubes.

Section 316.180 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines an electric

light bulb or tube as any device designed for the diffusion of artificial light for illuminative or decorative purposes through the use of electricity.

There is no restriction in the law or the regulations as to the scope or extent of the diffusion of light emitted by an electric light bulb or tube. No exemption from the excise tax is provided with respect to electric light bulbs or tubes sold or used for religious purposes.

Since the "glow lamps" described above are primarily designed for illuminative or decorative purposes, it is held that the lamps are electric light bulbs within the meaning of section 316.180 of the regulations. Accordingly, sales of such "glow lamps" are subject to the manufacturers excise tax imposed by section 4131 of the Code.

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is produced under patented rights. See Rev. Rul. 58–134, page 395.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

SUBCHAPTER C.—ENTERTAINMENT EQUIPMENT

PART I.—RADIO AND TELEVISION SETS, PHONOGRAPHS AND RECORDS

SECTION 4141.—IMPOSITION OF TAX

Rev. Rul. 58–333

Radio receiving set kits which are designed advertised, and sold as toys, are made up of substandard components, and when assembled are capable of only a semblance of audio production are not radio receiving sets within the meaning of section 4141 of the Internal Revenue Code of 1954.

Advice has been requested whether the manufacturers excise tax on radio receiving sets is applicable to sales by the manufacturer of the radio kits described below.

The kits contain all the necessary parts for the assembly of so-called "radio receiving sets." The kits are designed, advertised, and sold as toys and are made up of substandard components (tuning coils, transistors, and diodes). When assembled the sets are capable of only a semblance of audio production and do not meet the performance standards characteristic of a commercial radio receiving set with respect to tone and volume. From the standpoint of selectivity, only one station is obtainable.

Section 4141 of the Internal Revenue Code of 1954 imposes a tax upon sales by the manufacturer, producer, or importer of radio receiving sets of the entertainment type. Revenue Ruling 56–307,

C. B. 1956–2, 808, holds that kits which contain all of the necessary parts for the assembly of radio receiving sets are complete taxable articles in a knockdown condition even though the wire and/or solder for assembling the parts are not furnished.

It is held that the radio kits described above are not radio receiving sets as contemplated by section 4141 of the Code. Therefore, such sets are not subject to the manufacturers excise tax imposed by section 4141 of the Code. However, kits comprised of components which, when assembled, are suitable for use as radios of the conventional or commercial type, and are not merely made to simulate such sets, are radio receiving sets within the meaning of section 4141 of the Code regardless of their price or quality.

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is produced under patented rights. See Rev. Rul. 58–134, page 395.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

SECTION 4142.—DEFINITION OF RADIO AND TELEVISION COMPONENT

Rev. Rul. 58–27

An amplitude-modulation or frequency-modulation radio tuner which includes the detection or demodulation stage and is designed to furnish the audio frequency output for an amplifier and speaker is not in itself a radio receiving set, but is considered to be a chassis for such sets for purposes of the manufacturers excise tax imposed upon radio and television components by section 4141 of the Internal Revenue Code of 1954. However, a television tuner is not considered to be a chassis for a radio or television receiving set because it does not perform the detection or demodulation function as do ordinary radio tuners.

The Internal Revenue Service has been asked whether an amplitude-modulation (AM) or frequency-modulation (FM) radio tuner or a television tuner is considered to be a radio receiving set or a chassis for such sets for purposes of the manufacturers excise tax imposed upon the sale of radio and television components.

Section 4141 of the Internal Revenue Code of 1954 imposes a tax upon sales, by the manufacturer, producer, or importer, of radio receiving sets, automobile radio receiving sets, television receiving sets, automobile television receiving sets, phonographs, combinations of any of the foregoing, radio and television components, and phonograph records (including in each case parts or accessories therefor sold on or in connection with the sale thereof). Except in the case of radio and television components and phonograph records, the tax

imposed by this section applies only to articles of the entertainment type. Section 4142 of the Code defines the term "radio and television components" to mean chassis, cabinets, tubes, speakers, amplifiers, power supply units, antennae of the "built-in" type, and phonograph mechanisms, which are suitable for use on or in connection with, or as component parts of any of the articles enumerated in section 4141 of the Code, whether or not primarily adapted for such use.

It is held that an amplitude-modulation or frequency-modulation radio tuner which includes the detection or demodulation stage and is designed to furnish the audio frequency output for an amplifier and speaker is not in itself a radio receiving set but is considered to be a chassis for such sets. See Revenue Ruling 56–307, C. B. 1956–2, 808. However, a television tuner is not considered to be a radio receiving set or a chassis for a radio or television receiving set since it does not perform the detection or demodulation function as do ordinary radio tuners. Therefore, since an amplitude-modulation or frequency-modulation radio tuner is considered to be a chassis and a chassis is one of the components named in section 4142 of the Code, sales of such tuners are subject to the tax imposed by section 4141 of the Code. However, since a television tuner is not considered to be a chassis, separate sales of such tuners are not subject to the tax imposed by section 4141 of the Code.

PART II.—MUSICAL INSTRUMENTS

SECTION 4151.—IMPOSITION OF TAX

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is produced under patented rights. See Rev. Rul. 58–134, page 395.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

SUBCHAPTER D.—RECREATIONAL EQUIPMENT

PART I.—SPORTING GOODS

SECTION 4161.—IMPOSITION OF TAX

Rev. Rul. 58–28

Sales of archery equipment, rubber catapults, boomerangs, and blow guns are not subject to the manufacturers excise tax on sporting goods imposed by section 4161 of the Internal Revenue Code of 1954.

Advice has been requested whether the manufacturers excise tax on the sale of sporting goods applies to archery equipment, rubber catapults, boomerangs, and blow guns.

M company manufactures archery equipment which it sells as complete sets. *N* company manufactures various components of archery equipment, such as arrowheads, arrow shafts, bow staves, etc., which it sells separately to archery equipment manufacturers as well as directly to sportsmen. *O* company manufactures and sells rubber catapults, commonly called "sling shots," boomerangs, and blow guns, tubes from which arrows or darts may be propelled by the breath.

Archery equipment, catapults, boomerangs, and blow guns are not included in the articles of sporting goods enumerated in section 4161 of the Internal Revenue Code of 1954. Accordingly, it is held that sales of these items by the manufacturer, producer, or importer are not subject to the manufacturers excise tax on sporting goods.

Rev. Rul. 58–187

The manufacturers excise tax on sporting goods, imposed by section 4161 of the Internal Revenue Code of 1954, applies to the sale of a canvas bag which is designed and sold for use by anglers for carrying fish.

Advice has been requested whether the manufacturers excise tax on sporting goods applies to the sale of a canvas bag which is commonly known and sold as a fishing creel.

The canvas bag, which is designed and sold for use by anglers for carrying fish, is approximately 15 inches long, nine inches high, and three inches wide, with a large air vent on each end covered with small mesh wire. The opening at the top, which is 12 inches long, is held closed by means of steel spring hinges. The inside of the bag is rubber lined and the outside has three pockets of different sizes. The bag is equipped with adjustable web shoulder straps.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of various articles of sporting goods (including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof). Included in the taxable articles specified are fishing rods, creels, and reels.

While most fishing creels are of wickerwork construction, it is the purpose for which designed, rather than the material from which made, that determines whether a receptacle is a "fishing creel" within the meaning of section 4161 of the Code.

Accordingly, it is held that the canvas bag described above is a fishing creel within the meaning of section 4161 of the Code and the sales of this article by the manufacturer, producer, or importer are subject to the tax imposed by that section.

Rev. Rul. 58–202

Skis and ski poles designed for use by children are subject to the manufacturers excise tax on sporting goods, imposed by section 4161 of the Internal Revenue Code of 1954, if such skis and ski poles are constructed so as to be suitable for practical use in the sport of skiing.

Advice has been requested whether skis and ski poles designed for use by children are subject to the manufacturers excise tax on sporting goods.

A manufacturer sells sets consisting of skis and ski poles specifically designed for use by children. The skis range from three feet to five feet and six inches in length. Some of the skis are equipped with professional type ski bindings, which consist of adjustable metal clamps and metal springs or clasps, and otherwise are so constructed that they are suitable for use in the sport of skiing. The other so-called "skis" are, by the very nature of their construction, unfit for any use except in children's play, such as in backyards and on sidewalks. The poles which are sold with the latter "skis" also are of such a quality and design that they are inadequate for any use except in children's play.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax upon the sale by manufacturers, producers, or importers of certain enumerated articles of sporting goods. The enumeration of such articles includes skis and ski poles. It is the position of the Internal Revenue Service that the tax is imposed on sporting goods enumerated in section 4161 if they are constructed so as to be fit for practical use in the sport to which they relate, irrespective of whether they are designed to be used by children or by adults.

Accordingly, it is held that skis and ski poles designed for use by children are taxable sporting goods articles if such skis and ski poles are constructed so as to be suitable for practical use in the sport of skiing. Therefore, the manufacturers excise tax imposed by section 4161 of the Code applies to the manufacturer's sale of those skis and ski poles described in the instant case which are so constructed that they are suitable for use in the sport of skiing, but the tax does not apply to the sale of those so-called "skis" and "ski" poles which are suitable only for use in children's play, such as in backyards and on sidewalks.

Rev. Rul. 58–254

A ball designed with a wooden center for use only as part of a child's game, and which cannot be used in a regular golf game, is not a sporting goods article subject to the manufacturers excise tax imposed by section 4161 of the Internal Revenue Code of 1954, even though from outward appearance it resembles a golf ball.

Advice has been requested whether a ball made to resemble a golf ball but which, because of its wooden center, cannot be used in playing a regular game of golf, is subject to the manufacturers excise tax on sporting goods. The ball is produced by the manufacturer for use only as a part of a child's game.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax upon the sale by a manufacturer, producer, or importer of sporting goods, including golf balls.

Since the ball described above is designed with a wooden center for use only as part of a child's game and cannot be used in a regular game of golf, it is held that such a ball is not a golf ball within the meaning of section 4161 of the Code despite its outward resemblance to a golf ball. Accordingly, sales of the ball by the manufacturer are not subject to the tax imposed by that section.

Rev. Rul. 58–271

The manufacturers excise tax on sporting goods, imposed by section 4161 of the Internal Revenue Code of 1954, applies to sales of complete badminton, squash, and tennis rackets of taxable length which are produced by combining racket frames and string purchased on a tax-paid basis.

Advice has been requested whether a person selling a badminton, squash, or tennis racket, under the circumstances described below, is liable for the manufacturers excise tax on sporting goods.

The person selling such rackets purchases, on a tax-paid basis, badminton, squash, and tennis racket frames of taxable length and racket string. He then combines the frames and string to produce complete rackets of taxable length.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated articles of sporting goods. The enumeration of articles includes badminton, squash, and tennis racket frames and rackets (measuring 22 inches overall or more in length) and racket string.

Section 4220(1) of the Code provides, in part, that under regulations prescribed by the Secretary of the Treasury or his delegate, no tax under Chapter 32 shall be imposed with respect to the sale of any article (with certain exceptions not applicable here) for use by the vendee as material in the manufacture or production of, or as a component part of, an article enumerated in that chapter.

Under the provisions of section 6416(b)(3)(A) of the Code, if a manufacturer purchases an article of sporting goods on which the manufacturers excise tax has been paid and uses it in the manufacture of another article on which the manufacturers excise tax has been paid or which has been sold free of tax by virtue of section 4220 or 4224, relating to tax-free sales, the tax paid by the manufacturer of the first article may be credited or refunded to the manufacturer of the second article.

It is held that where a person produces complete rackets (measuring 22 inches overall or more in length) by combining frames and string, as in the instant case, that person is the manufacturer of the complete rackets and is liable for the manufacturers excise tax imposed by section 4161 of the Code on his sales thereof.

However, where the frames and string have been purchased on a tax-paid basis, such person is entitled, under the provisions of section 6416(b)(3)(A) of the Code, to claim a credit or refund of an amount equal to the tax paid by the manufacturer of the frames and string. Moreover, under the provisions of section 4220(1) of the Code, the frames and string for use in the production of the complete rackets may be purchased on a tax-free basis.

Rev. Rul. 58–312

Applicability of the manufacturers excise tax on sporting goods, imposed by section 4161 of the Internal Revenue Code of 1954, to the sale by the manufacturer of a so-called golf set which is designed for use in playing a game which simulates golf.

Advice has been requested whether the manufacturers excise tax on sporting goods applies to sales by the manufacturer of simulated golf sets designed for use primarily in confined areas.

A company manufacturer's so-called "golf sets" which consist of clubs made in the shape of and resembling golf clubs, plastic cups, and plastic balls. The clubs are 35 inches in length, weigh approximately seven ounces, and are constructed of plastic heads affixed to wooden shafts. The clubs resemble "No. 8" irons, "No. 3" woods, and putters, and are suitable for use only with the plastic balls furnished or with lightweight balls made of sponge rubber or some similar material. The plastic heads of the clubs are not of sufficient strength to be used with regulation of golf balls and would crack or shatter if they were so used. The plastic cups are designed to be inserted in the ground and utilized as hole cups so that a game similar to golf may be played. The clubs will drive balls of the type supplied with the set approximately 60 feet.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax on the sales by the manufacturer, producer, or importer of certain sportings goods, includings golf bags (measuring 26 inches or more in length), balls, and clubs (measuring 30 inches or more in length). In construing the law, it is the position of the Internal Revenue Service that the golf equipment taxed under this section includes eqiupment constructed for use in playing the conventional game of golf, since this is the context in which the term "golf" is employed.

It is held that the balls and clubs described in the instant case are not designed or constructed for use in a conventional game of golf, but can be used only to play a game which in some aspects merely simulates golf. In spite of their outward resemblance to the articles used in golf, such balls and clubs are not considered golf balls and clubs within the meaning of the statute. Therefore, sales by the manufacturer of the balls and clubs contained in the sets described above are not subject to the manufacturers excise tax on sporting goods.

Applicability of the manufacturers excise tax on sporting goods to a manufacturer's sale of an underwater rubber-powered spear gun. See Rev. Rul. 58–82, page 421.

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is produced under patented rights. See Rev. Rul. 58–134, page 395.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

PART II.—PHOTOGRAPHIC EQUIPMENT

SECTION 4171.—IMPOSITION OF TAX

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is produced under patented rights. See Rev. Rul. 58–134, page 395.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

SECTION 4172.—DEFINITION OF CERTAIN VENDEES AS MANUFACTURERS

Rev. Rul. 58–36

A company which purchases unexposed microfilm in lengths of more than one hundred and fifty feet and resells such film in one hundred-foot reels is liable for the manufacturers excise tax under the provisions of section 4172 of the Internal Revenue Code of 1954 with respect to such sales.

Advice has been requested concerning the applicability of the manufacturers excise tax to sales of unexposed microfilm under the circumstances described below.

A company modifies a standard 16 millimeter movie camera in such a way that it is used by banks, hotels, market operators, and others to microfilm invoices, checks, and similar items. The company purchases in bulk from film manufacturers large quantities of a special type of microfilm. Since the camera uses a maximum load of 100 feet of film, the company cuts the microfilm in 100-foot lengths and winds it on reels for sale to its customers.

Section 4171 of the Internal Revenue Code of 1954 imposes a tax upon sales by the manufacturer, producer, or importer of unexposed photographic film in rolls (including motion picture film). Section 4172 of the Code provides that any person who acquires unexposed photographic film not subject to tax and sells such unexposed film in form and dimensions subject to tax (or in connection with a sale cuts such film to form and dimensions subject to tax) shall for the purposes of section 4171 be considered the manufacturer of the film so sold by him.

Section 4173(3) of the Code provides that the tax imposed under section 4171 shall not apply to X-ray film, unperforated microfilm, film more than one hundred and fifty feet in length, or film more than twenty-five feet in length and more than thirty millimeters in width.

Since the bulk film purchased by the company is in lengths of more than one hundred and fifty feet, sales of such film by the manufacturer thereof are not subject to the tax. However, the 100-

foot reels of film which are resold by the purchasing company are in form and dimensions which are subject to the tax. Therefore, it is held that, under the provisions of section 4172 of the Code, the sales of such film by that company are subject to the manufacturers excise tax.

PART III.—FIREARMS

SECTION 4181.—IMPOSITION OF TAX

(Also Section 4161.) Rev. Rul. 58–82

Neither the manufacturers excise tax on sporting goods nor the manufacturers excise tax on firearms, imposed by sections 4161 and 4181 of the Internal Revenue Code of 1954, respectively, applies to the sale of an underwater rubber-powered spear gun.

Advice has been requested whether the manufacturers excise tax on sporting goods or the manufacturers excise tax on firearms applies to the sale of a spear gun which is designed for underwater deep sea fishing. The force necessary to project the spear is furnished by means of rubber bands or rubber tubes, rather than by an explosive.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated articles of sporting goods, including fishing rods, creels, reels and artificial lures, baits and flies. Since a spear gun is not one of the items enumerated in section 4161, the tax imposed by that section does not apply.

Section 4181 of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of firearms, shells, and cartridges. Section 316.80(b) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "firearms" to include all portable weapons, such as rifles, carbines, machine guns, shotguns and fowling pieces, from which a shot, bullet, or projectile may be discharged by an explosive.

It is held that a spear gun which projects a spear by means of rubber bands or rubber tubes, rather than by an explosive, does not constitute a "firearm" within the meaning of section 4181 of the Code; therefore, sales thereof are not subject to the manufacturers excise tax imposed by that section.

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is produced under patented rights. See Rev. Rul. 58–134, page 395.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

475254°—58——28

SUBCHAPTER E.—OTHER ITEMS

PART I.—BUSINESS MACHINES

SECTION 4191.—IMPOSITION OF TAX

Rev. Rul. 58–47

The manufacturers excise tax on business machines imposed by section 4191 of the Internal Revenue Code of 1954 applies to check perforating machines and number perforating machines, but does not apply to such perforating machines as a fixed die machine, a receipting machine, and certain dating machines.

Advice has been requested concerning the applicability of the manufacturers excise tax on business machines to several types of perforating machines. The machines are described as follows:

(1) A check perforating machine designed to make perforations of three lines, with the word "paid" on the first line, the date on the second line, and the bank's "ABA" number or initials on the third line, or the third line drilled solid.

(2) Numbering machines, such as a straight line numbering machine; a model with fixed wording above or below the number; a model that provides a combination of dating and numbering which is used for perforating installment loan coupon books; and a model that provides a combination of dating and numbering on one line.

(3) A fixed die machine, which cannot date or number, used in canceling warehouse receipts, coupons and tickets; in marking and coding labels; and in voiding notes, bonds, and bills.

(4) A dating machine which is used for dating purposes only.

(5) A dating machine which has the date and, on either side thereof, a wide selector ring with ten inscriptions, such as "paid," "void," etc., with the wording and date to be shown all on one line.

(6) A receipting machine with two dating heads and a knife in the die, used for receipting utility and tax bills. The machine perforates the word "paid," the date, and other wording, such as the name of the utility. With the exception of the date, all information is fixed in the die and cannot be changed.

(7) A code dating machine with wheels drilled for special code dating applications, particularly on perishable foods and drug items where the manufacturer wants a code date on the label to identify the date of shipment or manufacture.

(8) A single line dating machine with inserting keys which perforate above or below the date, the name of a person, or any special wording for dating or receipting purposes. The wording on the first or third line can be changed by inserting the proper key with the word or name desired.

(9) A dating machine with a two-line die which has the date, and above or below the date, the initials of a company or wording, such as "received," "canceled," "void," "paid," etc., used particularly in invoice dating, perforating the date on incoming mail, and also perforating revenue stamps.

Section 4191 of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of various

business machines, including in each case parts and accessories of such articles sold on or in connection therewith, or with the sale thereof. Among the many types of machines included in the enumeration in that section are numbering machines and check writing, signing, canceling, perforating, cutting, and dating machines, and other check protector devices.

It is held that the perforating machines described in examples (1) and (2) above are, respectively, check perforating machines and numbering machines as contemplated by section 4191 of the Code and are subject to the manufacturers excise tax imposed by that section.

It is further held that the perforating machines described in examples (3) to (6), are not business machines for the purposes of the manufacturers excise tax imposed by section 4191 of the Code and are, therefore, not subject to the tax, unless the particular machine involved is suitable for numbering or check perforating purposes, in which event it is considered subject to the tax.

The perforating machines described in examples (7), (8) and (9) are also held to be not subject to the excise tax, provided the code dating machine, example (7), is not suitable for numbering; the single line dating machine with inserting keys, example (8), is not sold for or is not suitable for check perforating, canceling, etc.; and the dating machine, example (9), is not equipped with dies which perforate bank numbers, bank initials, or are drilled solid. If these machines are suitable for numbering or check perforating, or are so equipped, they are then numbering machines or check perforating machines within the meaning of section 4191 of the Code, and are accordingly subject to the excise tax imposed by that section.

Rev. Rul. 58–117

A manufacturer sells a household type stapler designed for wall mounting in the kitchen of the home. The stapler has an overall dimension at the base of five and five-eighths inches, a width of two inches, and a height of one and seven-eighths inches. The base of the stapler is provided with two holes for mounting purposes, but the stapler operates in an efficient and satisfactory manner without being mounted on a wall. *Held*, the stapler is a portable paper fastening machine within the meaning of section 4191 of the Internal Revenue Code of 1954. Accordingly, the manufacturer of the stapler is liable for the manufacturers excise tax imposed by that section on his sales thereof. Compare Revenue Ruling 57–238, C. B. 1957–1, 380, which holds that the tax does not apply to an automatic eyeleter which is not suitable for performing its function in an efficient and satisfactory manner without being fastened to a desk, bench, or table.

Rev. Rul. 58–250

The sale of an independent carrying case for a typewriter is not subject to the manufacturers excise tax imposed by section 4191 of the Internal Revenue Code of 1954, whether sold separately or with a typewriter. However, where a typewriter and the case constitute one complete unit, such as where the typewriter is built into the base of a carrying case, the tax applies to the sale price of the complete unit, including the case.

Advice has been requested whether the manufacturers excise tax on business machines is applicable to the sale of carrying cases with portable typewriters.

Some of the cases are made of imitation leather and others are made of wood covered with fabric. One type is an independent carrying case. Another type has the typewriter built into the base.

Section 4191 of the Internal Revenue Code of 1954 imposes a tax on sales by the manufacturer, producer, or importer of the business machines enumerated in such section, including parts and accessories sold on or in connection therewith, or with the sale thereof. Typewriters are included in that enumeration.

It is held that the independent carrying cases are not parts or accessories for typewriters and, accordingly, are not subject to the tax imposed by section 4191 of the Code, whether sold separately or with a typewriter. However, it is further held that where a typewriter and the case constitute one complete unit, such as where the typewriter is built into the base of a carrying case, the tax applies to the sale price of the complete unit, including the case.

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is produced under patented rights. See Rev. Rul. 58–134, page 395.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

PART II.—PENS AND MECHANICAL PENCILS AND LIGHTERS

SECTION 4201.—IMPOSITION OF TAX

Rev. Rul. 58–114

A company, which furnishes the necessary materials and uses its own tools and dies in the production of an unpatented mechanical lighter, is the manufacturer for the purposes of the manufacturers excise tax imposed by section 4201 of the Internal Revenue Code of 1954.

The Internal Revenue Service has been requested to determine which company is the manufacturer or producer of a mechanical lighter, for the purposes of the manufacturers excise tax, under the circumstances described below.

M corporation makes mechanical lighters for cigarettes, cigars and pipes and sells them to *N* company. *M* designs the lighter; however, it is subject to change of style and design to suit the purchaser. *M* supplies all materials, tools and dies used in the manufacture of the lighter. The tools and dies remain the property of *M*. There is no contract, other than a verbal agreement between the parties, that

the lighters will be produced and shipped to *N* company in the quantities specified and at the agreed prices. *M* has consented to sell the lighters only to *N* company. The lighter is not patented; however, it bears a trade-mark owned by *N* company. The companies are separate entities, having no financial or other connections. All sales are bona fide arm's length transactions.

Section 4201 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of mechanical lighters for cigarettes, cigars and pipes.

Section 316.4(a) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "manufacturer" to include a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles. Section 316.4(b) provides that under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

It is held that, under the circumstances described here, *M* corporation is the manufacturer of the mechanical lighters and is liable for the manufacturers excise tax imposed by section 4201 of the Code.

In determining whether a person is a manufacturer or producer, each case must be decided upon its own particular facts and circumstances. The result in any case not coming within the circumstances set forth above must be based solely on the facts involved in such case.

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is nary barracks. See Rev. Rul. 58–103, page 394.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

PART III.—MATCHES

SECTION 4211.—IMPOSITION OF TAX

Sale of taxable articles by a United States Armed Forces disciplinary barracks. See Rev. Rul. 58–103, page 394.

Determination of who is the "manufacturer" where an article is produced under patented rights. See Rev. Rul. 58–134, page 395.

Procedure whereby an importer of articles subject to the manufacturers excise taxes may compute and prepay the tax at the time the taxable articles are imported. See Rev. Rul. 58–315, page 473.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO MANUFACTURERS TAX

SECTION 4216.—DEFINITION OF PRICE

Rev. Rul. 58–287

A finance or carrying charge on an installment sale of articles subject to the manufacturers excise taxes may be excluded from the tax base (1) if it computed on the unpaid balance of the sale price and the length of time agreed upon for payment of the balance due, (2) if the purchaser receives a credit or adjustment of the charge proportionate to any accelerated payment, (3) if the amount of the charge is stated separately on the installment sale agreement or on some other document pertinent to the transaction so that the purchaser is aware of his privilege to reduce the charge by accelerated payments, and (4) if there is nothing present which would negate the bona fides of the transaction.

Advice has been requested whether a finance or carrying charge on an installment sale is excludable from the taxable selling price for the purpose of computing the manufacturers excise tax.

A company sells business machines under an installment payment agreement. On all installment payment sales, a finance or carrying charge is computed on the unpaid balance of the sale price after deduction of the cash down payment. The charge is payable, along with the unpaid balance of the sale price, in monthly installments for the life of the installment payment agreement. The amount of the charge is stated separately on the installment payment agreement. The purchaser may accelerate the payments and receive a credit or adjustment of a proportionate part of the charge.

The manufacturers excise taxes which are based upon the price for which articles are sold, such as the tax on business machines imposed by section 4191 of the Internal Revenue Code of 1954, are subject to certain inclusions and exclusions set forth in section 4216 of the Code.

Whether a finance or carrying charge may be excluded in determining the selling price which is subject to the manufacturers excise tax should be ascertained in accordance with principles similar to those set forth in Revenue Ruling 57–437, C. B. 1957–2, 717, which pertains to the exclusion of bona fide service charges for the purpose of computing the retailers excise taxes.

The determination of whether a finance or carrying charge is to be excluded from the table selling price is a question of fact and is to be made from the circumstances in each case. In order for the charge to be excluded, (1) it must be based on the unpaid balance of the sale price and the length of time agreed upon for payment of the balance due, (2) the purchaser must receive a credit or adjustment of the charge proportionate to any accelerated payment, (3) the amount of the charge must be stated separately on the purchase agreement or on some other document pertinent to the transaction so that the

purchaser is aware of his privilege of reducing the charge by making accelerated payments, and (4) there must not be present any factors which negate the bona fides of the transaction. The finance or carrying charge may include not only lawful interest but also charges to compensate the manufacturer for the bookkeeping and other expenses actually incurred as a result of the time payment purchase.

Accordingly, it is held that a finance or carrying charge made by a manufacturer in accordance with the conditions set forth above may be excluded from the manufacturer's taxable selling price.

Rev. Rul. 58–313

Where a manufacturer sells articles in smaller quantities than usual and makes a special charge to cover the cost of repacking them for shipment, such special charge becomes a part of the manufacturer's sales price and is subject to the manufacturers excise taxes imposed by Chapter 32 of the Internal Revenue Code of 1954, irrespective of whether such charge is separately stated to the customer.

Advice has been requested whether the special charges made by a manufacturer, under the circumstances described below, should be included in the selling price of articles for purposes of computing the manufacturers excise taxes imposed by Chapter 32 of the Internal Revenue Code of 1954.

A manufacturer of certain articles, which are subject to the manufacturers excise taxes imposed by Chapter 32 of the Code, normally packs such articles for sale in cartons containing a certain number of articles. However, the manufacturer sometimes sells these articles in quantities less than a full carton. In such cases, the manufacturer makes an additional charge to cover the cost of repacking the articles. The customer is billed for the established selling price of the articles plus this additional charge.

Section 4216(a) of the Internal Revenue Code of 1954 provides that in determining the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature and any charge incident to placing the article in condition packed ready for shipment.

Since the additional charge for repacking described above is incident to placing the articles in condition packed ready for shipment to those customers who purchase smaller quantities of the articles, it is held that such charge becomes a part of the manufacturer's sales price which is subject to the manufacturers excise tax, irrespective of whether such charge is separately stated to the customer.

SECTION 4220.—EXEMPTIONS FOR SALES OR RESALES TO MANUFACTURERS

Futher manufacture of passenger automobile chassis and bodies into ambulances, funeral coaches, and combination funeral coach and ambulance. See Rev. Rul. 58–32, page 391.

SECTION 4222.—EXEMPTION FROM TAX OF CERTAIN SUPPLIES FOR VESSELS AND AIRPLANES

(Also Section 6416.) Rev. Rul. 58–171

Articles subject to the manufacturers excise tax may not be sold tax-free to a contractor for installation on vessels of war he is constructing for the United States Navy in fulfilling a Government contract. However, the manufacturer may claim refund or credit by securing a proper exemption certificate signed by an authorized official of the Navy Department.

Advice has been requested whether, under section 4222 of the Internal Revenue Code of 1954, articles which are subject to the manufacturers excise tax may be sold tax-free to a contractor for use in fulfilling a Government contract for the construction of a vessel for the United States Navy.

Section 4222 of the Code provides that, under regulations prescribed by the Secretary of the Treasury or his delegate, no manufacturers tax will apply to articles sold for use as fuel supplies, ships' stores, sea stores, or legitimate equipment on vessels of war of the United States and certain other vessels.

Section 316.28 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that sales of articles for use on these vessels may be made tax-free only if the sales are made by the manufacturer direct for use as fuel supplies, ships' stores, sea stores, or legitimate equipment on such vessels.

It is held, therefore, that articles subject to the manufacturers tax may not be sold tax-free to a contractor for installation on vessels of war he is constructing for the United States Navy in fulfilling a Government contract. However, the manufacturer may file a claim for credit or refund under section 6416(b)(2)(B) of the Code by complying with the provisions of section 316.204 of Regulations 46, whereby he must secure a proper form of exemption certificate signed by an authorized official of the Navy, or he must obtain a statement from the ultimate vendor as prescribed.

SECTION 4224.—STATE AND LOCAL GOVERNMENTAL EXEMPTION

(Also Sections 4055, 4292.) Rev. Rul. 58–59

The North Jeffco Metropolitan Recreation District is a political subdivision of the State of Colorado within the meaning of sections 4055 and 4224 of the Internal Revenue Code of 1954, which relate to sales of articles, otherwise subject to the retailers or manufacturers excise taxes, for the exclusive use of a State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia. The recreation district also comes within the scope of the exemption provided by section 4292 of the Code, which relates to excise taxes on communication and transportation services and facilities furnished to such governmental units.

Advice has been requested whether the North Jeffco Metropolitan Recreation District comes within the scope of the exemptions from certain Federal excise taxes provided with respect to transactions with states and other local governmental units.

The North Jeffco Metropolitan Recreation District was created in 1956 under the Colorado Revised Statutes of 1953, Chapter 89–12, for the purpose of supplying recreational facilities within the district. Pursuant to that statute, the recreation district is a governmental subdivision of the State of Colorado and a body corporate with all the powers of a public or quasi-municipal corporation. Among such powers are the right of perpetual existence and the power of eminent domain, whereby, in the manner provided by law for the condemnation of private property for public use, the district may take any property within the district necessary to the exercise of the powers granted in the statute. As a means of obtaining revenue or carrying out its purposes and activities, the district is authorized by law to assess taxes not exceeding, in any one year, four mills of the assessed valuation of the real property within the limits of the recreation district. Such taxes are collected by the appropriate county officers and paid over to the treasurer of the district.

Sections 4055 and 4224 of the Internal Revenue Code of 1954 provide that the retailers and manufacturers excise taxes will not apply to the sale of any article for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia.

Section 4292 of the Code provides that no tax shall apply to payments received for communication and transportation services and facilities furnished to the government of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia. That section also provides that the tax shall not be imposed upon amounts paid for the transportation of property to or from such governmental units.

It is held that the North Jeffco Metropolitan Recreation District formed under Colorado law is a political subdivision of that State within the meaning of (1) section 4055 of the Internal Revenue Code of 1954, relating to the retailers excise taxes, (2) section 4224 of the Code, relating to the manufacturers excies taxes, and (3) section 4292 of the Code, relating to the tax on communications and transportation services and facilities. Acordingly, where taxable articles are sold to the recreation district for its exclusive use or where communication and transportation services and facilities are furnished to such district, the exemptions will apply, provided the requirements of the law and applicable regulations with respect to the particular exemption are met.

Rev. Rul. 58–107

There is no provision of the Internal Revenue Code which exempts from the manufacturers excise tax the sale of an article by a manufacturer, producer, or importer, where the purchaser of such article donates it to a State or political subdivision thereof.

Advice has been requested whether the manufacturers excise tax applies to the sale of an article by the manufacturer, producer, or importer, where the purchaser of such article donates it to a public school or other instrumentality of a State or political subdivision thereof.

In the instant case, a manufacturer sold a taxable article to a local unit of the Parent-Teachers Association, which in turn donated the article to a State-operated school.

Section 4224 of the Internal Revenue Code of 1954 provides that under regulations prescribed by the Secretary or his delegate, no manufacturers excise tax shall be imposed upon the sale of any article for the exclusive use of any State or political subdivision thereof. Section 316.24(a) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that no tax attaches to articles sold by the manufacturer *direct* to any State or political subdivision thereof for its exclusive use.

Section 6416(b)(2)(A) of the Code provides that credit or refund shall be allowed where an article subject to the manufacturers excise tax is resold by any person for the exclusive use of any State or political subdivision thereof.

The above provisions of law and regulations apply to articles which are *sold* direct by the manufacturer, or *resold* by another person to a State or political subdivision thereof. The statute contains no provision which exempts from tax the sale of an article by the manufacturer, where the purchaser of the article *donates* it to such a governmental unit. Furthermore, there is no provision of the Code whereby the tax paid by the manufacturer may be credited or refunded because the purchaser donates the article to such a governmental unit.

Accordingly, it is held that the manufacturer's sale of a taxable article to the Parent-Teachers Association is not exempt from tax under section 4224 of the Code; neither does the subsequent donation of the article to a State-operated school establish a basis for a credit or refund under section 6416(b)(2)(A) of the Code.

Rev. Rul. 58–288

Sales of articles subject to the manufacturers excise taxes to a public school which makes payment out of a fund belonging to, controlled by, and administered by the school, although collected from the school children, are exempt from tax under the provisions of section 4224 of the Internal Revenue Code of 1954. The tax-exempt character of the transaction must be supported by an appropriate exemption certificate executed by an authorized officer of the school.

Advice has been requested concerning the applicability of the manufacturers excise taxes to sales of articles to a public school under the circumstances described below.

A public school has a fund made up of amounts collected from students. This fund is used to purchase needed supplies for the exclusive use of the school. From the fund, the school purchased several portable paper fastening machines which are used by the students and by the teachers in carrying out the school program.

Section 4191 of the Internal Revenue Code of 1954 imposes a tax upon sales by the manufacturer, producer, or importer of business machines, including portable paper fastening machines. Section 4224 of the Code provides for exemption from the manufacturers excise tax in the case of articles sold for the exclusive use of any State, Territory of the United States, any political subdivision of the foregoing, or the District of Columbia.

It is the position of the Internal Revenue Service that the exemption from the manufacturers excise taxes authorized under section 4224 of the Code applies to articles sold for the exclusive use of educational institutions which are operated and supported by any State, Territory

of the United States, any political subdivision of the foregoing, or the District of Columbia, and for which payment is made from funds belonging to, administered by, and controlled by the educational institution. The exemption applies even though the funds may contain money other than that appropriated by the State or other governmental unit. The essential factor is that the funds used to pay for the equipment or supplies must belong to, and must be controlled and administered by, the institution.

Accordingly, it is held that sales of articles subject to the manufacturers excise taxes to a public school which makes payment out of a fund belonging to, controlled by, and administered by the school, although collected from the school children, are exempt from tax under the provisions of section 4224 of the Code. The tax-exempt character of the transaction must be supported by an appropriate exemption certificate executed by an authorized officer of the school as provided by section 316.24 of Regulations 46, which have been made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47.

Whether the Connecticut River Valley Flood Control Commission comes within the scope of exemptions from certain Federal excise taxes provided with respect to transactions with state and other local governmental units. See Rev. Rul. 58–61, page 456.

Whether state associations of municipalities come within the scope of exemptions from certain Federal excise taxes provided with respect to transactions with states and local governmental units. See Rev. Rul. 58–156, page 389.

CHAPTER 33.—FACILITIES AND SERVICES

SUBCHAPTER A.—ADMISSIONS AND DUES

PART I.—ADMISSIONS

SECTION 4233—EXEMPTIONS

Rev. Rul. 58–203

Admissions the proceeds of which inure exclusively to a retirement, pension, or disability fund maintained for the benefit of members of a policemen's or firemen's benevolent association are exempt from the tax on admissions, if such fund is maintained separately from other funds and accounts of the association and is dedicated exclusively for the benefit of the members of the police or fire department, or to a fund for the heirs of such members.

The Internal Revenue Service has been asked whether, in order to qualify for the exemption from the admissions tax provided by section 4233(a)(1)(B) of the Internal Revenue Code of 1954, a policemen's or firemen's benevolent association must establish by incorporation or trust agreement a separate retirement, pension, or disability fund.

Section 4233(a)(1)(B) of the Code provides, subject to the exceptions set forth in section 4233(a)(1)(C) of the Code, that the tax on admissions shall not apply to any admissions all the proceeds of which inure exclusively to the benefit of a police or fire department of any city, town, village, or any municipality, or exclusively to a retirement, pension, or disability fund for the sole benefit of members of such a police or fire department, or to a fund for the heirs of such members.

It is held that in order for admissions, the proceeds of which inure to a retirement, pension, or disability fund maintained by a policemen's or firemen's benevolent association, to qualify for the admissions tax exemption provided by section 4233(a)(1)(B) of the Code, the fund must be maintained separately from other funds and accounts of the association, but not necessarily by incorporation or trust agreement, and must be dedicated exclusively for use as a retirement, pension, or disability fund for the sole benefit of members of such police or fire department, or to a fund for the heirs of such members. See Revenue Ruling 54–243, C. B. 1954–1, 92, which relates to the requisites for the establishment of separate funds by organizations now within the scope of section 501(c) of the Code.

Rev. Rul. 58–204

A municipal police department, too small to finance an independent retirement, pension, or disability fund, such as is maintained by policemen's and firemen's organizations of large cities, purchases health and accident insurance for the benefit of its members. Funds with which to purchase this insurance are derived, in part, from charges for admission to dances sponsored by members of the police department. All of the proceeds from the admissions are applied to the purchase of the insurance described. *Held*, where the proceeds from admissions to a dance, or other similar affair, are used exclusively to provide the same benefits for members of a police or fire department as those that would inure to them from an independent retirement, pension, or disability fund, the admissions qualify for the exemption provided with respect to policemen's and firemen's disability funds by section 4233(a)(1)(B) of the Internal Revenue Code of 1954. In the instant case, since the benefits derived by the members of the police department from the health and accident insurance are the same as those that they would receive from an independent disability fund, charges for admission to the dances are exempt from the tax. See Revenue Ruling 58–203, page 431, which holds that the exemption provided by section 4233(a)(1)(B) of the Code applies only in respect of admissions all the proceeds of which inure to the benefit of a separate fund maintained by the association exclusively for the requisite statutory purposes, and fixes the requisites for such separate fund.

Rev. Rul. 58–334

A clinic for the treatment of diseases of children's eyes does not qualify as a "hospital for crippled children" as contemplated by section 4233(a)(1)(c) of the Internal Revenue Code of 1954, which exempts from the admissions tax amounts paid for admission to an

athletic game between teams composed of students from elementary or secondary schools, or colleges, if the entire gross proceeds from such game inure to the benefit of a hospital for crippled children.

Advice has been requested whether, for purposes of the exemption from the admissions tax, a clinic for the treatment of diseases of children's eyes may be considered to be a "hospital for crippled children."

The clinic was organized and is operated solely to provide medical care and treatment for the diseases of children's eyes and to conduct research on the causes of and cures for such diseases. The treatment is extended only to needy children. To raise money to help defray expenses in connection with the operation of the clinic, the association which organized it sponsors an annual all-star football game between teams composed of high school students of the area. The entire gross proceeds from the game inure to the benefit of the clinic.

Section 4233 of the Internal Revenue Code 1954 confers exemption from the tax on admissions under certain conditions and within certain limitations. Included in the exemptions conferred by that section are charges for admission to any athletic game between teams composed of students from elementary or secondary schools, or colleges, if the entire gross proceeds from such game inure to the benefit of a hospital for crippled children.

As contemplated by the Code, a hospital for crippled children is an institution providing such hospital facilities as beds, meals, rooms equipped for operating and/or therapy, and other forms of correctional treatment, a staff of physicians, and a full-time complement of nurses, in which children suffering from major bone, joint or muscle abnormalities or diseases or injuries affecting the bones, joints or muscles, such as poliomyelitis, muscular dystrophy, cerebral palsy, osteomyelitis, etc., whether congenital or acquired by accident, injury or disease, are treated with a view to rehabilitation or ultimate cure. Additionally, the institution must be a hospital specializing in the care and treatment of children afflicted with such abnormalities and diseases and operated solely for that purpose, except that emergency treatment of adults and emergency treatment of children not admitted for care and treatment of these abnormalities and diseases by reason of the fact that no other hospital is available, will not, in itself, deny such an institution status as a hospital for crippled children.

Pursuant to the foregoing construction of the words "hospital for crippled children," and consistent with Revenue Ruling 56–175, C. B. 1956–1, 516, wherein it was concluded that the routine dental examinations and treatments generally characteristic of a dental clinic do not qualify the clinic as a "hospital for crippled children," it is held that an eye clinic principally performing the functions of a dispensary administering routine eye examinations and treatments to children does not qualify as a hospital for crippled children, because such a clinic is neither a hospital nor an institution operated for the care and treatment of "crippled children" within the meaning of section 4233 of the Code.

Admissions to certain musical or dramatic performances and to certain athletic games. See P. L. 85–380, page 633.

PART II.—CLUB DUES

SECTION 4241.—IMPOSITION OF TAX

Rev. Rul. 58–188

A 20-year non-dues-paying membership given to a member of a social, athletic, or sporting club who has reached 70 years of age and who has been a member of such club for 20 years is not a life membership within the meaning of section 4241 of the Internal Revenue Code of 1954.

Revenue Ruling 55–198, C. B. 1955–1, 510, amplified.

An inquiry has been received regarding the applicability of the club dues tax on life memberships to a 20-year non-dues-paying membership under the circumstances described below.

The by-laws of a social, athletic, or sporting club provide that any resident member who has reached 70 years of age and who has been a member of such club for 20 years may exchange his membership for a 20-year non-dues-paying membership.

Section 4241(a)(1) of the Internal Revenue Code of 1954 provides that a tax is imposed on any amount paid as dues or membership fees to any social, athletic, or sporting club or organization, if the dues or fees of an active resident annual member are in excess of $10 per year. Section 4241(a)(3) of the Code provides that, in the case of life memberships, a tax is imposed equivalent to the tax upon the amount paid by active resident annual members for dues or membership fees other than assessments, but no tax shall be paid upon the amount paid for life membership.

Section 101.29 of Regulations 43, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides, in part, that the tax on club dues or membership fees attaches to amounts paid for membership for more than one year but for less than life, such as 10-year or 20-year memberships. However, unless the holders of such memberships are required to pay annual dues or membership fees, or assessments, they are exempt from the annual tax imposed on active resident annual members and life members. If any dues or membership fees or assessments are levied on such 10-year or 20-year members, the amounts so paid by them are taxable.

Revenue Ruling 55–198, C. B. 1955–1, 510, holds, in part, that honorary memberships which are granted for a definite period of time and are in fact terminated at the expiration of that period, and not renewed, are not considered life memberships and are not subject to the tax provided no dues or membership fees are paid.

In the instant case, the membership is granted for a definite period of 20 years. It is immaterial that such period may cover the life of the recipient. Accordingly, it is held that the 20-year non-dues-paying membership, granted by the club to any resident member who has reached the age of 70 and who has been a member of such club for 20 years, is not a life membership within the meaning of section 4241 of the Code. Therefore, since the membership terminates at the expiration of the 20-year period, such membership is not subject to the club dues tax on life memberships imposed by section 4241(a)(3) of the Code.

Revenue Ruling 55–198, *supra*, amplified.

Rev. Rul. 58–272

The club dues tax on initiation fees, imposed by section 4241 of the Internal Revenue Code of 1954, does not apply to amounts deposited in escrow by subscribers to a club until such time as the escrow is terminated and the funds are transferred to the club.

Advice has been requested concerning the applicability of the club dues tax on initiation fees to amounts deposited in escrow by subscribers to a social, athletic, or sporting club.

A club has been organized and incorporated as a social, athletic, or sporting club within the meaning of section 4241 of the Internal Revenue Code of 1954. However, the development of physical facilities of the club is dependent upon the number of club members obtained. Under the terms of a contract between the club and an insurance company, each subscriber deposits $100 with the insurance company to be held in escrow to the credit of the subscribers. The deposits are to be held in escrow until the club receives subscriptions for not less than 500 memberships or until sufficient subscriptions have been received to permit the development of a substantial portion of the club facilities and the board of directors elect, by resolution, to proceed with such improvements. The club has no control over the deposits made by the subscribers, unless and until the requisite number of memberships or subscriptions have been paid, at which time they will be paid over to it.

Section 4241(a)(2) of the Code imposes a tax on any amount paid as initiation fees to any social, athletic, or sporting club or organization, if such fees amount to more than ten dollars, or if the dues or membership fees, not including initiation fees, of an active resident annual member are in excess of ten dollars per year. Section 4242(b) of the Code defines "initiation fees" to include any payment, contribution, or loan, required as a condition precedent to membership, whether or not any such payment, contribution, or loan is evidenced by a certificate of interest or indebtedness or share of stock, and irrespective of the person or organization to whom paid, contributed, or loaned.

In accordance with the provisions of section 4242(b) of the Code, the initial fee required as a condition precedent to membership in a social, athletic, or sporting club or organization, is an initiation fee. However, it is held that where the initial fees are deposited in escrow by the subscribers to the club for future transfer to the club, the incidence of the tax does not arise until the funds are paid over to the club. Accordingly, the tax on initiation fees, imposed by 4241(a)(2) of the Code, will become due and payable when the club has met the conditions prescribed and the amount held in escrow is paid over to and officially accepted by the club. Where the applicable tax has not been deposited together with the initial deposit, the club is required to collect the tax due from the members at the time the escrow is terminated.

Compare S. M. 1781, C. B. III–I, 459 (1924), which holds that the tax applies at the time amounts are deposited into a special fund which is administered by the club.

SUBCHAPTER B.—COMMUNICATIONS

SECTION 4251.—IMPOSITION OF TAX

Rev. Rul. 58–299

In addition to the usual listing in the so-called "white," or alphabetical, pages of a telephone directory, a subscriber has an additional listing in the white pages and another listing in the so-called "yellow," or classified, section of the directory. For purposes of the excise tax on communications, section 130.40 of Regulations 42, made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, C. B. 1954–2, 47, states that "the term 'local telephone service' relates generally to the ordinary residential or business or commercial telephone service within a local exchange area and includes all types of such service, such as individual line and party line telephones, and extension telephones." *Held*, the alphabetical listing, whether primary or additional, of subscribers in the white pages of telephone directories is a feature of local telephone service, and the tax imposed by section 4251 of the Code applies to amounts paid for such listings. On the other hand, the listing of subscribers in the yellow pages of the directory is regarded as advertising rather than a feature of local telephone service, and amounts paid for such listings are not taxable under section 4251 of the Code.

SUBCHAPTER C.—TRANSPORTATION

PART I.—PERSONS

SECTION 4261.—IMPOSITION OF TAX

26 CFR 42.4261–2: Rate and application of tax. Rev. Rul. 58–60

> Where a sightseeing company furnishes, in addition to the driver of the vehicle, a separate guide-lecturer for a sightseeing tour, the services performed by the guide-lecturer constitute nontransportation services and the charges for such services may be excluded from the total charge for the tour in determining the basis for computing the excise tax on the transportation of persons.
>
> Pursuant to the foregoing, the Internal Revenue Service approves a formula whereby 25 percent of the total charge for a sightseeing tour may be allocated to the services of a separate guide-lecturer furnished by the sightseeing company. If the total charge also includes other nontransportation services, such as meals, hotel accommodations, admissions, etc., such services will be deducted from the total charge before applying the exclusion of 25 percent.

The Internal Revenue Service has been asked to determine a reasonable basis for allocating total charges for sightseeing tours between taxable transportation and nontaxable services performed in connection with such transportation under the circumstances described below.

Sightseeing tours, as conducted by various companies throughout the nation, usually consist of transportation by rail, bus, or other

vehicle along routes prescribed by the sightseeing company and include points of interest selected by the company. In many instances, the driver of the vehicle acts as a guide and imparts interesting information to the passengers during the course of the tour. In other instances, the company furnishes, in addition to the driver, a separate guide-lecturer who performs such service. Some tours are quite extensive and may include meals and hotel accommodations as well as admissions to historical sites and similar places. A total charge is usually made by the company for the entire tour and such charge includes all services and accommodations. The question arises as to what constitutes a reasonable basis for allocating the total charge between taxable transportation and nontaxable services for purposes of computing and collecting the tax on the transportation of persons. The examples set forth below are illustrative of the various types of tours and the extent of the services performed with each.

Example (1). The driver, in addition to his duties as such, acts as a guide-lecturer, and there are no meals, admissions, or other nontransportation services included in the tour. A total charge of four dollars (per person), excluding tax, is made for the tour.

Example (2). A separate guide-lecturer is furnished, but there are no other services included. A total charge of six dollars, excluding tax, is made.

Example (3). A separate guide-lecturer is furnished and the tour also includes a one hour stop at a historical site for which the sightseeing company pays the historical society an admission charge of 50 cents (per person). A total charge of seven dollars, excluding tax, is made for the tour.

Example (4). A tour includes a separate guide, meals, hotel room for one night, and admissions to various places of interest. The sightseeing company incurs expenditures (per person) of six dollars for meals, four dollars for hotel room, and two dollars for admissions. A total charge of $24, excluding tax, is made by the sightseeing company for the tour.

Many sightseeing companies have filed tariffs with the Interstate Commerce Commission which set forth their own allocations of total charges between taxable transportation and separate guide-lecturer service. These allocations vary considerably and some show a much higher percentage applied to nontaxable guide-lecturer services than others.

Section 4261 of the Internal Revenue Code of 1954 imposes a tax on the amount paid within the United States for taxable transportation of any person by rail, motor vehicle, water, or air. Section 4262 of the Code defines "taxable transportation" to include "transportation which begins in the United States or in the 225-mile zone and ends in the United States or in the 225-mile zone."

Section 42.4261–2(d) of the Facilities and Services Excise Tax Regulations provides that where a payment covers charges for nontransportation services as well as for transportation of a person, such as charges for meals, hotel accommodations, etc., the charges for the nontransportation services may be excluded in computing the tax payable with respect to such payment, provided such charges are separable and are shown in the exact amounts thereof in the records

pertaining to the transportation charge. If the charges for nontransportation services are not separable from the charge for transportation of the person, the tax must be computed upon the full amount of the payment. Section 42.4261–8(f)(4) of the regulations provides that charges for admissions, guides, meals, hotel accommodations, and other nontransportation services are exempt from the tax where such charges are separable from the payment for the transportation of a person and are shown in the exact amount thereof on the records pertaining to the transportation payment.

It is held that where the driver of the vehicle also acts as a guide-lecturer no amount may be excluded from the total charge as a payment for nontransportation services of a guide-lecturer.

However, where a sightseeing company furnishes, in addition to the driver of the vehicle, a separate guide-lecturer for a sightseeing tour, the services performed by the guide-lecturer constitute nontransportation services, and the charges for such service may be excluded from the total charge for the tour in determining the basis for computing the transportation tax. It is further held that in such cases where a total charge is made for a tour which includes a separate guide-lecturer, an exclusion of 25 percent will be applied on a nationwide basis to represent the allocation for the separate guide. Where, in addition to the separate guide-lecturer, the tour also includes costs for admissions, hotels, meals, and other nontaxable services, these costs will be deducted from the total charge before applying the exclusion of 25 percent for the guide.

Thus, in *Example* (1) (above), the tax is computed on the entire charge of four dollars, as follows:

Total charge	$4.00
Tax (10% of $4.00)	.40

In *Example* (2), the computation is as follows:

Total charge	$6.00
Nontaxable portion (25% of $6.00)	1.50
Taxable portion of charge (75% of $6.00)	4.50
Tax (10% of $4.50)	.45

In *Example* (3), the following computation would be used:

Total charge	$7.00
Less: Cost of admission	.50
Balance	$6.50
Nontaxable portion (25% of $6.50)	1.62
Taxable portion of charge (75% of $6.50)	4.88
Tax (10% of $4.88)	.49

In example (4), the computation would be as follows:

Total charge	$24.00
Less: Meals, hotel, and admissions	12.00
Balance	$12.00
Nontaxable portion (25% of $12.00)	3.00
Taxable portion of charge (75% of $12.00)	9.00
Tax (10% of $9.00)	.90

If a tariff filed with the Interstate Commerce Commission indicates an allocation in excess of 25 percent for separate guide-lecturer services, such allocation will not be acceptable unless the carrier is able to substantiate such allocation from its records. In the absence of such substantiation, the 25 percent formula will apply, regardless of the allocation listed in the tariff.

---

26 CFR 42.4261–7: Examples of payments subject to tax. Rev. Rul. 58–215

> Where a corporation owns an aircraft and appoints an airline company as its agent to service, maintain, overhaul, and operate such aircraft for the purpose of transporting the corporation's personnel, the airline company is not furnishing transportation service to such corporation within the purview of section 4261 of the Internal Revenue Code of 1954. Therefore, amounts paid for such services are not subject to the tax on the transportation of persons. Revenue Ruling 56–608, C. B. 1956–2, 878, distinguished.

The Internal Revenue Service has been asked whether the tax on the transportation of persons applies to payments by the owner of an aircraft to an airline company for the service, maintenance, overhaul, and operation of such aircraft under the circumstances described below.

A corporation made a bona fide purchase of an aircraft from an airline company for the purpose of transporting its own personnel and to use as a "flying-office car." Because of the airline's long experience in the operation of this type of aircraft, the corporation entered into an agreement which appointed the airline company its agent to service, maintain, overhaul, and operate the aircraft.

The aircraft is serviced, maintained, and overhauled by the airline company on a scheduled basis for a specified amount, which is paid for by the corporation. The corporation pays to the airline company a certain sum for each hour flown for gasoline, oil, and hydraulic fluid. Also, at its own expense, the corporation maintains all risk and liability insurance on the aircraft and its operations, with the airline company named as an additional insured for the liability insurance. Furthermore, the corporation reimburses the airline company for landing fees. However, weather and flight information is furnished by the airline company at no cost to the corporation. Also, the airline company indemnifies the corporation for any loss or damages arising out of the hangering, maintaining, servicing, and overhauling of the aircraft.

According to the terms of the agreement, the airline company furnishes, subject to the approval of the corporation, the pilot and co-pilot to operate the aircraft. After the pilot and the co-pilot have been selected and approved, they are permanently based at a place designated by the corporation. If for any reason the corporation desires that the pilot and/or the co-pilot be relieved of his duties, a new pilot and/or co-pilot will be assigned by the airline subject to the approval of the corporation. The pilot and the co-pilot assigned to the aircraft are under the corporation's exclusive control, subject to the discretion of the pilot and the co-pilot as to safety of operation. The corporation pays to the airline company the salaries of the flight

crew based on the established pay scale for the crew selected and approved. Moreover, the airline company maintains workmen's compensation and employees liability insurance on all its employees participating in, or in any way connected with, the operation of the aircraft.

Section 4261 of the Internal Revenue Code of 1954 imposes a tax upon the amount paid within the United States for taxable transportation of persons by rail, motor vehicle, water, or air within the United States.

It is held that, since the corporation owns the aircraft, has exclusive control over the aircraft's personnel, pays the operating expenses of the aircraft, and maintains liability and risk insurance and the airline operates the aircraft as an agent for the corporation, the airline company is not, with respect to this service, furnishing a transportation service for hire. Accordingly, the tax on the transportation of persons does not apply to amounts paid by the corporation to the airline company. Compare Revenue Ruling 57–545, C. B. 1957–2, 749, which holds that the tax on the transportation of persons is applicable to amounts paid by a company to an airline company for the lease of an aircraft, including the maintenance and operation thereof.

The views expressed herein are not inconsistent with those expressed in Revenue Ruling 56–608, C. B. 1956–2, 878, which holds that where a carrier operates a shipper's tank truck equipment with its own employees, under its own exclusive control, management, and supervision as an independent contractor, at its own expense, and not in the name of or as the agent for the shipper, the carrier furnishes a transportation service for hire, irrespective of the fact that the shipper owns the equipment in which its products is transported by the carrier. Therefore, in such a case the amounts paid to the carrier by the shipper are subject to the tax on the transportation of property.

Revenue Ruling 56–608, C. B. 1956–2, 878, distinguished.

PART II.—PROPERTY

SECTION 4271.—IMPOSITION OF TAX

Rev. Rul. 58–6

A logging contractor, in performing a complete logging operation, including transportation of the logs from the timber tract to a millpond, sawmill, or other designated place, is not a "person engaged in the business of transporting property for hire" within the meaning of section 4272(a) of the Internal Revenue Code of 1954. Therefore, payments for a complete logging operation are not subject to the tax on transportation of property. However, a person who as an independent contractor, contracts only for loading the logs and hauling them to a designated place is a "person engaged in the business of transporting property for hire," and payments for such loading and hauling are subject to the tax on transportation of property.

Advice has been requested concerning the applicability of the tax on transportation of property imposed by section 4271(a) of the Internal Revenue Code of 1954 to payments for the transportation of logs in connection with a logging operation.

A lumber company purchases tracts of standing timber from which it has all of the merchantable timber cut and delivered to its sawmill. The lumber company contracts with two logging contractors, each for performance of the complete logging operations as separate tracts. These operations include felling, topping, limbing, yarding, and skidding the logs to designated log dumps along the edge of the tracts, loading the logs from the log dumps onto trucks and transporting them to a millpond. In order to perform these operations, the logging contractors, at their own expense, must build access roads into the timber tracts, and also must build certain other roads over which the logs are hauled to the millpond. The lumber company owns the road building equipment but the logging contractors are responsible for its repair and maintenance. The logging contractors are paid a set price per thousand feet of logs delivered to the millpond.

A, one of the logging contractors, performs all of the logging operations from the cutting of the timber to the delivery of the logs at the millpond. *B*, the other logging contractor, performs only the logging operations up to and including delivery of the logs at the log dumps along the edge of the tract. *B* contracts with *C*, as an independent contractor, to load the logs from the log dump onto trucks owned and operated by *C* and to transport them to the millpond. *C* is required to build the necessary roads over which he hauls the logs and is responsible for the repair and maintenance of the lumber company's equipment used for this purpose. *B* pays *C* a set price per thousand feet of logs hauled.

Section 4271(a) of the Code imposes a tax upon the amount paid for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Section 4272(a) of the Code provides that the tax shall apply only to amounts paid to a person engaged in the business of transporting property for hire.

Section 143.1(b) of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "person engaged in the business of transporting property for hire" to include a common carrier, contract carrier, local moving or drayage concern, freight forwarder, express company, or other person transporting property for hire wholly or in part by rail, motor vehicle, water or air. That section defines the term "transportation" to mean the movement of property by a person engaged in the business of transporting property for hire.

Although transportation is an important part of a logging contractor's work in the performance of a complete logging operation, it is only one of a large number of important operations, and it is considered as being incidental to the performance of the complete logging operation. It is held that, in performing a complete logging operation, including the transportation of the logs by trucks to a millpond, sawmill, or other designated place, a logging contractor is not a "person engaged in the business of transporting property for hire" within the meaning of section 4272(a) of the Code. Accordingly, payments for such a complete logging operation are not subject to the tax on transportation of property.

However, where a logging contractor engages a subcontractor under circumstances which make him an independent contractor, to haul the logs which the logging contractor has cut and delivered to a

designated place, the subcontractor is a "person engaged in the business of transporting property for hire" within the meaning of the Code. Accordingly, payments received by the subcontractor are subject to the tax on transportation of property. The same is true where the lumber company contracts with a person who performs only the hauling and other services which are accessorial to the hauling. Furthermore, the cost incurred in building roads over which the logs are hauled and in maintaining and repairing equipment used for that purpose is not deductible from the contract price for hauling the logs in computing the transportation tax.

In the instant case, since both *A* and *B* contracted to perform the complete logging operations, no part of the payments to them by the lumber company are subject to the tax on transportation of property. However, since *C* contracted with *B* only for the loading and hauling operations, the entire amount paid by *B* to *C* is taxable.

Rev. Rul. 58-149

The tax on the transportation of property imposed by section 4271 of the Internal Revenue Code of 1954 applies to an amount paid to a carrier for weighing empty tank cars at the request of a shipper or consignee, regardless of whether the charge for such service is billed separately.

Advice has been requested whether the tax on the transportation of property applies to an amount paid by a shipper to a carrier for weighing empty tank cars.

A carrier billed a shipper for weighing an empty tank car before it was loaded for an outbound shipment. The weighing was performed at the request of the shipper to determine the exact weight of the tank car. The shipper also has had occasion to request the carrier to weigh inbound tank cars after they have been unloaded as an additional check on the weight of the contents of the tank car. The tariffs of the carrier provide that, when either an empty or a loaded car is weighed or reweighed at the request of the consignor or consignee, a charge will be made by the carrier for the weighing, switching, and/or spotting services performed in connection with each weighing. However, there will be no charge made by the carrier provided that (1) in the case of the reweighing of a car containing a commodity which is not subject to shrinkage from its inherent nature, the reweighing discloses error in the billed weight of more than the tolerance provided in the tariff, (2) in the case of the weighing or reweighing of an empty car, such weighing or reweighing discloses error in the tare weight in excess of the tolerance provided in the tariff and, (3) in the case where reweighing requires the weighing of both the loaded and empty car, the difference between the net weight obtained by the weighing and the previous net weight exceeds the tolerance provided in the tariff.

Section 4271(a) of the Internal Revenue Code of 1954 imposes a tax upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Under the provisions of section 143.1(d) of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47, the term "transportation" means the movement of property by a person engaged in the business of transporting property for hire, including interstate, intrastate, and

intracity or other local movements, as well as towing, ferrying, switching, etc. In general, it includes accessorial services furnished in connection with a transportation movement, such as loading, unloading, storage, demurrage, ventilation, refrigeration, icing, and similar services and facilities.

The weighing service requested by the shipper is primarily for the purpose of determining errors in the billed weight, tare weight, etc. Accordingly, it is held that such weighing service is an accessorial service furnished in connection with the prior or subsequent transportation of the commodity involved. Therefore, the amount paid to the carrier for such service, when furnished at the request of a shipper or consignee and in connection with a taxable transportation movement, is subject to the tax on the transportation of property, regardless of whether the charge is billed separately.

Rev. Rul. 58–150

The tax on the transportation of property imposed by section 4271 of the Internal Revenue Code of 1954 does not apply to amounts charged to milk producers by a milk processing company for hauling milk, in trucks which it owns and operates, from the producers' farms to its processing plant.

The Internal Revenue Service has been asked whether the tax on the transportation of property applies to amounts charged to milk producers by a milk processing company for hauling milk from the producers' farms to its processing plant.

A company is engaged in the manufacture and sale of dairy products. In connection with the manufacture of its products, the company purchases milk from producers and hauls the milk, in trucks which it owns and operates, from the various farms to its own plant for processing. Upon arrival at the company's plant, the milk is weighed and tested. If the milk meets certain prescribed standards, the company accepts the milk and credits the farmer's account. A charge for hauling the milk is computed on the basis of the rate per hundred-weight applicable to milk hauled in that particular area and such charge is deducted from the gross amount due the producer for milk purchased during each month.

Section 4271 of the Internal Revenue Code of 1954 imposes a tax upon the amount paid for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Section 4272(a) of the Code provides that the tax applies only to amounts paid to a person engaged in the business of transporting property for hire. The tax is payable by the person making the taxable transportation payment and is collectible by the person receiving such payment.

Section 143.1(b) of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "person engaged in the business of transporting property for hire" to include a common carrier, contract carrier, local moving or drayage concern, freight forwarder, express company or any other person transporting property for hire wholly or in part by rail, motor vehicle, water or air.

In the instant case, it is held that since the milk processing company purchases milk from producers and hauls the milk to its own plant in

trucks which it owns and operates, and the milk is necessary to the conduct of the processing company's business, such hauling is merely incidental to the company's processing business. Accordingly, the processing company is not considered to be a "person engaged in the business of transporting property for hire" within the meaning of section 4272(a) of the Code with respect to such hauling. Therefore, the tax on the transportation of property is not applicable to the amounts charged by the processing company to the farmers for such hauling services. See Revenue Ruling 55–752, C. B. 1955–2, 466, which relates to the trucking by a cooperative association of its members' produce to its general retail store.

(Also Section 4272.) Rev. Rul. 58–157

For purposes of the tax on transportation of property, a person who transports property for others as a regular practice and makes a charge therefor is considered to be engaged in the business of transporting property for hire, even though such business may not constitute his principal means of livelihood.

Advice has been requested whether the tax on the transportation of property applies to amounts paid to a person for transporting property, even though such hauling does not constitute his principal business or means of livelihood.

Illustratively, a publishing firm contracts with individuals, who have other means of livelihood, to transport newspapers from its plant to adjoining towns. Those individuals transport the newspapers daily in their own personal automobiles. Similarly, a farmer hauls milk for his neighbors to a creamery as a regular practice and makes a charge therefor.

Section 4271(a) of the Internal Revenue Code of 1954 imposes a tax on the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Section 4272(a) of the Code provides, in part, that the tax imposed on the transportation of property shall apply only to amounts paid to a person engaged in the business of transporting property for hire.

It is held that if a person transports property for others as a regular practice and makes a charge therefor, he is considered to be engaged in the business of transporting property for hire even though such business may not constitute his principal business or means of livelihood. Accordingly, the tax on the transportation of property imposed by section 4271(a) of the Code properly applies to the amounts paid for transporting property in each of the examples mentioned above.

Rev. Rul. 58–159

The tax on transportation of property does not apply to amounts paid to a moving and storage company, which transports office effects and equipment from one location to another, for the services of (1) tagging and marking effects prior to removal, (2) planning of removal, (3) packing effects prior to removal, (4) marking of floors for equipment at destination, (5) unpacking and arranging effects after removal, and (6) installing appliances after movement to the new location, if such charges are shown separately on the invoices. The tax does not apply to amounts paid for unloading effects from another carrier's vans if the moving company does not

transport the effects, but does apply if unloaded from the van into the moving company's trucks for further transportation.

Advice has been requested concerning the applicability of the tax on transportation of property to amounts paid for certain services performed by the carrier in connection with the moving of office effects and equipment from on location to another.

A moving and storage company contracted with a business firm to perform the complete moving operations of the firm's office effects and equipment from several separate locations to a new location. In addition to the actual transportation of the effects, the moving and storage company was required to furnish the following related services; (1) tagging and marking effects prior to removal, (2) planning of removal, (3) packing effects prior to removal, (4) marking of floors for equipment at destination, (5) unpacking and arranging effects after removal, and (6) installing appliances after movement to the new location. The contract also included the unloading of additional equipment from vans owned and operated by a trucking company. Some of the equipment delivered by these vans was unloaded by the moving and storage company at the firm's new location, and the remainder was unloaded from the vans into the moving and storage company's own trucks and delivered to a warehouse. The charges for the various services rendered by the moving and storage company are listed as separate items on the invoices.

Section 4271 of the Internal Revenue Code of 1954 imposes a tax upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another, with certain exceptions not here applicable. Under section 4272 of the Code, the tax applies only to amounts paid to a person engaged in the business of transporting property for hire.

Section 143.1 (d) of Regulations 113, made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "transportation" means the movement of property by a person engaged in the business of transporting property for hire, including interstate, intrastate, and intra-city or other local movements. In general, the term includes accessorial services furnished in connection with a transportation movement, such as loading, unloading, storage, handling, and similar services and facilities.

M. T. 15, C. B. 1943, 1158, holds that amounts paid for packing and unpacking, or crating and uncrating, occurring before and after a transportation movement, are not taxable if the charges therefor are billed separately. Also, see Rev. Rul. 55–126, C. B. 1955–1, 536.

It is held that, under the circumstances described above, the services of (1) tagging and marking effects prior to removal, (2) planning of removal, (3) packing effects prior to removal, (4) marking of floors for equipment at destination, (5) unpacking and arranging effects after removal, and (6) installing appliances after movement to the new location, are not accessorial to the transportation movement performed by the moving and storage company in moving the firm's office effects and equipment to the new location. Therefore, the amounts paid for these services are not subject to the tax on transportation of property, provided the charges are shown as separate items on the invoices. Likewise, the tax does not apply to amounts paid to the moving and storage

company for unloading equipment from the vans of another company at the firm's new location, provided the moving and storage company does not transport the property. However, where the property is unloaded from such vans into the moving and storage company's trucks and is transported by such trucks to another location, the unloading is accessorial to the taxable transportation movement furnished by the moving and storage company. In the latter case, the amount paid for unloading, as well as the amount paid for transporting the property involved, is taxable.

Rev. Rul. 58–160

Amounts paid to a trucking company for frozen food warehouse, assembly, and clerical services are not considered to be accessorial to a transportation movement and, therefore, are not subject to the transportation of property tax imposed by section 4271 of the Internal Revenue Code of 1954.

The Internal Revenue Service has been asked whether, under the facts stated below, the amounts paid by a retail grocer to a trucking company for frozen food warehouse, assembly, and clerical services are subject to the tax on the transportation of property.

A trucking company has a contract with several retail chain food stores under which it performs transportation services. Under a separate contract, the trucking company performs so-called "other services" for these customers. These "other services" consist of frozen food warehousing, assembly, and clerical service in which the stocks of frozen foods that are owned principally by packers are stored and made available for an assembly operation whereby orders from retail chain food stores are assembled from these frozen food stocks.

To perform these services, the trucking company leases space in a public cold storage warehouse wherein serveral frozen food packers store large quantities of their products. This leased space, which is known as a "break-up" room, is used for storage and for the assembly of orders of frozen foods received from the retail grocers. The trucking company receives orders for the frozen foods from the retail grocers on specially designed order forms furnished by the trucking company. Merchandise is selected from the "break-up" room stock to fill those orders. The merchandise is brought to the loading platform after it has been assembled, checked, and marked to fill a particular order. Title to the products remains in the packer until they are loaded onto trucks for delivery to the grocer. The packer is advised by the trucking company of the quantities of his products that have been delivered to each of the retail grocers. The packer then bills each grocer directly for that merchandise. At the end of each week, the trucking company bills the grocer for the warehousing while the goods were in the break-up room, and for the assembly, and clerical services furnished, and makes a separate charge for the delivery of the order to the retail store.

Restocking of the "break-up" room is based upon estimated needs for filling the next day's orders. The merchandise is usually withdrawn from the public portion of the warehouse in standard warehouse pallet loads. Some items may remain in the "break-up" room for an indeterminate period of time depending upon orders from retail grocers. One of the customers has in its warehousing service agree-

ment with the trucking company a provision requiring the trucking company to maintain stockpiles. Some of the merchandise which has been transferred from the public portion of the warehouse to the "break-up" room may be hauled by the customer or some other carrier after it has been assembled by the trucking company. Since the products moved to the "break-up" room are not intended for sale to a particular customer, the sale of the products by the packers does not occur at this time. Therefore, the stocks in the "break-up" room are still the property of the packers and the trucking company assumes a warehouseman's responsibility to the packers for all the merchandise in the "break-up" room.

Section 4271 of the Internal Revenue Code of 1954 imposes a tax upon the amounts paid for the transportation of property by rail, motor vehicle, water, or air, from one point in the United States to another. The tax is payable by the person making the taxable transportation payment and is collectible by the person receiving such payment. Section 143.1(d) of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "transportation" as used in the statute and regulations to mean the movement of property by a person engaged in the business of transporting property for hire, including interstate, intrastate, and intracity or other local movements. In general, it includes accessorial services furnished in connection with a transportation movement, such as loading, unloading, storage, handling and similar services and facilities.

The services described above are not merely assembling services but are actually a specialized type of warehouse service. The services furnished include the assembling of frozen foods to fill orders for delivery to retailers, but are much broader in scope than the assembling services normally furnished by a carrier. This is established by (1) the fact that the trucker does not merely withdraw from the public warehouse the quantity of merchandise necessary to fill orders on hand but withdraws on the basis of estimates of retailers needs and usually in standard warehouse pallet loads and stores such products in the "break-up" room until needed to fill particular orders, (2) the fact that the trucking company assumes a warehouseman's responsibility to the packers for all frozen foods withdrawn from the public portion of the cold storage warehouse and placed in the break-up room regardless of whether such merchandise is to be delivered by it or by another carrier, and (3) the nature and purpose of the records maintained by the trucking company.

Accordingly, it is held that the warehousing, assembling, and clerical services, described above, performed by the trucking company are not considered accessorial to the delivery services which it performs and the separate charges billed therefor are not subject to the tax on the transportation of property imposed by section 4271 of the Code.

Rev. Rul. 58–205

Where, under a reciprocal agreement between cotton warehouses, a warehouse receives carloads of "mixed cotton" and drays that portion of the cotton consigned to other warehouses to the receiving warehouses, such warehouse is, to the extent that it performs drayage services for other warehouses, "a person engaged in the business

of transporting property for hire" within the meaning of section 4272(a) of the Internal Revenue Code of 1954. Accordingly, amounts paid for the drayage services are subject to the tax on transportation of property imposed by section 4271(a) of the Code.

Advice has been requested whether the tax on transportation of property applies to payments made to a cotton warehouse for drayage services rendered under the circumstances described below.

The *M* company is engaged in the storage, compression, and handling of cotton. In the course of its business, *M* receives and unloads carloads of cotton for which it receives allowances from the railroads. Among the cars received are a few carloads of "mixed cotton," which means that a portion of the cotton is destined for other warehouses. Under a reciprocal agreement between *M* and other cotton warehouses, such cars are placed at the warehouse to which is consigned the greatest portion of the cotton. That warehouse unloads all the cotton, and loads that cotton consigned to other warehouses on drays and hauls it to the receiving warehouses. The receiving warehouse pays to the warehouse which performs the drayage a fixed drayage charge for each bale of cotton received.

Section 4271(a) of the Internal Revenue Code of 1954 imposes a tax upon the amount paid for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Section 4272(a) of the Code provides that the tax applies only to amounts paid to a person engaged in the business of transporting property for hire. Section 143.1(b) of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "person engaged in the business of transporting property for hire" to include a common carrier, contract carrier, local moving or drayage concern, freight forwarder, express company or any other person transporting property for hire wholly or in part by rail, motor vehicle, water or air.

On the basis of the facts stated above, it is held that, since *M's* drayage of cotton consigned to other warehouses under the reciprocal agreement is not incidental to *M's* business of storing, compressing, and handling cotton, *M* is, to the extent that it performs the drayage of cotton to other warehouses, "a person engaged in the business of transporting property for hire" within the meaning of section 4272(a) of the Code. Accordingly, amounts paid to *M* for such drayage services are subject to the tax on transportation of property imposed by section 4271(a) of the Code.

Rev. Rul. 58–206

Where a shipper obtains his own cargo insurance protection and is given an allowance therefor by the carrier, the excise tax on the transportation of property, imposed by section 4271(a) of the Internal Revenue Code of 1954, applies to the actual amount paid by the shipper after the deduction for the insurance allowance.

Advice has been requested concerning the proper handling of a shipper's insurance allowance with respect to the computation of the excise tax on the transportation of property.

A carrier provides transportation services which ordinarily include cargo insurance protection paid for by the carrier, such costs being included in the charge made for transportation. However, several

shippers obtain their own insurance protection. In such instances, the carrier makes a percentage deduction, called an insurance allowance, from the transportation charge.

Section 4271(a) of the Internal Revenue Code of 1954 imposes a tax upon the amount paid for the transportation of property by rail, motor vehicle, water, or air, from one point in the United States to another.

In the instant case, where the carrier includes insurance protection as a part of the transportation service he furnishes, the tax applies to the entire amount paid to the carrier for that service, without any reduction for that portion of the amount charged by the carrier to cover his cost of the insurance. However, where the shipper obtains his own insurance, the carrier is, in effect, providing the transportation service without insurance protection, and the tax should be based upon the actual amount paid by the shipper for that transportation service.

Therefore, it is held that where the shipper obtains his own cargo insurance protection, and in turn is given an allowance therefor by the carrier, the excise tax on the transportation of property applies to the actual amount paid by the shipper after the deduction for the insurance allowance.

Rev. Rul. 58–227

The excise tax on transportation of property, imposed by section 4271(a) of the Internal Revenue Code of 1954, does not apply to payments for the transportation of export shipments made on commercial bills of lading to a port of exportation in fulfillment of a contract with the Armed Services, provided evidence is submitted to the carrier when the transportation charges are paid which will establish the exempt character of the transportation.

Mimeograph 5987, C. B. 1946–1, 300, revoked.

The Internal Revenue Service has been asked whether Mimeograph 5987, C. B. 1946–1, 300, relating to the applicability of the excise tax on the transportation of property to export shipments consigned on commercial bills of lading to Army or Navy officers at the ports of exportation, is affected by the decision in the case of *G. W. Powers and Ida Powers*, d/b/a *Powers Produce Company* v. *United States*, decided February 8, 1956, by the United States District Court for the District of Minnesota, Fourth Division, Civil Action No. 5155, 565 C. C. H. 9358; 1956 P–H 44,292.

Mimeograph 5987 states that in some cases the War and Navy Departments require the inclusion of the tax on transportation of property in the price fixed by a prime contract (including related subcontracts) in respect of an export shipment made on a commercial bill of lading consigned to an Army or Navy officer at a port of exportation. In other cases, the transportation tax is expressly excluded from the contract price by the terms of the contract.

Mimeograph 5987 held that an export shipment made on a commercial bill of lading consigned to an Army or Navy officer at a port of exportation is not exempt from the transportation tax where the shipment is made pursuant to a contract of the War or Navy Department which expressly provides for inclusion of such tax in the contract price. However, such a shipment is exempt from the trans-

portation tax where the contract expressly provides for the exclusion of such tax from the contract price.

In the *Powers* case, the Army Quartermaster located in Chicago issued to Powers contracts for the purchase of eggs for export. The contracts provided that (a) all of the eggs were to be of standard export grade, (b) the eggs were to be "packed and marked for overseas," (c) the eggs were to be shipped to property officers in Quartermaster Market Centers of the United States Army in various ports of exportation in the United States, and (d) the terms of delivery to the carrier should specify that the eggs were being shipped for "export storage in transit." All of the shipments were consigned on commercial bills of lading to Army property officers in various seacoast ports in the United States.

The court said that all of the shipments were intended to be exported by the Department of the Army and were, in fact, sent to overseas destinations and possessions of the United States other than Alaska and Hawaii; that there was no break in the course of exportation of any of the shipments, and such shipments from the date of their delivery by the plaintiffs to the original carrier until the date of their arrival at their ultimate destination overseas were in one continuous course of exportation. In that case the transportation tax had been paid. The court held that the plaintiffs were entitled to a refund of the taxes which they had paid on the shipments.

Section 4271(a) of the Internal Revenue Code of 1954 imposes a tax on the amount paid for the transportation of property, except coal, by rail, motor vehicle, water, or air from one point in the United States to another.

Section 143.30 of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the tax will not apply to an amount paid for transportation of property in course of exportation to a foreign destination, or shipment to a possession of the United States, in accordance with the applicable requirements of these regulations. Property will be considered to be in course of exportation from the time of delivery to a carrier in the United States for transportation by continuous movement to a point beyond the boundaries of the United States. The term "United States" means the States, the Territories of Alaska and Hawaii, and the District of Columbia.

Section 143.33 of the regulations provides that an amount paid for an export shipment not made on a through bill of lading, a through export bill of lading, or a domestic bill of lading showing the name of the foreign consignee and the ultimate foreign destination, will be exempt from the transportation tax, provided (1) the shipment is covered by an Export Exemption Certificate, Form 1363, and (2) proof of exportation is obtained as required by section 143.34 of the regulations.

It is held that property which under Armed Services contracts is intended for export and is shipped on commercial bills of lading to a port of exportation in fulfillment of such contract is considered to be in the course of exportation from the time of delivery to the carrier in the United States until delivered to overseas destinations, other than Alaska or Hawaii. Accordingly, amounts paid for such transportation are not subject to the transportation tax, provided evidence

is submitted to the carrier in the United States when the transportation charges are paid which will clearly establish the exempt character of the transportation. The exempt character of the transportation is not governed by any provision in the contract which requires the inclusion of the tax in the contract price or the exclusion of the tax from the contract price.

Where export shipments made on commercial bills of lading in fulfillment of an Armed Services contract are consigned to an Army, Navy, or other Armed Services officer at the designated port of exportation, such shipments will be exempt from the tax, provided the person paying the transportation charges files with the carrier at the time such charges are paid an Export Exemption Certificate, Form 1363, modified by entering across the bottom thereof the following statement:

Shipped under prime contract No. ——— for export.

In such case, further evidence of actual exportation will not be required. See Rev. Rul. 57–338, C. B. 1957–2, 755.

However, where export shipments made in fulfillment of an Armed Services contract are not consigned to an Army, Navy or other Armed Services officer at the port of exportation, the export requirements of the regulations must be fully complied with.

Mimeograph 5987, C. B. 1946–1, 300, is hereby revoked.

SECTION 4272.—EXEMPTIONS

Rev. Rul. 58–83

Where a truck broker (1) does not contract with the shipper to transport property or assume primary responsibility for such transportation, (2) is not liable for payment of the trucker's charges, and (3) receives remuneration only from the trucker, he is not considered to be "a person engaged in the business of transporting property for hire" within the meaning of section 4272 of the Internal Revenue Code of 1954.

Rev. Rul. 54–54, C. B. 1954–1, 273, modified.

Advice has been requested whether a truck broker who performs the services described below is considered to be a person engaged in the business of transporting property for hire.

A truck broker solicits business by advertising in trade publications, by distributing calendars and scratch pads, and by placing notices in various meeting places of truckers. He does not own or operate any transportation equipment. When a shipper contacts the broker describing the goods to be transported and the destination, the broker informs the shipper of the "going rate" being asked and received by truckers. If the rate is satisfactory, the shipper states the time and place the trucker is to pick up the merchandise. The broker then contacts a trucker and set forth the conditions of the shipment. If the conditions are unsatisfactory to the trucker and the broker is unable to locate other truckers to perform the transportation, the shipper has the alternative of offering an increased rate or contacting another broker.

Where the trucker agrees to the conditions of the shipment, he signs the bill of lading given to the shipper, which is furnished by the broker or the shipper. On a prepaid shipment, the broker collects

the amount of the transportation charge and the excise tax from the shipper, deducts his commission, and, after receiving a receipt from the trucker showing delivery and acceptance of the shipment by the consignee, pays the trucker the amount agreed upon. In the case of a collect shipment, the trucker normally pays the broker's commission in advance and collects the amount of the transportation charge and the tax from the consignee. In some instances, the consignee is instructed by the broker to forward directly to the broker an amount which covers the commission and to pay the balance to the trucker. The broker receives no remuneration from the shipper or the consignee, but collects his commission from the trucker's charges.

There is no written agreement between the broker and the shipper, but the broker expressly or impliedly agrees to indemnify the shipper against any loss resulting to the shipper from the failure of the trucker to perform and deliver the load on time and in good condition. In the event of loss, the shipper is paid by the broker. However, the bill of lading normally provides that the trucker assumes full responsibility for any and all loss or damage of any nature whatever to the load while in his possession and until delivery to the consignee at destination, as well as any loss occasioned by delay. In some cases, the trucker executes a receipt for the merchandise in good condition and guarantees to deliver the load free from damage; in others, the trucker merely states that he is fully insured to cover the shipment.

Section 4271(a) of the Internal Revenue Code of 1954 imposes a tax upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another.

Under the provisions of section 4272(a) of the Code, the tax applies only to amounts paid to a person engaged in the business of transporting property for hire. Section 143.1(b) of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "person engaged in the business of transporting property for hire" to include a common carrier, contract carrier, local moving or drayage concern, freight forwarder, express company, or other person transporting property for hire wholly or in part by rail, motor vehicle, water or air.

It is held that the term "person engaged in the business of transporting property for hire" for the purpose of the tax imposed by section 4271(a) of the Code applies only to a person who actually transports the property or to one who contracts to transport property for compensation and assumes the responsibility for such transportation but who assigns the transportation to another to perform. Since the truck broker in the instant case (1) does not contract with the shipper to transport the property or assume primary responsibility for such transportation, (2) is not liable to the trucker for payment of the trucker's charges, and (3) receives a commission payable by the trucker as the only remuneration for the services he performs, he is not considered to be "a person engaged in the business of transporting property for hire" within the meaning of section 4272(a) of the Code. Accordingly, he is not liable for reporting and remitting the transportation tax to the Government. However, where the transportation charge is paid to the truck broker, he is required to collect

the transportation tax from the person making the payment and to forward such tax to the trucker. See Revenue Ruling 55–501, C. B. 1955–2, 469, which sets forth a similar conclusion with respect to a trucking exchange.

Revenue Ruling 54–54, C. B. 1954–1, 273, is modified to the extent that it defines the term "person engaged in the business of transporting property for hire" to include not only a carrier who actually transports the property but also a person who holds himself out to the public as one who for compensation sells, provides, procures, furnishes, or arranges for the transportation of property.

Whether a person who transports property for others as a regular practice is considered to be engaged in the business of transporting property for hire, even though such hauling does not constitute his principal business or means of livelihood. See Rev. Rul. 58–157, page 444.

PART III.—OIL BY PIPELINE

SECTION 4281.—IMPOSITION OF TAX

Rev. Rul. 58–314

Where butane and propane, under pressure, are transported in liquid form through a pipeline, the transportation is subject to the excise tax imposed by section 4281 of the Internal Revenue Code of 1954 on the transportation of oil by pipeline.

Advice has been requested whether the excise tax on the transportation of oil by pipeline applies to the transportation, by pipeline, of butane or propane.

A company which sells and delivers butane and propane to some of its customers in small containers and cylinders also sells and delivers such products to other customers by means of a pipeline. The company maintains storage tanks at several strategic points along the pipeline system. These petroleum products, liquefied by pressure, are put into these tanks from railroad tank cars and motor transports. They are then moved in liquid form through the pipeline to various customers, either commercial or residential, who have individual storage tanks and heating or cooking units connected to the pipeline system. When the valves of the heating units are opened, the liquid is released from pressure and is thereby converted into a gas to be used for heating or cooking purposes. The complete charge for the gas and service is based on individual meters. No separate charge is stated for the transportation movement by pipeline.

Section 4281 of the Internal Revenue Code of 1954 imposes a tax on the amount paid for transportation of crude petroleum and liquid products thereof by pipeline. That section further provides that if no charge is made for transportation by pipeline, either by reason of ownership of the commodity transported or for any other reason, then such tax shall be imposed on the fair charge for such transportation. The tax is to be paid by the person furnishing the transportation.

475254°—58——30

Section 4282 of the Code provides that the fair charge for transportation shall be computed (1) from actual bona fide rates or tariffs; or (2) if no such rates or tariffs exist, then on the basis of the actual bona fide rates or tariffs of other pipelines for like services, as determined by the Secretary of the Treasury or his delegate; or (3) if no such rates or tariffs exist, then on the basis of a reasonable charge for such transportation, as determined by the Secretary or his delegate.

Since butane and propane are products of crude petroleum, it is held that where, as in the instant case, they are transported by pipeline in liquid form their transportation is subject to the excise tax imposed by section 4281 of the Code. In the absence of a separate charge for such transportation, the tax should be computed in accordance with the provisions of section 4282 of the Code.

SUBCHAPTER E.—SPECIAL PROVISIONS APPLICABLE TO SERVICES AND FACILITIES TAXES

SECTION 4291.—CASES WHERE PERSONS RECEIVING PAYMENT MUST COLLECT TAX

(Also Sections 6601, 6651; 26 CFR 301.6601-1.) Rev. Rul. 58-300
(Also Part V, 26 CFR 601.403.)

Where a "taxpayer" refuses to pay so-called "collected" excise taxes to a collecting agency and the tax is to be assessed directly against the "taxpayer," there will be no basis for assertion of a delinquent filing penalty. However, interest on the amount of unpaid tax will be assessed from the date the tax should have been paid to the collecting agency to the date when payment of the tax is made by the "taxpayer."

Procedures pertaining to the "collected" excise taxes whereby direct assessment may be made against a "taxpayer" who refuses to pay the tax to a collecting agency.

Advice has been requested concerning the penalties and interest which are applicable in cases where a "taxpayer" refuses to pay any of the so-called "collected" excise taxes to a collecting agency and the tax is to be assessed directly against such "taxpayer." The Internal Revenue Service has also been asked to explain the procedure to be followed in making an assessment directly against such "taxpayer" in the examples described below.

Example 1. A shipper refused to pay the excise tax on the payments made for transportation of property and the carrier, being unable to collect the tax, reports such information to the Director of Internal Revenue for the district in which its returns are filed.

Example 2. A sporting club is unable to collect the tax on all amounts paid as dues and initiation fees from its members inasmuch as some members refuse to pay the tax. The club informs the District Director that it has been unable to collect the full amount of the tax.

The term "collected" excise taxes refers to those miscellaneous excise taxes imposed on the person making the taxable payment for certain facilities and services and which are collectible by the person receiving such payment. This classification includes the excise taxes on communications, admissions, club dues and initiation fees, leases

of safe deposit boxes, and the transportation of persons and of property.

Section 4291 of the Internal Revenue Code of 1954 provides, with a certain exception not here in issue, that every person receiving any payment for facilities or services on which a tax is imposed upon the payor thereof under Chapter 33 of the Code, shall collect the amount of the tax from the person making such payment. The collecting agency is then required by regulations to file returns and pay the tax to the government. Section 6601(a) of the Code provides that if any amount of tax imposed by the Code (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of six percent per annum shall be paid for the period from such last date to the date paid. Section 6601(c)(4) of the Code provides that in the case of taxes payable by stamp and in all other cases in which the last date for payment is not otherwise prescribed, the last date for payment shall be deemed to be the date the liability for tax arises. Section 6651 of the Code imposes a penalty for failure to file certain tax returns required by the Code or regulations, including those returns required to be filed to report the "collected" excise taxes.

It is held that the date the liability for a "collected" tax arises is the date on which the taxpayer makes payment to the collecting agency for the services rendered. Accordingly, where a direct assessment is made against a taxpayer of such a tax incurred on and after January 1, 1955 (the effective date of the 1954 Code with respect to excise taxes), interest on the amount assessed is due from the date the tax should have been paid to the collecting agency until payment of the tax is made. Since it is the collecting agency which must file the tax returns, the "taxpayer" is under no duty to file a return. Therefore, it is further held that in nonpayment cases where the tax is to be assessed directly against the "taxpayer," there will be no basis for assertion of a delinquent filing penalty.

In accordance with section 601.403(c)(2) of the Statement of Procedural Rules, C. B. 1955–2, 921, if the person from whom the tax is required to be collected refuses to pay it, or if for any reason it is impossible for the collecting agency to collect the tax from such person, the collecting agency is required to report to the District Director of Internal Revenue for the district in which its returns are required to be filed the name and address of such person, the nature of the service or facility provided, the amount paid therefor, and the date on which paid. This section further provides that upon receipt of the above information, the tax due will be assessed against the person for whom the facilities were provided or the services rendered.

In any case involving "collected" excise taxes where the person liable for paying the tax has refused to make payment to the collecting agency, the District Director will proceed against such person by following generally the prescribed procedures applicable to other excise tax cases, but usually utilizing office audit methods. Before a direct assessment is made, the taxpayer will be accorded all of the privileges to which other excise taxpayers are entitled, such as the right to execute an agreement form, the right to an informal conference, the right of protest, and the opportunity for consideration

of the case before the Regional Appellate Division, unless the tax is in jeopardy.

Thus, in the first example described above, the District Director, if he determines the tax to be due, will proceed pursuant to established procedures to make a direct assessment against the shipper for the amount of the unpaid transportation tax, plus applicable interest accruing from the date the payment was made by the shipper to the carrier for the services rendered. Likewise, in the second example, the District Director will follow established procedures in making direct assessments against the individual club members for the amounts of unpaid tax on club dues and initiation fees, plus interest accruing from the dates the respective payments of dues or fees were made by the members to the club. The procedures followed by the Service prior to entering a direct assessment in these cases is applicable with respect to all "collected" excise taxes and applies equally in cases arising as a result of examinations of collecting agencies by internal revenue agents.

SECTION 4292.—STATE AND LOCAL GOVERNMENTAL EXEMPTION

(Also Sections 4055, 4224.) Rev. Rul. 58-61

The Connecticut River Valley Flood Control Commission is an instrumentality of the participating States and, therefore, comes within the scope of the exemptions from certain excise taxes provided by sections 4055, 4224, and 4292 of the Internal Revenue Code of 1954.

Advice has been requested whether The Connecticut River Valley Flood Control Commission comes within the scope of the exemptions from certain Federal excise taxes provided with respect to transactions with states and other local governmental units.

The Connecticut River Valley Flood Control Commission was created and is operated under the Connecticut River Flood Control Compact as a joint and common agency of the Commonwealth of Massachusetts and the States of Connecticut, New Hampshire, and Vermont. The compact, which has been approved by the legislatures of each State and by the Congress of the United States, provides that the Commission shall constitute a body, both corporate and politic. The purpose of the Commission is to accomplish the object of flood control and water resources utilization in the basin of the Connecticut River and its tributaries. The individual members of the Commission are chosen by their respective States and the compensation of the members is fixed, determined, and paid by the State which they represent. The Commission's funds, out of which are paid all of its operating expenses, come from appropriations made for that purpose by the legislature of each of the four participating States. The Commission is required to make an annual report to the governor and legislature of each of the states setting forth in detail the operations and transactions conducted by it pursuant to the compact.

Sections 4055 and 4224 of the Internal Revenue Code of 1954 provide that the retailers and manufacturers excise taxes will not apply to the sale of any article for the exclusive use of any State, Territory

of the United States, or any political subdivision of the foregoing, or the District of Columbia.

Section 4292 of the Code provides that no tax shall apply to payments received for communication and transportation services and facilities furnished to the government of any State, Territory of the United States, or to any political subdivision of the foregoing, or the District of Columbia. That section also provides that the tax shall not be imposed upon amounts paid for the transportation of property to or from such governmental units.

These state and local governmental exemptions apply to the Federal excise taxes tabulated below along with the applicable sections of the regulations which prescribe the manner of establishing the right to the exemptions. Those regulations issued under the Internal Revenue Code of 1939 have been made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47.

Tax	Exemption section of Code	Applicable regulations
(1) Retailers	Sec. 4055	Regs. 51, Sec. 320.20. Regs. 119, Sec. 324.30.
(2) Manufacturers	Sec. 4224	Regs. 44, Sec. 314.24. Regs. 46, Sec. 316.24.
(3) Communications	Sec. 4292	Regs. 42, Sec. 130.44.
(4) Transportation of persons.	Sec. 4292	Sec. 42.4292–1 of the Facilities and Services Excise Tax Regulations.
(5) Transportation of property.	Sec. 4292	Regs. 113, Sec. 143.24.

It is held that the Connecticut River Valley Flood Control Commission is an instrumentality of the participating States and, therefore, comes within the scope of the exemptions set forth above.

Whether the North Jeffco Metropolitan Recreation District of Colorado comes within the scope of the exemptions relating to state and local governmental units. See Rev. Rul. 58–59, page 428.

Whether state associations of municipalities come within the scope of exemptions from certain Federal excise taxes provided with respect to transactions with states and local governmental units. See Rev. Rul. 58–156, page 389.

PART II.—ISSUANCE OF CERTIFICATES OF INDEBTEDNESS

SECTION 4311.—IMPOSITION OF TAX

(Also Section 4313.) Rev. Rul. 58–49

A mere agreement to change a mortgage bond arrangement so as to make payments on a first and a second mortgage on the same date does not constitute such a material change in the mortgage bond as to make it taxable as a new issue under sections 4311 and 4313 of the Internal Revenue Code of 1954.

Advice has been requested whether an agreement to change a mortgage bond arrangement so as to make payments on a first and a second mortgage on the same date constitutes such a material change as to make the mortgage bond taxable as a new issue under sections 4311 and 4313 of the Internal Revenue Code of 1954.

In the instant case, a loan, evidenced by a bond and mortgage, was made for the purpose of expanding the facilities of a certain institution. An additional loan was made for the same purpose which also was evidenced by the borrower's bond and secured by a second mortgage. Documentary stamps were affixed to both bonds. An agreement was made between the institution and the mortgagee whereby the payments on the first mortgage and the second mortgage were to be made on the same day. The agreement was limited to this one change in the terms of the bonds and mortgages. The maturity dates of the bonds were not extended.

Section 4311 of the Code provides that a tax shall be imposed on all certificates of indebtedness issued by a corporation. Section 4313 of the Code provides that every renewal of any certificate of indebtedness shall be taxed as a new issue.

It is held that a mere agreement to make payments on a first and a second mortgage on the same date does not constitute such a material change in the mortgage bond as to make it taxable as a new issue under sections 4311 and 4313 of the Code.

SECTION 4313.—RENEWALS

Whether an agreement to make payments on a first and second mortgage on the same date makes it taxable as a new issue. See Rev. Rul. 58–49, page 457.

SUBCHAPTER B.—SALES OR TRANSFERS OF CAPITAL STOCK AND CERTIFICATES OF INDEBTEDNESS OF A CORPORATION

PART I.—SALES OR TRANSFERS OF CAPITAL STOCK AND SIMILAR INTERESTS

SECTION 4321.—IMPOSITION OF TAX

(Also Sections 4331, 4342, 4343.) Rev. Rul. 58–73

In the State of New York the transfer of securities from a donor to a custodian of a minor constitutes a transfer of legal title to the minor and is, therefore, subject to the documentary stamp tax imposed by sections 4321 and/or 4331 of the Internal Revenue Code of 1954. The subsequent transfer of such securities from the custodian to the minor upon the latter's attaining his majority is exempt from the documentary stamp taxes by section 4343(a) of the Code.

Advice has been requested concerning the applicability of the documentary stamp tax to the transfer of securities from a custodian, under Article 8–A of the Personal Property Law of New York, to a minor upon the minor's attaining the age of 21 years.

Sections 4321 and 4331 of the Internal Revenue Code of 1954 impose a tax on the sale or transfer of shares of stock and certificates of indebtedness, respectively.

Section 4342(2)(A) of the Code provides that the taxes imposed by sections 4321 and 4331 of the Code shall not apply to any delivery or transfer from the owner to a custodian if, under a written agreement between the parties, such instruments are to be held or disposed of by such custodian for, and subject at all times to the instructions of, the owners; or from such custodian to such owner.

Section 4343(a)(2) of the Code provides that the taxes imposed by sections 4321 and 4331 of the Code shall not apply to any delivery or transfer from a minor to his guardian, or from a guardian to his ward upon attaining majority.

Section 4344 of the Code provides that no exemption shall be granted under section 4342 or 4343(a) of the Code unless the delivery or transfer is accompanied by an exemption certificate.

Article 8–A of the Personal Property Law of New York provides that a gift of securities to a minor in the manner prescribed by the statute irrevocably conveys to the minor indefeasibly vested legal title to the securities. The law also provides that all registered securities held by the custodian shall be registered in his name followed by the words "as custodian for *X*, a minor under article eight–a of the personal property law of New York." When the minor attains the age of 21 years, all property held by the custodian shall be delivered to the minor, and if the minor dies before attaining the age of 21 years the property must be delivered to the estate of the minor. The custodian holds "a power in trust" over the subject matter of the gift and also has the power to hold, manage, invest, and reinvest the property, collect the income therefrom and apply so much of the income and so much of the other property as he may deem advisable for the support, maintenance, education, and benefit of the minor.

The terms of the New York statute indicate clearly that the custodian has discretionary power in the management of the securities and is not a mere custodian within the meaning of the Code. Accordingly, the transfer of the securities from the donor to the custodian is not exempt from the tax under section 4342(2)(A) of the Code. However, the term "guardian" as used in section 4343(a)(2) of the Code is broad enough to comprehend the custodian relationship defined by Article 8–A of the New York statute.

Therefore, it is held that the transfer tax imposed by section 4321 and/or section 4331 of the Code attaches at the time the donor registers the securities in the name of the custodian or delivers them by deed or gift, thereby vesting legal title to the securities in the minor. The subsequent transfer of the securities from the custodian to the name of the minor upon the latter attaining his majority involves no transfer of legal title. That transaction would come within the exemption provided by section 4343(a)(2) of the Code applying to transfers from a minor to his guardian, or from a guardian to his ward upon attaining majority. Accordingly, the transaction would not be taxable, provided the delivery or transfer from the custodian to the ward is accompanied by an exemption certificate as required by section 4344 of the Code. This Revenue Ruling is equally applicable to similar

transfers of securities in those states which have enacted statutes similar to Article 8–A of the Personal Property Law of New York.

Rev. Rul. 58–228

Where, as in California, a testator bequeaths shares of stock "share and share alike" subject to the legatees' surviving the period of the estate's administration, title vests in them as a class on the decedent's death, and further where, upon expiration of this period, the surviving legatees take as tenants in common, the transfer to the beneficiaries as a class is subject to the documentary stamp tax, and a second tax is incurred when their interests in common are partitioned.

Advice has been requested concerning the applicability of the documentary stamp tax, imposed by section 4321 of the Internal Revenue Code of 1954, under the circumstances described below.

A testator, a resident of California, bequeathed the residue of his estate, which consisted of shares of stock, to each of four named legatees equally, share and share alike. The will provides that should any of the named beneficiaries die before becoming entitled to receive distribution of his or her share, then such share shall be distributed to the survivors of them in the proportions which the survivors' shares bear to each other, or all to the survivor if only one of them is then surviving. All the legatees survived. Pursuant to a "Transfer of Interests Agreement" executed by the named legatees and ratified by the Probate Court as equitably partitioning their interests in common, specific certificates of stock were distributed to each legatee individually and not in common. The question is whether a single transfer tax applies on the transfer of the shares of stock to them as individuals or whether two transfer taxes were incurred, one on the transfer of the shares of stock to the beneficiaries upon the death of the testator, and the other on the transfer of the shares of stock to the beneficiaries individually when a partition of their interests in common under the will was affected.

Section 4321 of the Code imposes a tax on each sale or transfer of shares or certificates of stock, or of rights to subscribe for or to receive such shares or certificates issued by a corporation.

Section 113.33(e) of Regulation 71, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, includes, among several examples of taxable transactions, transfers of stock from persons holding legal title as tenants in common to the same persons separately to effect a partition.

Since the decedent died a resident of the State of California, the estate must be distributed in accordance with California law. The Probate Code of the State of California provides that the title to real and personal property of a California decedent vests immedately upon the death of the decedent in the heirs or beneficiaries named in the will. However, where a bequest is made to a group of individuals subject to the condition of surviving distribution, title vests in them as a class; and, after the period of administration, those surviving take the bequest as tenants in common. See In re Moore's Estate, 286 P. (2d) 939; In re Backesto's Estate, 235 Pac. 670.

Accordingly, in the instant case, a tax is due upon the transfer of title to the beneficiaries as a class and again when their undivided interests in the stock are partitioned at the time of distribution.

PART II.—SALES OR TRANSFERS OF CERTIFICATES OF INDEBTEDNESS

SECTION 4331.—IMPOSITION OF TAX

Whether under the Personal Property Law of New York the transfer of certificates of indebtedness from a custodian to a minor upon the latter attaining his majority is subject to the tax. See Rev. Rul. 58–73, page 458.

PART III.—PROVISIONS COMMON TO SALE OR TRANSFERS OF CAPITAL STOCK AND CERTIFICATES OF INDEBTEDNESS

Subpart A.—Exemptions

SECTION 4342.—FIDUCIARIES AND CUSTODIANS

Whether under the Personal Property Law of New York the transfer of shares or certificates of stock or certificates of indebtedness from the donor to a custodian for a minor is exempt from the tax. See Rev. Rul. 58–73, page 458.

SECTION 4343.—TRANSFER BY OPERATION OF LAW

Whether under the Personal Property Law of New York a transfer of shares or certificates of stock or certificates of indebtedness from a custodian to a minor upon attaining majority is exempt from the tax. See Rev. Rul. 58–73, page 458.

SUBCHAPTER C.—CONVEYANCES

SECTION 4361.—IMPOSITION OF TAX

Rev. Rul. 58–50

Conveyances of realty by a corporation to its trustee in dissolution are not subject to the documentary stamp tax. However, the delivery of deeds by the trustee to the stockholders is taxable if the conveyances are subject to the debts of the corporation or the stockholders assume such debts. If there are no debts of the corporation and no other consideration is involved, no tax would be incurred on the delivery of such deeds.

Advice has been requested concerning the applicability of the documentary stamp tax to conveyances of realty from a corporation to a trustee in dissolution and also whether such tax is applicable to the conveyance of the realty from the trustee to the individual shareholders.

In the instant case, a corporation in liquidation sold all of its assets with the exception of certain parcels of real property which were conveyed to its president as trustee in dissolution acting in behalf

of the corporation. The corporation was then dissolved. Subsequently, the trustee conveyed the property to the former shareholders in pro rata liquidation of their holdings. All conveyances were made by quitclaim deeds and no monetary consideration was involved.

Section 4361 of the Internal Revenue Code of 1954 imposes a tax on deeds or other instruments by which title to realty sold is conveyed.

Section 113.81(b) of Regulations 71, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "sold" imparts a transfer of title for a valuable consideration which may involve money or anything of value. Section 113.83(g) of the regulations provides that the documentary stamp tax is applicable where there is a conveyance of realty by a corporation in liquidation or in dissolution to its shareholders subject to the debts of the corporation; however, if there are no corporate debts and the conveyance is made solely for the cancellation and retirement of the capital stock, the tax does not apply. Included in section 113.84(b) of the regulations as examples where the tax does not apply are "conveyances of realty without consideration and otherwise than in connection with a sale," and "a deed to or by a trustee not pursuant to a sale."

The trustee in dissolution for the corporation stands in the place of and acts for the corporation. Accordingly, it is held that conveyances of realty by such corporation to its trustee in dissolution are not subject to the documentary stamp tax imposed by section 4361 of the Code. However, the delivery of the deeds by the trustee to the stockholders is taxable if the conveyances are subject to the debts of the corporation or the stockholders assume such debts. The measure of the tax would be the amount of the debts of the corporation. If the realty is conveyed to the stockholders and there are no debts of the corporation and no other consideration is involved, no tax would be incurred on the delivery of such deeds.

Rev. Rul. 58–161

Where a deed of conveyance is between a state and one of its political subdivisions with both parties thereto functioning in their governmental capacities, both parties thereto are immune from the payment of the documentary stamp tax imposed by section 4361 of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the documentary stamp tax imposed on conveyances of realty to a deed conveying real property to a state by one of the cities located within that state.

A city, in compliance with a resolution of its Common Council, conveyed certain city-owned real property to its parent state, such property to be used for the construction of a state highway. The property was previously a part of the city's waterworks system.

Section 4361 of the Internal Revenue Code of 1954 imposes a tax on each deed, instrument, or writing whereby lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, by his, her, or their direction, when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of the

sale exceeds $100. Section 4383 of the Code provides that the tax imposed by section 4361 shall be paid by any person who makes, signs, issues, or sells any of the documents and instruments which are subject to tax or for whose use or benefit the same are made, signed, issued, or sold.

M. T. 39, C. B. 1950–1, 141, holds that conveyances of real property to or by a state or a political subdivision or corporate instrumentality thereof are not exempt from the documentary stamp tax merely by reason of the governmental character of one of the parties to the transaction. However, where a state, or a political subdivision or instrumentality thereof, is acting in its governmental capacity, it is considered immune from the tax imposed by section 4361 of the Code. See Revenue Ruling 56–259, C. B. 1956–1, 530, which relates to insurance policies purchased from foreign insurers by instrumentalities of a state, and Revenue Ruling 57–349, C. B. 1957–2, 770, which relates to sales or transfers of corporate securities to or by a state or a political subdivision thereof.

The above principle is also applicable where the conveyance is between parties both of which are governmental in character. Therefore, where a deed is given by a county to a town or by a town to a county, if both the county and the town are functioning in a governmental capacity, as distinguished from a proprietary capacity, no liability is incurred by either party because both parties are immune from the tax. For the purpose of determining which functions are governmental and which are proprietary, the presumption may be made that when a state or a political subdivision, or instrumentality thereof, transfers or acquires real property, such transfer or acquisition may be said to be in the exercise of a governmental function. In the situation set forth above, relating to the conveyance of real property from a city to a state, there are no facts which would overcome this presumption.

Accordingly, it is held that, even though the transaction described above is not exempt from the documentary stamp tax, each party to the transaction is immune from the tax imposed by section 4361 of the Code.

CHAPTER 36.—CERTAIN OTHER EXCISE TAXES

SUBCHAPTER A.—PLAYING CARDS

SECTION 4451.—IMPOSITION OF TAX

Rev. Rul. 58–273

No credit or refund of the excise tax on playing cards is allowable where playing cards are sold to an agency of the United States and withdrawn from the place of manufacture with Federal tax stamps affixed.

Advice has been requested whether a credit or refund of the excise tax on playing cards is allowable where the manufacturer sells playing cards, with Federal tax stamps affixed, to an agency of the United

States, at a price which was established by the manufacturer for such cards based upon all elements of cost, including the cost of the tax stamps. The agency subsequently submits to the manufacturer a form prescribed for the withdrawal of articles from a factory, free of tax, for use of the United States.

Section 4451 of the Internal Revenue Code of 1954 imposes a tax upon every pack of playing cards containing not more than 54 cards, manufactured or imported and sold, or removed for consumption or sale, by a manufacturer.

Section 7510 of the Code, relating to the exemption from tax of domestic goods purchased for the United States, provides that the privilege existing by provision of law on December 1, 1873, or thereafter, of purchasing supplies of goods imported from foreign countries for the use of the United States, duty free, shall be extended, under such regulations as the Secretary of the Treasury or his delegate may prescribe, to all articles of domestic production which are subject to tax by provisions of the Internal Revenue Code of 1954.

Section 301.7510–1 of the Regulations on Procedure and Administration, relating to miscellaneous provisions, provides that for any regulations under section 7510 of the Code, the applicable regulations with respect to the various taxes should be consulted.

Article 22 of Regulations 66, relating to the tax on playing cards, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, states that the regulations governing the withdrawal of playing cards free of tax for use of the United States are prescribed in Regulations 34.

Regulations 34, governing the withdrawal of playing cards and other articles free of tax for use of the United States, sets forth definite procedures to be followed before tax-free cards may be removed from the factory for such use. Article 1 states that whenever a product within the scope of those regulations is purchased for the use of the United States and it is proposed to make withdrawals, tax free, from the place of manufacture, a requisition on Form 663 approved by the head of the institution or organization desiring the product must be filed with the Commissioner of Internal Revenue. Article 4 specifically states that all products withdrawn in advance of the receipt by the manufacturer of a permit will be held subject to tax.

There is no provision in the law or regulations which would permit a refund of tax paid with respect to playing cards removed from a factory with stamps affixed regardless of whether such cards are subsequently exported, sold for use of the United States, or for any other reason. Accordingly, it is held that where a manufacturer sells playing cards with Federal tax stamps affixed, he is not entitled to a credit or refund of the excise tax paid with respect to such cards, even though the cards were sold to an agency of the United States which subsequently submitted to the manufacturer a Form 663, Requisition for Withdrawal of Articles from Factory Free of Tax, for Use of the United States.

SUBCHAPTER B.—OCCUPATIONAL TAX ON COIN-OPERATED DEVICES

SECTION 4461.—IMPOSITION OF TAX

Rev. Rul. 58–51

The tax on coin-operated gaming devices imposed by section 4461(2) of the Internal Revenue Code of 1954 applies to a vending machine which dispenses a variety of articles where the values of some of the articles which the patron may receive may be greater than the value of the coin required to operate it.

Advice has been requested whether a coin-operated vending machine that dispenses a variety of articles, the values of some of which exceed the value of the coin required to operate it, is taxable as a gaming device.

A vending machine dispenses a novelty in a plastic capsule each time a customer inserts a dime. The machine is filled with a packaged capsule mix of approximately 175 miniature items consisting of rings, dice, decks of cards, compasses, baby shoes, pen knives, charms, and cigarette lighters. The patron inserting a dime into the machine knows that he will receive a capsule containing a novelty. but he has no choice or advance knowledge as to which capsule the machine will dispense. The values of the articles dispensed by this machine range from one and six-tenth cents (charms) to 15 cents (cigarette lighter).

Section 4461(2) of the Internal Revenue Code of 1954 provides that every person who maintains for use or permits the use of, on any place or premises occupied by him, a coin-operated gaming device shall pay a tax of $250 per year with respect to each such device.

Section 4462(b) of the Code excludes from the term "coin-operated amusement or gaming device," bona fide vending machines in which are not incorporated gaming or amusement features.

Where a coin-operated vending machine dispenses a variety of articles and, by the exercise of the element of chance, a patron may receive an article the value of which is greater than the value of the coin required to operate the machine, it must be classified as a coin-operated gaming device.

Accordingly, it is held that, since the values of the articles dispensed by the vending machine in the instant case range from one and six-tenths cents to 15 cents and the patron may thus, by chance, receive an article the value of which is greater than the value of the ten-cent coin required to operate the machine, the vending machine is classified as a coin-operated gaming device and is subject to the tax imposed by section 4461(2) of the Code.

SECTION 4462.—DEFINITION OF COIN-OPERATED AMUSEMENT OR GAMING DEVICE

Rev. Rul. 58–172

A coin-operated machine which for a penny always dispenses a ball of chewing gum, but which effects delivery thereof only after the operator manipulates the ball of gum through a simulated

basketball basket, is a coin-operated amusement device within the meaning of section 4462 of the Internal Revenue Code of 1954.

Advice has been requested whether the coin-operated machine described below is subject to the occupational tax on coin-operated amusement devices.

When the operator inserts a penny into the machine, a ball of chewing gum drops into view inside the machine and rolls onto a spring fastened to a lever located on the outside of the machine. Movement of the lever activates the spring which tosses the ball of gum into the air. If the ball of gum falls through the simulated basketball basket inside the machine it rolls out of the machine into a cup. If the ball of gum does not fall through the basket, it rolls back onto the spring. The operator may, without additional cost, repeat the toss until the ball of gum falls through the basket. Thus, a ball of gum is always dispensed if the purchaser flips the ball often enough.

Section 4461 of the Internal Revenue Code of 1954 imposes a special tax to be paid by every person who maintains for use or permits the use of, on any place or premises occupied by him, a coin-operated amusement device, which is defined in section 4462(a) of the Code as any amusement or music machine operated by means of the insertion of a coin, token, or similar object. Section 4462(b) provides that the term "coin-operated amusement device" does not include bona fide vending machines in which are not incorporated amusement features.

It is held that a penny-operated machine which, in addition to delivering a ball of gum, has incorporated therein the amusement feature described above is a coin-operated amusement device within the meaning of section 4462 of the Code. Accordingly, a person who maintains for use such a coin-operated machine is liable for the special tax imposed by section 4461 of the Code on coin-operated amusement devices.

SUBCHAPTER C.—OCCUPATIONAL TAX ON BOWLING ALLEYS, BILLIARD AND POOL TABLES

SECTION 4473.—EXEMPTIONS

Rev. Rul. 58-29

A home for the aged does not qualify as a "hospital" for purposes of the exemption from the occupational tax on pool tables provided by section 4473(1) of the Internal Revenue Code of 1954, even though such a home has facilities to care for residents who become ill.

Advice has been requested whether a home for the aged is exempt, as a hospital, from the occupational tax imposed on pool tables.

A private nonprofit institution, known as a home for the aged, provides living facilities for a large number of elderly people. In order to care for any resident who may become ill, the institution maintains a relatively small number of hospital beds and full-time nurses. Under the laws of the State in which it is located, the insti-

tution is licensed as a "nursing home." To encourage activity among the residents, the institution maintains a pool table which may be used by the residents free of any separate charge.

Section 4471 of the Internal Revenue Code of 1954 imposes a special tax to be paid by every person who operates a bowling alley, billiard room, or pool room and provides that such tax shall be paid for each bowling alley, billiard table, or pool table. Section 4472 of the Code provides that every building or place where bowls are thrown or where games of billiards or pool are played, except in private homes, shall be regarded as a bowling alley, billiard room, or pool room, respectively. Section 4473(1) of the Code provides that the tax shall not apply to any billiard table or pool table in a hospital if no charge is made for the use of such table.

The common conception of a hospital is that of a place for medical and surgical treatment, while a home for the aged is an institution for persons of advanced years who desire the companionship of other older people, or who do not have a home or someone able and willing to care for them. Such persons do not enter a home for the aged because they are in need of medical or surgical care, but rather they enter in order to be provided with the necessities of life and a part or all of the comforts of a private home. While many such homes have facilities for caring for any resident who becomes ill, such service is merely incidental to the main purpose for which the institution is maintained. Therefore, it is held that such an institution does not qualify as a "hospital" for the purposes of the exemption provided by section 4473(1) of the Code. Accordingly, the institution in the instant case is liable for the occupational tax imposed by section 4471 of the Code on any pool table or any billiard table which it maintains for use of the residents.

SUBCHAPTER D.—TAX ON USE OF CERTAIN VEHICLES

SECTION 4482.—DEFINITIONS

Rev. Rul. 58-251

A mobile milling unit mounted on a single-unit highway motor vehicle may be excluded in determining the "actual unloaded weight" of a vehicle for purposes of the highway motor vehicle use tax.

The Internal Revenue Service has been asked whether a mobile milling unit that is used for custom feed grinding on farms may be excluded in determining the "actual unloaded weight" of a single-unit highway motor vehicle for purposes of determining the applicability of the highway motor vehicle use tax.

Section 4481(a) of the Internal Revenue Code of 1954 imposes a tax upon the use of any highway motor vehicle which has a taxable gross weight of more than 26,000 pounds.

Section 4482(b) of the Code provides as follows:

TAXABLE GROSS WEIGHT.—For purposes of this subchapter, the term "taxable gross weight," when used with respect to any highway motor vehicle, means the sum of—

(1) the actual unloaded weight of—

(A) such highway motor vehicle fully equipped for service, and

(B) the semitrailers and trailers (fully equipped for service) customarily used in connection with highway motor vehicles of the same type as such highway motor vehicle, and

(2) The weight of the maximum load customarily carried on highway motor vehicles of the same type as such highway motor vehicle and on the semitrailers and trailers referred to in paragraph (1) (B).

Taxable gross weight shall be determined under regulations prescribed by the Secretary or his delegate (which regulations may include formulas or other methods for determining the taxable gross weight of vehicles by classes, specifications, or otherwise).

Section 41.4482(a)-1(a) of the Highway Motor Vehicle Use Tax Regulations defines a highway motor vehicle as any vehicle that is propelled by means of its own motor and that is of a type used for highway transportation. Thus, trailers and semi-trailers do not come within the meaning of the term.

Section 41.4482(b)-1(b) of the regulations provides:

MEANING OF TERMS.—For purposes of the schedule of taxable gross weights prescribed in paragraph (c) of this section—

(1) The term "actual unloaded weight" means the empty (or tare) weight of the truck, truck-tractor, or bus, fully equipped for service.

(2) The term "fully equipped for service" includes body (whether or not designed and adapted primarily for transporting cargo, as for example, concrete mixers); all accessories; all equipment attached to or carried on such truck, truck-tractor, or bus, for use in connection with the movement of the vehicle by means of its own motor or for use in the maintenance of the vehicle; and a full complement of lubricants, fuel, and water. The term does not include driver, any equipment (not including body) attached to or carried on the vehicle for use in handling or transporting cargo; or any special equipment (such as air compressor, crane, specialized oil-field machinery, etc.) mounted on the vehicle for use on construction jobs, in oil field operations, etc.

A schedule of taxable gross weights, prescribed under the authority of section 4482(b) of the Code, is set forth in section 41.4482(b)-1(c) of the regulations. Highway motor vehicles are classified under this schedule according to the number of axles, the actual unloaded weight, and the type (whether equipped for use as a single unit or in combinations).

It is held that special equipment mounted on a highway motor vehicle for use in performing special services on a farm, which is not a part of the body and performs no function in the operation and maintenance of the vehicle, is considered to be in the same category as special equipment mounted on a highway motor vehicle for use in oil-field operations, on construction jobs, etc. Accordingly, a mobile milling unit may be excluded in determining the actual unloaded weight of the truck on which it is mounted.

CHAPTER 37.—SUGAR, COCONUT AND PALM OIL

SUBCHAPTER B.—COCONUT AND PALM OIL

SECTION 4511.—IMPOSITION OF TAX

Rev. Rul. 58-173

Applicability of the tax imposed by section 4511 of the Internal Revenue Code of 1954 to the first domestic processing of coconut oil fatty acids.

Advice has been requested concerning the applicability of the additional tax imposed by section 4511(b) of the Internal Revenue Code of 1954 to coconut oil fatty acids (of non-Philippine origin) imported after October 1, 1957.

Coconut oil fatty acids result from the refining of crude coconut oil. These fatty acids, if not eliminated, would impart an objectionable odor and flavor to the refined coconut oil. They are therefore removed by alkali refining. These separated fatty acids are then shipped to soap makers or to fatty acid manufacturers for refining and fractionating.

Section 4511(a) of the Code imposes a tax on the first domestic processing of coconut oil, fatty acids derived from the oil, salts of such oil, or any combination or mixture containing a substantial quantity of such oil, fatty acids, or salts. The Act of August 30, 1957, Public Law 85–235, 68A Stat. 536, C. B. 1957–2, 1061, suspends for the period from October 1, 1957, to June 30, 1960, the provisions of section 4511(a) which apply to coconut oil, fatty acids, and salts derived therefrom.

Section 4511(b) of the Code imposes an additional tax on the first domestic processing of coconut oil or of any combination or mixture containing a substantial quantity of coconut oil with respect to which oil there has been no previous domestic processing.

Section 4513(b) of the Code provides that the additional tax imposed by section 4511(b) shall not apply when it is established, in accordance with regulations prescribed by the Secretary of the Treasury or his delegate, that the coconut oil (whether or not contained in a combination or mixture)—

> (1) is wholly the production of the Philippine Islands, any possession of the United States, or the Territory of the Pacific Islands (referred to as the Trust Territory), or (2) was produced wholly from materials the growth or production of the Philippine Islands, any possessions of the United States, or the Trust Territory.

The applicability of the processing tax relating to coconut oil fatty acids is determined under the provisions of section 4511(a) of the Code. Since application of that section is suspended for the period from October 1, 1957, to June 30, 1960, by Public Law 85–235, *supra*, no tax is incurred with respect to the first domestic processing of such fatty acids during that period.

Since coconut oil fatty acids are neither "coconut oil" nor a "combination or mixture containing a substantial quantity of coconut oil" within the meaning of section 4511(b) of the Code, it is held that the additional tax imposed by that section does not apply to the processing of such fatty acids, regardless of the origin of the oil from which they are derived.

CHAPTER 39.—REGULATORY TAXES

SUBCHAPTER A.—NARCOTICS DRUGS AND MARIHUANA

PART I.—NARCOTIC DRUGS

Subpart A.—Tax on Opium, Isonipecaine, Opiates, and Coca Leaves

SECTION 4705.—ORDER FORMS

26 CFR 151.172a: Narcotic drugs and compounds for which oral prescription is authorized. (Narcotics) T. D. 57

TITLE 26—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER C, PART 151—REGULATIONS UNDER THE HARRISON NARCOTIC LAW, AS AMENDED

Finding and designation of narcotic drugs and compounds of narcotic drugs subject to oral prescription procedure.

TREASURY DEPARTMENT,
OFFICE OF THE COMMISSIONER OF NARCOTICS,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

Section 151.172a of this chapter (20 F. R. 6526), relating to narcotic drugs and compounds for which oral prescription is authorized, is hereby amended by adding a new paragraph (j), as follows:

(j) Any compound consisting of dihydrocodeine or any salt thereof with one or more active non-narcotic ingredients in recognized therapeutic amounts, where the content of dihydrocodeine or any salt thereof does not exceed eight grains per fluid ounce or one grain per dosage unit of the compound.

Because the finding and designation made by this Treasury Decision relieves restrictions, it is found unnecessary to issue the decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of the act.

This Treasury Decision shall be effective upon its filiing for publication in the Federal Register.

(68 Stat. 1001; 26 U. S. C. 4705)

G. W. CUNNINGHAM,
Acting Commissioner of Narcotics.

February 28, 1958.

(Filed by the division of the Federal Register March 5, 1958, 8:53 a. m. and published in the issue of the Federal Register for March 6, 1958, 23 F. R. 1599.)

SUBTITLE E.—ALCOHOL, TOBACCO AND CERTAIN OTHER EXCISE TAXES

CHAPTER 52.—TOBACCO, CIGARS, CIGARETTES, AND CIGARETTE PAPERS AND TUBES

SUBCHAPTER A.—DEFINITIONS; RATE AND PAYMENT OF TAX; EXEMPTION FROM TAX; AND REFUND AND DRAWBACK OF TAX

SECTION 5703.—LIABILITY FOR TAX AND METHOD OF PAYMENT

26 CFR 270.148: Stamps.

Authorization of new size of the Class A, denomination 10 cigarette tax stamp. See Rev. Proc. 58–1, page 683.

SECTION 5705.—REFUND OR ALLOWANCE OF TAX

26 CFR 270.164: Claim for refund of tax.

Means of establishing that claims, filed after June 30, 1959, by manufacturers and importers of cigars, for refund of tax paid by return on cigars withdrawn from the market, were filed within the statutory period of limitation. See Rev. Proc. 58–9, page 692.

26 CFR 270.197: Claim for refund of tax.

Means of establishing that claims, filed after June 30, 1959, by manufacturers and importers of cigars, for refund of tax paid by return on cigars withdrawn from the market, were filed within the statutory period of limitation. See Rev. Proc. 58–9, page 692.

SUBCHAPTER C.—OPERATIONS BY MANUFACTURERS OF ARTICLES

SECTION 5721.—INVENTORIES

26 CFR 275.131: Inventories.

For discontinuance of annual inventory, see Rev. Proc. 58–7, page 689.

26 CFR 270.141: Inventories.

For discontinuance of annual inventory, see Rev. Proc. 58–7, page 689.

CHAPTER 53.—MACHINE GUNS AND CERTAIN OTHER FIREARMS

SUBCHAPTER A.—TAXES

PART II.—TRANSFER TAX

SECTION 5812.—EXEMPTIONS

26 CFR 179.95: Scope of tax.

For the applicable procedure for the deactivation of firearms as "DEWATs," see Rev. Proc. 58–8, page 690.

SUBCHAPTER B.—GENERAL PROVISIONS

SECTION 5848.—DEFINITIONS

26 CFR 179.20: Firearm.

For the applicable procedure for the deactivation of firearms as "DEWATs," see Rev. Proc. 58–8, page 690.

SUBTITLE F.—PROCEDURE AND ADMINISTRATION

CHAPTER 61.—INFORMATION AND RETURNS

SUBCHAPTER A.—RETURNS AND RECORDS

PART I.—RECORDS, STATEMENTS, AND SPECIAL RETURNS

SECTION 6001.—NOTICE OR REGULATIONS REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS

Records to be maintained for the purpose of computing depreciation deductions. Rev. Rul. 58–306, page 123.

Use of substitutes for Form 2439, Notice to Shareholder of Undistributed Long-term Capital Gains, see Rev. Proc. 58–2, page 684.

PART II.—TAX RETURNS OR STATEMENTS

Subpart A.—General Requirements

SECTION 6011.—GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST

(Also Sections 4061, 4071, 4081, 4111, 4121, 4131, 4141, 4151, 4161, 4171, 4181, 4191, 4201, 4211.) Rev. Rul. 58-315

An importer of articles subject to the manufacturers excise taxes may, under certain conditions, compute and prepay the tax at the time the taxable articles are imported, rather than when they are sold.

The Internal Revenue Service has been asked whether importers of articles subject to the manufacturers excise taxes may be permitted to compute and prepay the tax at the time articles are imported, in a manner similar to that provided in Revenue Ruling 56-261, C. B. 1956-1, 556, for retailers of articles subject to the retailers excise taxes.

Manufacturers excise taxes are imposed by chapter 32 of the Internal Revenue Code of 1954 upon the sale by the manufacturer, producer, or importer of motor vehicles, tires and tubes, petroleum products, household-type equipment, etc., radio and television sets, phonographs and records, musical instruments, sporting goods, photographic equipment, firearms, business machines, pens and mechanical pencils and lighters, and matches.

The incidence of the above taxes is upon the sale of the articles by the manufacturer, producer, or importer. However, the Service will interpose no objection to the computation and prepayment of the tax at the time the taxable articles are imported, provided (1) the tax so prepaid is computed on the wholesale selling price of the articles; (2) the tax applicable to the wholesale price of any taxable articles previously imported by the company and on hand at the beginning of the period for which the prepayment plan is adopted is included in the Form 720, Quarterly Federal Excise Tax Return, filed for that period; (3) the importer maintains (a) an accurate record of the inventory upon which tax is prepaid when the plan is adopted, and (b) an accurate record of all taxable articles imported by the company showing the date of import and the purchase prices, as well as a record of the markup over purchase price used in arriving at the established wholesale selling price in each case; and (4) the prepayment method is used with respect to all articles subject to tax which the company imports for sale.

Occasions may arise where, subsequent to the time of prepayment of tax under this plan, articles will be sold at prices higher than those used as a basis for computing the tax prepayment. In such cases, the additional tax resulting from the increase in wholesale sale prices must be included in the quarterly return for the period in which the articles are sold.

On the other hand, there may be occasions where there will be excess prepayments of tax for which a credit or refund will be allowable. Such excess prepayments might arise from the sale of the

imported articles at prices lower than the established wholesale prices upon which the prepayment was based, from a reduction in the applicable tax rate, or from the loss, destruction, or return to suppliers, of articles upon which tax has been prepaid. Interest will not be allowed upon such excess prepayments.

Each importer who desires permission to prepay tax at the time of purchase of taxable articles, based upon the established wholesale sale price of the articles, should file a request in writing with his local District Director of Internal Revenue describing fully the nature of his business and the kinds of taxable articles imported. Prepayment of the tax by the importer under this procedure should not be commenced until approval has been received from the District Director. Approval by District Directors of such requests will be conditioned upon the acceptance by the importer of the requirements set forth herein and of the responsibility for maintaining such records and accounts as will enable internal revenue officers to determine whether the correct amount of tax has been paid the Government.

Where a person, who has received the approval of his local District Director of Internal Revenue to so compute and prepay the tax, desires at a later time to discontinue such prepayment method, he should advise the District Director to that effect.

Subpart B.—Income Tax Returns

SECTION 6013.—JOINT RETURNS OF INCOME TAX BY HUSBAND AND WIFE

Return of taxpayer having a common-law wife in a state that recognizes common-law marriages. See Rev. Rul. 58–66, page 60.

PART III.—INFORMATION RETURNS

Subpart B.—Information Concerning Transactions With Other Persons

---

SECTION 6044.—RETURNS REGARDING PATRONAGE DIVIDENDS

Rev. Rul. 58–335

A cooperative tax exempt organization is not required to file an information return, Form 1099, for an individual receiving patronage dividends as well as regular dividends if the total amount of each, computed independently, is less than $100 for such individual.

Advice has been requested by a tax exempt cooperative organization regarding the requirements for filing information returns, Form 1099, where it has made patronage refunds and dividend payments in the factual situations described below.

(1) Stockholder *A* was credited with a patronage refund and also was paid a cash dividend on his shares of stock. Each amount was less than $100.00, but in the aggregate exceeded $100.

(2) Stockholder *B* was credited with a patronage refund of less than $100.00, and also was paid a cash dividend on his shares of stock in excess of $100.00.

Section 6044 of the Internal Revenue Code of 1954, which is substantially identical to section 148(f) of the Internal Revenue Code of 1939, relating to the required information returns to be prepared by corporations allocating patronage dividends, provides in part as follows:

> "(a) PAYMENTS OF $100 OR MORE.—Any corporation allocating amounts as patronage dividends, rebates, or refunds (whether in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the amount of such dividend, refund, or rebate) shall make a return showing—
>
> (1) The name and address of each patron to whom it has made such allocations amounting to $100 or more during the calendar year; and (2) the amount of such allocations to each patron.

Section 39.148(f)-(1)(a) of Regulations 118 made applicable to the Internal Revenue Code of 1954 by virtue of Treasury Decision 6091, C. B. 1954–2, 47, provides that a corporation is required to file an information return when the amounts of patronage dividends, rebates or refunds allocated to each patron aggregate $100 or more during the calendar year.

Section 6042 of the Internal Revenue Code of 1954 provides, in part, that every corporation shall, when required by the Commissioner of Internal Revenue, render a correct return of its payments of dividends, stating the name and address of each shareholder.

Section 39.148(a)-1(b) of Regulations 118, as amended by T. D. 6113, C. B. 1954–2, 236, also applicable herein by virtue of Treasury Decision 6091, *supra*, provided in part as follows:

> * * * In the case of a corporation described in sections 101(10), (11), (12), or (13), or, for calendar years after 1953, in the case of a national farm loan association or a production credit association, making a payment of a dividend or a distribution to any shareholder, the information return on Forms 1096 and 1099 shall be rendered only in the case of payments amounting to $100 or more durinng the calendar year. * * *

The reference to patronage dividends and ordinary dividends is contained in separate sections of the Code and appear to be two distinct types of dividends, neither one of which appears to supplement the other. The words "amounts aggregating" used in section 39.148(f)-(1)(a) and the words "amounting to" used in section 39.148(a)-1(b) of Regulations 118, as amended, apply to an aggregation of like distributions of income. Thus, it follows that patronage dividends in whatever form allocated and cash dividends paid on stock are not "like" distributions requiring an aggregation.

In view of the foregoing, it is held in situation (1) that since neither the patronage dividend nor the cash dividend, exclusive of each other, is in excess of $100, an information return need not be filed by the corporation. In situation (2) an information return is required to be filed only to cover the payment to *B* of the cash dividend paid, which is in excess of $100.

SUBCHAPTER B.—MISCELLANEOUS PROVISIONS

SECTION 6102.—COMPUTATIONS ON RETURNS OR OTHER DOCUMENTS

26 CFR 301.6102–1: Computations on returns or other documents.

Optional tax table for determining self-employment tax on the Individual Income Tax Return, Form 1040, for any taxable year beginning after December 31, 1956 and before January 1, 1960. See Rev. Rul. 58–137, page 320.

SECTION 6103.—PUBLICITY OF RETURNS AND LISTS OF TAXPAYERS

Disclosure by the Service to a divorced parent of the dependency exemption claimed by the other. See Rev. Rul. 58–120, page 498.

CHAPTER 63.—ASSESSMENT

SUBCHAPTER A.—IN GENERAL

SECTION 6206.—SPECIAL RULES APPLICABLE TO EXCESSIVE CLAIMS UNDER SECTIONS 6420 AND 6421

26 CFR 301.6206: Statutory provisions; special rules applicable to excessive claims under section 6420 and 6421. (Also Sections 6312, 6334, 6402, 7502; 301.6312–1, 301.6334–1, 301.6402–2, 301.6402–3, 301.7502–1.)

T. D. 6292 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Miscellaneous amendments to the Regulations on procedure and Administration.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers And Employees of The Internal Revenue Service and Others Concerned:

In order to conform the Regulations on Procedure and Administration (26 CFR Part 301) to (1) the amendments made to the Internal Revenue Code of 1954 by the Social Security Amendments of 1954 (68 Stat. 1052) [C. B. 1954–2, 603], the Tax Rate Extension Acts of 1955 [C. B. 1955–1, 619], 1956 [C. B. 1955–1, 619], and 1957 [C. B. 1957–1, 666] (69 Stat. 14, 70 Stat. 66, and 71 Stat. 9, respectively),

[1] 23 F. R. 2597.

Act of August 11, 1955 (Public Law 355, 84th Cong., 69 Stat. 676) [C. B. 1955–2, 765], Act of August 11, 1955 (Public Law 367, 84th Cong., 69 Stat. 689) [C. B. 1955–2, 768], Act of April 2, 1956 (Public Law 466, 84th Cong., 70 Stat. 87) [C. B. 1956–1, 870], Act of May 29, 1956 (Public Law 545, 84th Cong., 70 Stat. 217) [C. B. 1956–1, 887], the Highway Revenue Act of 1956 (70 Stat. 374) [C. B. 1956–2, 1150], Act of July 25, 1956 (Public Law 796, 84th Cong., 70 Stat. 644 [C. B. 1956–2, 1180], and (2) the Act of August 12, 1955 (Public Law 383, 84th Cong., 69 Stat. 715) C. B. 1955–2, 770; and in order to make certain other changes in such regulations, the regulations are amended as follows:

PARAGRAPH 1. Section 301.6206 is amended as follows:

(A) By renumbering § 301.6206 as § 301.6207.

(B) By striking out "6206" the section number of the law set forth in such section as renumbered, and inserting "6207" in lieu thereof.

(C) By adding at the end of such section 6207 the following historical note:

[Sec. 6206 as renumbered 6207 by sec. 4(b)(1), Act of Apr. 2, 1956 (Pub. Law 466, 84th Cong., 70 Stat. 90)]

PAR. 2. Immediately after § 301.6205–1 insert the following new sections:

§ 301.6206. STATUTORY PROVISIONS; SPECIAL RULES APPLICABLE TO EXCESSIVE CLAIMS UNDER SECTIONS 6420 AND 6421.

SEC. 6206. SPECIAL RULES APPLICABLE TO EXCESSIVE CLAIMS UNDER SECTIONS 6420 AND 6421.

Any portion of a payment made under section 6420 or 6421 which constitutes an excessive amount (as defined in section 6675 (b)), and any civil penalty provided by section 6675, may be assessed and collected as if it were a tax imposed by section 4081 and as if the person who made the claim were liable for such tax. The period for assessing any such portion, and for assessing any such penalty, shall be 3 years from the last day prescribed for the filing of the claim under section 6420 or 6421, as the case may be.

[Sec. 6206 as added by sec. 4(b)(1), Act of Apr. 2, 1956 (Pub. Law 466, 84th Cong., 70 Stat. 90), and as amended by sec. 208(d)(1), Highway Revenue Act 1956 (70 Stat. 396)]

§ 301.6206–1 SPECIAL RULES APPLICABLE TO EXCESSIVE CLAIMS UNDER SECTIONS 6420 AND 6421.—For regulations under section 6206, see the Manufacturers and Retailers Excise Tax Regulations (Part 40 of this chapter).

PAR. 3. Section 301.6312–1 is amended as follows:

(A) By striking out the period at the end of the first sentence in paragraph (c) and inserting in lieu thereof the following:", or with the Office of the Treasurer of the United States, Treasury Building, Washington, D. C."

(B) By striking out the last sentence of paragraph (c) and inserting in lieu thereof the following:

In such cases, the Federal reserve bank or branch, or the Office of the Treasurer of the United States, shall issue a receipt in the name of the district director, describing the certificates, notes, or bills by par or dollar face amount and stating on the face of the receipt that the certificates, notes, or bills represented thereby are held by the bank or branch, or the Office of the Treasurer of the United States, for redemption at the value specified in the terms under which the certificates, notes, or bills were issued, and for application of the proceeds in payment of taxes due or for the purchase of stamps on a specified date by the taxpayer named therein.

PAR. 4. Immediately preceding § 301.6334–1 insert the following:

SEC. 12 [Railroad Retirement Act of 1937, as amended]. Notwithstanding any other law of the United States, or of any State, Territory, or of the District of Columbia, no annuity or pension payment shall be assignable or be subject to any tax or to garnishment, attachment, or other legal process under any circumstances whatsoever, nor shall the payment thereof be anticipated.

[Sec. 12 as amended by sec. 4, Act of Aug. 12, 1955 (Pub. Law 383, 84th Cong., 69 Stat. 716), effective as of Aug. 29, 1935]

SEC. 2 [Railroad Unemployment Insurance Act]. * * *

(e) Notwithstanding any other law of the United States, or of any State, Territory, or the District of Colombia, no benefits shall be assignable or be subject to any tax or to garnishment, attachment, or other legal process under any circumstances whatsoever, nor shall the payment thereof be anticipated.

[Sec. 2 as amended by sec. 4, Act of Aug. 12, 1955 (Pub. Law 383, 84th Cong., 69 Stat. 716), effective as of June 25, 1938]

PAR. 5. Section 301.6334–1 is amended by striking out all of paragraph (c) and inserting in lieu thereof the following:

(c) *Other property.*—Annuity or pension payments under the Railroad Retirement Act and benefits under the Railroad Unemployment Insurance Act are exempt from levy. No other property or rights to property are exempt from levy except the property specifically exempted by section 6334 (a). No provision of a State law may exempt property or rights to property from levy for the collection of any Federal tax. Thus, property exempt from execution under State personal or homestead exemption laws is, nevertheless, subject to levy by the United States for collection of its taxes.

PAR. 6. Section 301.6402–2 is amended by striking out all of paragraph (f) and inserting in lieu thereof the following:

(f) *Mailing of refund check.*—(1) Checks in payment of claims allowed will be drawn in the names of the persons entitled to the money and, except as provided in subparagraph (2) of this paragraph, the district director may send the checks direct to the claimant or to such person in care of an attorney or agent who has filed a power of attorney specifically authorizing him to receive such checks.

(2) Checks in payment of claims which have either been reduced to judgment or settled in the course or as a result of litigation will be drawn in the name of the person or persons entitled to the money and, in the case of actions arising in the United States district courts, will be sent to the appropriate United States Attorney, and, in actions arising in the United States Court of Claims, to the Assistant Attorney General, Tax Division, Department of Justice, for delivery to the taxpayer or the counsel of record in the court proceeding.

(3) For restrictions on the assignment of claims, see section 3477 of the Revised Statutes (31 U. S. C. 203).

PAR. 7. Section 301.6402–3 is amended as follows:

(A) By striking out paragraph (a) and inserting in lieu thereof the following:

(a) In the case of income tax, claims for refund may not only be made on Form 843 but may also be made on any individual or corporation income tax return, or on any amended income tax return.

(B) By striking out the first two sentences of paragraph (b) and inserting in lieu thereof the following:

A properly executed individual or corporation income tax return shall, at the election of the taxpayer, constitute a claim for refund or credit within the meaning of section 6402 and section 6511 for the amount of the overpayment disclosed by such return. For the purposes of section 6511, such claim shall be considered as filed on the date on which such return is considered as filed, except that if the requirements of § 301.7502–1, relating to timely mailing treated as timely filing, are met the claim shall be considered to be filed on the date of the postmark stamped on the cover in which the return was mailed.

(C) By striking out the last sentence of paragraph (c) and inserting in lieu thereof the following:

For purposes of section 6511, such claim shall be considered as filed on the date on which such return is considered as filed, except that if the requirements of § 301.7502–1, relating to timely mailing treated as timely filing, are met the claim shall be considered to be filed on the date of the postmark stamped on the cover in which the return was mailed.

PAR. 8. Section 301.6412 is amended to read as follows:

§ 301.6412 Statutory provisions; floor stocks refunds.

SEC. 6412. FLOOR STOCKS REFUNDS.

(a) IN GENERAL.—

(1) PASSENGER AUTOMOBILES, ETC.—Where before July 1, 1958, any article subject to the tax imposed by section 4061(a)(2) has been sold by the manufacturer, producer, or importer and on such date is held by a dealer and has not been used and is intended for sale, there shall be credited or refunded (without interest) to the manufacturer, producer, or importer an amount equal to the difference between the tax paid by such manufacturer, producer, or importer on his sale of the article and the amount of tax made applicable to such article on and after July 1, 1958, if claim for such credit or refund is filed with the Secretary or his delegate on or before November 10, 1958, based upon a request submitted to the manufacturer, producer, or importer before October 1, 1958, by the dealer who held the article in respect of which the credit or refund is claimed, and, on or before November 10, 1958, reimbursement has been made to such dealer by such manufacturer, producer, or importer for the tax reduction on such article or written consent has been obtained from such dealer to allowance of such credit or refund.

(2) TRUCKS AND BUSES, TIRES, TREAD RUBBER, AND GASOLINE.—Where before July 1, 1972, any article subject to the tax imposed by section 4061(a)(1), 4071(a)(1) or (4), or 4081 has been sold by the manufacturer, producer, or importer and on such date is held by a dealer and has not been used and is intended for sale (or, in the case of tread rubber, is intended for sale or is held for use), there shall be credited or refunded (without interest) to the manufacturer, producer, or importer an amount equal to the difference between the tax paid by such manufacturer, producer, or importer on his sale of the article and the amount of tax made applicable to such article on and after July 1, 1972, if claim for such credit or refund is filed with the Secretary or his delegate on or before November 10, 1972, based upon a request submitted to the manufacturer, producer, or importer before October 1, 1972, by the dealer who held the article in respect of which the credit or refund is claimed, and, on or before November 10, 1972, reimbursement has been made to such dealer by such manufacturer, producer, or importer for the tax reduction on such article or written consent has been obtained from such dealer to allowance of such credit or refund. No credit or refund shall be allowable under this paragraph with respect to gasoline in retail stocks held at the place where intended to be sold at retail, nor with respect to gasoline held for sale by a producer or importer of gasoline.

(3) DEFINITIONS.—For purposes of this section.—

(A) The term "dealer" includes a wholesaler, jobber, distributor, or retailer, or, in the case of tread rubber subject to tax under section 4071(a)(4), includes any person (other than the manufacturer, producer, or importer thereof) who holds such tread rubber for sale or use.

(B) An article shall be considered as "held by a dealer" if title thereto has passed to such dealer (whether or not delivery to him has been made), and if for purposes of consumption title to such article or possession thereof has not at any time been transferred to any person other than a dealer.

(b) LIMITATION ON ELIGIBILITY FOR CREDIT OR REFUND.—No manufacturer, producer, or importer shall be entitled to credit or refund under subsection (a) unless he has in his possession such evidence of the inventories with respect to which the credit or refund is claimed as may be required by regulations prescribed under this section.

(c) OTHER LAWS APPLICABLE.—All provisions of law, including penalties, applicable in respect of the taxes imposed by sections 4061, 4071, and 4081 shall, insofar as applicable and not inconsistent with subsections (a) and (b) of this section, apply in respect of the credits and refunds provided for in subsection (a) to the same extent as if such credits or refunds constituted overpayments of such taxes.

(d) SUGAR.—With respect to any sugar or articles composed in chief value of sugar upon which tax imposed under section 4501 (b) has been paid and which, on June 30, 1961, are held by the importer and intended for sale or other disposition, there shall be refunded (without interest) to such importer, subject to such regulations as may be prescribed by the Secretary or his delegate (an amount equal to the tax paid with respect to such sugar or articles composed in chief value of sugar.

(e) CROSS REFERENCE.—For floor stocks refunds in case of certain alcohol and tobacco taxes, see sections 5063 and 5707.

[Sec. 6412 as amended by sec. 3 (b) (4), Tax Rate Extension Act 1955 (69 Stat. 15); sec 3 (b) (4), Tax Rate Extension Act 1956 (70 Stat. 67); sec. 19, Act of May 29, 1956 (Pub. Law 545, 84th Cong., 70 Stat. 221); sec. 208 (a), Highway Revenue Act 1956 (70 Stat. 392); sec. 3 (b) (4), Tax Rate Extension Act 1957 (71 Stat. 10)]

PAR. 9. Section 301.6413 is amended by striking out subsections (c) and (d) of section 6413 and inserting in lieu thereof the following:

(c) SPECIAL REFUNDS

(1) IN GENERAL.—If by reason of an employee receiving wages from more than one employer during a calendar year after the calendar year 1950 and prior to the calendar year 1955, the wages received by him during such year exceed $3,600 the employee shall be entitled (subject to the provisions of section 31 (b)) to a credit or refund of any amount of tax, with respect to such wages, imposed by section 1400 of the Internal Revenue Code of 1939 and deducted from the employee's wages (whether or not paid to the Secretary or his delegate), which exceeds the tax with respect to the first $3,600 of such wages received; or if by reason of an employee receiving wages from more than one employer during any calendar year after the calendar year 1954, the wages received by him during such year exceed $4,200, the employee shall be entitled (subject to the provisions of section 31 (b)) to a credit or refund of any amount of tax, with respect to such wages, imposed by section 3101 and deducted from the employee's wages (whether or not paid to the Secretary or his delegate), which exceeds the tax with respect to the first $4,200 of such wages received.

(2) APPLICABILITY IN CASE OF FEDERAL AND STATE EMPLOYEES AND EMPLOYEES OF CERTAIN FOREIGN CORPORATIONS.—

(A) FEDERAL EMPLOYEES.—In the case of remuneration received from the United States or a wholly-owned instrumentality thereof during any calendar year, each head of a Federal agency or instrumentality who makes a return pursuant to section 3122 and each agent, designated by the head of a Federal agency or instrumentality, who makes a return pursuant to such section shall for purposes of this subsection, be deemed a separate employer; and the term "wages" includes, for purposes of this subsection, the amount, not to exceed $3,600 for the calendar year 1951, 1952, 1953, or 1954, or $4,200 for any calendar year after 1954, determined by each such head or agent as constituting wages paid to an employee.

(B) STATE EMPLOYEES.—For purposes of this subsection, in the case of remuneration received during any calendar year, the term "wages" includes such remuneration for services covered by an agreement made pursuant to section 218 of the Social

Security Act as would be wages if such services constituted employment: the term "employer" includes a State or any political subdivision thereof, or any instrumentality of any one or more of the foregoing; the term "tax" or "tax imposed by section 3101" includes, in the case of services covered by an agreement made pursuant to section 218 of the Social Security Act, an amount equivalent to the tax which would be imposed by section 3101, if such services constituted employment as defined in section 3121; and the provisions of this subsection shall apply whether or not any amount deducted from the employee's remuneration as a result of an agreement made pursuant to section 218 of the Social Security Act has been paid to the Secretary.

(C) EMPLOYEES OF CERTAIN FOREIGN CORPORATIONS.—For purposes of paragraph (1) of this subsection, the term "wages" includes such remuneration for services covered by an agreement made pursuant to section 3121(l) as would be wages if such services constituted employment; the term "employer" inincludes any domestic corporation which has entered into an agreement pursuant to section 3121(l); the term "tax" or "tax imposed by section 3101," includes, in the case of services covered by an agreement entered into pursuant to section 3121(l), an amount equivalent to the tax which would be imposed by section 3101, if such services constituted employment as defined in section 3121; and the provisions of paragraph (1) of this subsection shall apply whether or not any amount deducted from the employee's remuneration as a result of the agreement entered into pursuant to section 3121(l) has been paid to the Secretary or his delegate.

(d) REFUND OR CREDIT OF FEDERAL UNEMPLOYMENT TAX.—Any credit allowable under section 3302, to the extent not previously allowed, shall be considered an overpayment, but no interest shall be allowed or paid with respect to such overpayment.

[Sec. 6413 as amended by sec. 202 of the Social Security Amendments 1954 (68 Stat. 1089)]

PAR. 10. Section 301.6416 is amended as follows:

(A) By striking out subsection (b) of section 6416 and inserting in lieu thereof the following:

(b) SPECIAL CASES IN WHICH TAX PAYMENTS CONSIDERED OVERPAYMENTS.—Under regulations prescribed by the Secretary or his delegate credit or refund, without interest, shall be made of the overpayments determined under the following paragraphs:

(1) PRICE READJUSTMENTS.—If the price of any article in respect of which a tax, based on such price, is imposed by chapter 31 or 32, is readjusted by reason of the return or repossession of the article or a covering or container, or by a bona fide discount, rebate or allowance, the part of the tax proportionate to the part of the price repaid or credited to the purchaser shall be deemed to be an overpayment.

(2) SPECIFIED USES AND RESALES.—The tax paid under subchapter E of chapter 31 or chapter 32 in respect of any article shall be deemed to be an overpayment if such article was, by any person.—

(A) Resold for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia, or, in the case of musical instruments embraced in section 4151, resold for the use of any religious or nonprofit educational institution for exclusively religious or educational purposes;

(B) Used or resold for use for any of the purposes, but subject to the conditions, provided in section 4222;

(C) In the case of a liquid taxable under section 4041, sold for use as fuel in a diesel-powered highway vehicle or as fuel for the propulsion of a motor vehicle, motorboat, or airplane, if (i) the vendee used such liquid otherwise than as fuel in such a vehicle, motorboat, or airplane or resold

such liquid, or (ii) such liquid was (within the meaning of paragraphs (1), (2), and (3) of section 6420(c)) used on a farm for farming purposes;

(D) In the case of lubricating oils, used or resold for non-lubricating purposes;

(E) In the case of unexposed motion picture films, used or resold for use in the making of newsreel motion picture films;

(F) In the case of articles taxable under section 4061(b) (other than spark plugs, storage batteries, leaf springs, coils, timers, and tire chains), used or resold for use as repair or replacement parts or accessories for farm equipment (other than equipment taxable under section 4061(a));

(G) [Repealed.]

(H) In the case of gasoline, used in production of special motor fuels referred to in section 4041(b);

(I) In the case of lubricating oils in respect to which tax was paid at the rate of 6 cents a gallon, used or resold for use on or after the effective date of this subparagraph as cutting oils (within the meaning of section 4092(b)); except that the amount of such overpayment shall not exceed an amount computed at the rate of 3 cents a gallon;

(J) In the case of a liquid in respect of which tax was paid under section 4041(a)(1) at the rate of 3 cents a gallon, used or resold for use as a fuel in a diesel-powered highway vehicle (i) which (at the time of such use or resale) is not registered, and is not required to be registered, for highway use under the laws of any State or foreign country, or (ii) which, in the case of a diesel-powered highway vehicle owned by the United States, is not used on the highway; except that the amount of any overpayment by reason of this subparagraph shall not exceed an amount computed at the rate of 1 cent a gallon;

(K) In the case of a liquid in respect of which tax was paid under section 4041(b)(1) at the rate of 3 cents a gallon, used or resold for use otherwise than as a fuel for the propulsion of a highway vehicle (i) which (at the time of such use or resale) is registered, or is required to be registered, for highway use under the laws of any State or foreign country, or (ii) which, in the case of a highway vehicle owned by the United States, is used on the highway; except that the amount of any overpayment by reason of this subparagraph shall not exceed an amount computed at the rate of 1 cent a gallon;

(L) In the case of a liquid in respect of which tax was paid under section 4041 at the rate of 3 cents a gallon, used during any calendar quarter in vehicles while engaged in furnishing scheduled common carrier public passenger land transportation service along regular routes; except that (i) this subparagraph shall apply only if the 60 percent passenger fare revenue test set forth in section 6421(b)(2) is met with respect to such quarter, and (ii) the amount of such overpayment for such quarter shall be an amount determined by multiplying 1 cent for each gallon of liquid so used by the percentage which such person's tax-exempt passenger fare revenue (as defined in section 6421(d)(2)) derived from such scheduled service during such quarter was of his total passenger fare revenue (not including the tax imposed by section 4261, relating to the tax on transportation of persons) derived from such scheduled service during such quarter;

(M) In the case of tread rubber in respect of which tax was paid under section 4071(a)(4), used or resold for use otherwise than in the recapping or retreading of tires of the type used on highway vehicles (as defined in section 4072(c)), unless credit or refund of such tax is allowable under subsection (b)(3).

(3) TAX-PAID ARTICLES USED FOR FURTHER MANUFACTURE.—If the tax imposed by chapter 32 has been paid with respect to the sale of—

(A) Any article (other than a tire, inner tube, or automobile radio or television receiving set taxable under section 4141 and other than an automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4111, a radio or television component taxable under section 4141, or a camera lens taxable under section 4171) purchased by a manufacturer or producer and used by him as material in the manufacture or production of, or as a component part of, an article with respect to which tax under chapter 32 has been paid, or which has been sold free of tax by virtue of section 4220 or 4224, relating to tax-free sales;

(B) An automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4111, a radio or television component taxable under section 4141, or a camera lens taxable under section 4171, purchased by a manufacturer or producer and used by him as material in the manufacture of, production of, or as a component part of, any article;

such tax shall be deemed an overpayment by such manufacturer or producer.

(B) By adding at the end of section 6416 the following historical note:

[Sec. 6416 as amended by sec. 2, Act of Aug. 11, 1955 (Pub. Law 355, 84th Cong., 69 Stat. 676); secs. 1(h), (i), 2(b), Act of Aug. 11, 1955 (Pub. Law 367, 84th Cong., 69 Stat. 690); sec. 2(b), Act of Apr. 2, 1956 (Pub. Law 466, 84th Cong., 70 Stat. 90); sec. 208(b), Highway Revenue Act 1956 (70 Stat. 393)]

PAR. 11. Section 301.6418 is amended as follows:

(A) By striking out "4501(a)" in section 6418(a) and inserting "4501" in lieu thereof.

(B) By adding at the end of section 6418 the following historical note:

[Sec. 6418 as amended by sec. 21(b), Act of May 29, 1956 (Pub. Law 545, 84th Cong., 70 Stat. 221)]

PAR. 12. Section 301.6420 is amended as follows:

(A) By renumbering § 301.6420 as § 301.6422.

(B) By striking out "6420", the section number of the law set forth in such section as renumbered, and inserting "6422" in lieu thereof.

(C) By adding at the end of such section 6422 the following historical note:

[Sec. 6420 as renumbered 6422 by sec. 1, Act of Apr. 2, 1956 (Pub. Law 466, 84th Cong., 70 Stat. 87); sec. 208(c), Highway Revenue Act 1956 (70 Stat. 394)]

PAR. 13. Immediately after § 301.6419–1 insert the following new sections:

§ 301.6420 STATUTORY PROVISIONS; GASOLINE USED ON FARMS.

SEC. 6420. GASOLINE USED ON FARMS.

(a) GASOLINE.—If gasoline is used on a farm for farming purposes, the Secretary or his delegate shall pay (without interest) to the ultimate purchaser of such gasoline the amount determined by multiplying—

(1) The number of gallons so used, by

(2) The rate of tax on gasoline under section 4081 which applied on the date he purchased such gasoline.

(b) TIME FOR FILING CLAIM; PERIOD COVERED.—Not more than one claim may be filed under this section by any person with respect to gasoline used during the one-year period ending on June 30 of any year. No claim shall be allowed under this section with respect to any one-year period unless filed on or before September 30 of the year in which such one-year period ends.

(c) MEANING OF TERMS.—For purposes of this section—

(1) USE ON A FARM FOR FARMING PURPOSES.—Gasoline shall be treated as used on a farm for farming purposes only if used (A) in

carrying on a trade or business, (B) on a farm situated in the United States, and (C) for farming purposes.

(2) FARM.—The term "farm" includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards.

(3) FARMING PURPOSES.—Gasoline shall be treated as used for farming purposes only if used—

(A) By the owner, tenant, or operator of a farm, in connection with cultivating the soil, or in connection with raising or harvesting any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training, and management of livestock, bees, poultry, and fur-bearing animals and wild life, on a farm of which he is the owner, tenant, or operator; except that if such use is by any person other than the owner, tenant, or operator of such farm, then (i) for purposes of this subparagraph, in applying subsection (a) to this subparagraph, and for purposes of section 6416(b)(2)(C)(ii) (but not for purposes of section 4041), the owner, tenant, or operator of the farm on which gasoline or a liquid taxable under section 4041 is used shall be treated as the user and ultimate purchaser of such gasoline or liquid, and (ii) for purposes of applying section 6416(b)(2)(C)(ii), any tax paid under section 4041 in respect of a liquid used on a farm for farming purposes (within the meaning of this subparagraph) shall be treated as having been paid by the owner, tenant, or operator of the farm on which such liquid is used;

(B) By the owner, tenant, or operator of a farm, in handling, drying, packing, grading, or storing any agricultural or horticultural commodity in its unmanufactured state; but only if such owner, tenant, or operator produced more than one-half of the commodity which he so treated during the period with respect to which claim is filed;

(C) By the owner, tenant, or operator of a farm, in connection with—

(i) The planting, cultivating, caring for, or cutting of trees, or

(ii) The preparation (other than milling) of trees for market,

incidental to farming operations; or

(D) By the owner, tenant, or operator of a farm, in connection with the operation, management, conservation, improvement, or maintenance of such farm and its tools and equipment.

(4) GASOLINE.—The term "gasoline" has the meaning given to such term by section 4082(b).

(d) EXEMPT SALES; OTHER PAYMENTS OR REFUNDS AVAILABLE.—No amount shall be paid under this section with respect to any gasoline which the Secretary or his delegate determines was exempt from the tax imposed by section 4081. The amount which (but for this sentence) would be payable under this section with respect to any gasoline shall be reduced by any other amount which the Secretary or his delegate determines is payable under this section, or is refundable under any provision of this title, to any person with respect to such gasoline.

(e) APPLICABLE LAWS.—

(1) IN GENERAL.—All provisions of law, including penalties, applicable in respect of the tax imposed by section 4081 shall, insofar as applicable and not inconsistent with this section, apply in respect of the payments provided for in this section to the same extent as if such payments constituted refunds of overpayments of the tax so imposed.

(2) EXAMINATION OF BOOKS AND WITNESSES.—For the purpose of ascertaining the correctness of any claim made under this section, or the correctness of any payment made in respect of any such claim,

the Secretary or his delegate shall have the authority granted by paragraphs (1), (2), and (3) of section 7602 (relating to examination of books and witnesses) as if the claimant were the person liable for tax.

(3) FRACTIONAL PARTS OF A DOLLAR.—Section 7504 (granting the Secretary discretion with respect to fractional parts of a dollar) shall not apply.

(f) REGULATIONS.—The Secretary or his delegate may by regulations prescribe the conditions, not inconsistent with the provisions of this section, under which payments may be made under this section.

(g) EFFECTIVE DATE.—This section shall apply only with respect to gasoline purchased after December 31, 1955.

(h) CROSS REFERENCES.—

(1) For exemption from tax in case of diesel fuel and special motor fuels used on a farm for farming purposes, see section 4041(d).

(2) For civil penalty for excessive claim under this section, see section 6675.

(3) For fraud penalties, etc. see chapter 75 (section 7201 and following, relating to crimes, other offenses, and forfeitures).

[Sec. 6420 as added by sec. 1, Act of Apr. 2, 1956 (Pub. Law 466, 84th Cong., 70 Stat. 87)]

§ 301.6420–1 GASOLINE USED ON FARMS.—For regulations under section 6420, see the Manufacturers and Retailers Excise Tax Regulations (Part 40 of this chapter).

§ 301.6421 STATUTORY PROVISIONS; GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS.

SEC. 6421. GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS

(a) NONHIGHWAY USES.—If gasoline is used otherwise than as a fuel in a highway vehicle (1) which (at the time of such use) is registered, or is required to be registered, for highway use under the laws of any State or foreign country, or (2) which, in the case of a highway vehicle owned by the United States, is used on the highway, the Secretary or his delegate shall pay (without interest) to the ultimate purchaser of such gasoline an amount equal to 1 cent for each gallon of gasoline so used.

(b) LOCAL TRANSIT SYSTEMS.—

(1) ALLOWANCE.—If gasoline is used during any calendar quarter in vehicles while engaged in furnishing scheduled common carrier public passenger land transportation service along regular routes, the Secretary or his delegate shall, subject to the provisions of paragraph (2), pay (without interest) to the ultimate purchaser of such gasoline the amount determined by multiplying—

(A) 1 cent for each gallon of gasoline so used, by

(B) The percentage which the ultimate purchaser's tax-exempt passenger fare revenue derived from such scheduled service during such quarter was of his total passenger fare revenue (not including the tax imposed by section 4261, relating to the tax on thansportation of persons) derived from such scheduled service during such quarter.

(2) LIMITATION.—Paragraph (1) shall apply in respect of gasoline used during any calendar quarter only if at least 60 percent of the total passenger fare revenue (not including the tax imposed by section 4261, relating to the tax on transportation of persons) derived during such quarter from scheduled service described in paragraph (1) by the person filing the claim was attributable to tax-exempt passenger fare revenue derived during such quarter by such person from such scheduled service.

(c) TIME FOR FILING CLAIM; PERIOD COVERED.—Not more than one claim may be filed under subsection (a), and not more than one claim may be filed under subsection (b), by any person with respect to gasoline used during the one-year period ending on June 30 of any year. No claim shall be allowed under this section with respect to any one-year period unless filed on or before September 30 of the year in which such one-year period ends.

(d) DEFINITIONS.—For purposes of this section—

(1) GASOLINE.—The term "gasoline" has the meaning given to such term by section 4082(b).

(2) TAX-EXEMPT PASSENGER FARE REVENUE.—The term "tax exempt passenger fare revenue" means revenue attributable to fares which were exempt from the tax imposed by section 4261 by reason of section 4263(a) (relating to the exemption for commutation travel, etc.).

(e) EXEMPT SALES; OTHER PAYMENTS OR REFUNDS AVAILABLE.—

(1) EXEMPT SALES.—No amount shall be paid under this section with respect to any gasoline which the Secretary or his delegate determines was exempt from the tax imposed by section 4081. The amount which (but for this sentence) would be payable under this section with respect to any gasoline shall be reduced by any other amount which the Secretary or his delegate determines is payable under this section, or is refundable under any provision of this title, to any person with respect to such gasoline.

(2) GASOLINE USED ON FARMS.—This section shall not apply in respect of gasoline which was (within the meaning of paragraphs (1), (2), and (3) of section 6420(c)) used on a farm for farming purposes.

(f) APPLICABLE LAWS.—

(1) IN GENERAL.—All provisions of law, including penalties, applicable in respect of the tax imposed by section 4081 shall, insofar as applicable and not inconsistent with this section, apply in respect of the payments provided for in this section to the same extent as if such payments constituted refunds of overpayments of the tax so imposed.

(2) EXAMINATION OF BOOKS AND WITNESSES.—For the purpose of ascertaining the correctness of any claim made under this section, or the correctness of any payment made in respect of any such claim, the Secretary or his delegate shall have the authority granted by paragraphs (1), (2), and (3) of section 7602 (relating to examination of books and witnesses) as if the claimant were the person liable for tax.

(g) REGULATIONS.—The Secretary or his delegate may by regulations prescribe the conditions, not inconsistent with the provisions of this section, under which payments may be made under this section.

(h) EFFECTIVE DATE.—This section shall apply only with respect to gasoline purchased after June 30, 1956, and before July 1, 1972.

(i) CROSS REFERENCES—

(1) For reduced rate of tax in case of diesel fuel and special motor fuels used for certain nonhighway purposes, see subsections (a) and (b) of section 4041.

(2) For partial refund of tax in case of diesel fuel and special motor fuels used for certain nonhighway purposes, see section 6416(b)(2)(J) and (K).

(3) For partial refund of tax in case of diesel fuel and special motor fuels used by local transit systems, see section 6416(b)(2)(L).

(4) For civil penalty for excessive claims under this section, see section 6675.

(5) For fraud penalties, etc., see chapter 75 (section 7201 and following, relating to crimes, other offenses, and forfeitures).

[Sec. 6421 as added by sec. 208(c), Highway Revenue Act 1956 (70 Stat. 394), and as amended by sec. 2, Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 644)]

§ 301.6421–1 GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS.—For regulations under section 6421, see the Manufacturers and Retailers Excise Tax Regulations (Part 40 of this chapter).

PAR. 14. Section 301.6504 is amended by adding at the end of section 6504 the following:

(13) Assessments to recover excessive amounts paid under section 6420 (relating to gasoline used on farms) and assessments of civil penalties under section 6675 for excessive claims under section 6420, see section 6206.

(14) Assessments to recover excessive amounts paid under section 6421 (relating to gasoline used for certain nonhighway purposes or by local transit systems) and assessments of civil penalties under section 6675 for excessive claims under section 6421, see section 6206.

[Sec. 6504 as amended by sec. 4(d), Act of Apr. 2, 1956 (Pub. Law 466, 84th Cong., 70 Stat. 91); sec. 208(e)(5), Highway Revenue Act 1956 (70 Stat. 397)]

PAR. 15. Section 301.6511(f) is amended by adding at the end of section 6511(f) the following:

(5) For limitations in case of payments under section 6420 (relating to gasoline used on farms), see section 6420(b).

(6) For limitations in case of payments under section 6421 (relating to gasoline used for certain nonhighway purposes or by local transit systems), see section 6421(c).

[Sec. 6511(f) as amended by sec. 4(e), Act of Apr. 2, 1956 (Pub. Law 466, 84th Cong., 70 Stat. 91); sec. 208(e)(6), Highway Revenue Act 1956 (70 Stat. 397)]

PAR. 16. Paragraph (c)(1)(iii)(*a*) of § 301.7502–1 is amended by inserting at the end thereof the following new sentence:

Furthermore, in case the cover containing a document bearing a timely postmark made by the United States Post Office is received after the time when a document postmarked and mailed at such time would ordinarily be received, the sender may be required to prove that it was timely mailed.

Because this Treasury Decision makes only clarifying, procedural, and technical changes, it is hereby found that it is unnecessary to issue this Treasury decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U. S. C. 7805).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved April 15, 1958.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on April 18, 1958, 8:53 a. m., and published in the issue of the Federal Register for April 19, 1958, 23 F. R. 2597)

CHAPTER 64.—COLLECTION

SUBCHAPTER B.—RECEIPT OF PAYMENT

SECTION 6312.—PAYMENT BY UNITED STATES NOTES AND CERTIFICATES OF INDEBTEDNESS

26 CFR 301.6312–1: Treasury certificates of indebtedness, Treasury notes, and Treasury bills acceptable in payment of internal revenue taxes or stamps.

Regulations under the Internal Revenue Code of 1954 are amended. See T. D. 6292, page 476.

SUBCHAPTER D.—SEIZURE OF PROPERTY FOR COLLECTION OF TAXES

SECTION 6334.—PROPERTY EXEMPT FROM LEVY

26 CFR 301.6334–1: Property exempt from levy.

Regulations under the Internal Revenue Code of 1954 are amended. See T. D. 6292, page 476.

CHAPTER 65.—ABATEMENTS, CREDITS, AND REFUNDS

SUBCHAPTER A.—PROCEDURE IN GENERAL

SECTION 6402.—AUTHORITY TO MAKE CREDITS OR REFUNDS

26 CFR 301.6402–2: Claims for credit or refund.

Regulations under the Internal Revenue Code of 1954 are amended. See T. D. 6292, page 476.

26 CFR 301.6402–3: Special rules applicable to income tax.

Regulations under the Internal Revenue Code of 1954 are amended. See T. D. 6292, page 476.

SUBCHAPTER B.—RULES OF SPECIAL APPLICATION

SECTION 6416.—CERTAIN TAXES ON SALES AND SERVICES

(Also Section 4061.) Rev. Rul. 58-216

The act of mounting a body on a truck chassis is not considered a use or further manufacture of either the chassis or the body. Such an act by an exporter of complete garbage collection units does not preclude such exporter from filing, under appropriate waiver, a claim for refund or credit with respect to the manufacturers excise tax paid by the manufacturer of the truck chassis and passed on to the exporter in the sale price. A claim should be filed by the exporter with the District Director of Internal Revenue for the district in which is located the claimant's principal place of business.

Advice has been requested whether an exporter of articles, on which the manufacturers excise taxes have been paid, is entitled to file a claim for refund or credit under the circumstances described below.

A company is engaged in the exporting of garbage collection units. The company purchases truck chassis from a manufacturer through a domestic dealer and mounts its own garbage collection bodies on the chassis to form the complete units. The chassis are purchased from the manufacturer on a tax-paid basis. The manufacturer of the truck chassis advises that he does not intend to file a claim for refund or credit of the tax paid with respect to the chassis exported.

Section 6416(e) of the Internal Revenue Code of 1954 provides that the amount of tax collected in respect of any article exported to a foreign country or shipped to a possession of the United States may be refunded to the exporter or shipper if the person who paid such tax waives his claim to such an amount.

Revenue Ruling 247, C. B. 1953-2, 353, provides that an exporter or shipper may file a claim for refund of the tax paid with respect to articles purchased for export and exported in due course, provided he obtains a signed statement from the manufacturer waiving any claim for the amount to be refunded and showing (1) that the manufacturer had in his possession at the time of the sale of the articles evidence that the articles were to be exported, (2) the amount of tax paid, and (3) the District Director's office to which the tax was paid as well as the date of payment.

Section 4061 of the Code provides that, for the purposes of the manufacturers tax, the sale of an automobile truck, bus, truck or bus trailer or semi-trailer shall be considered to be a sale of the chassis and of the body.

Section 316.25 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47, requires, among other things, that an article in due course of exportation must be so exported prior to use or further manufacture in the United States.

It is held that the act of mounting a body upon a chassis, in the situation described above, is not considered to be a use or further manufacture of either the chassis or the body, because the sale of an automobile truck is the sale of the chassis and of the body. Therefore, such an act by an exporter of complete garbage collection units does not preclude the exporter from filing a claim for refund with

respect to the manufacturers tax paid by the manufacturer of the chassis and passed on to the exporter in the sale price. The exporter should file his claim with the District Director of Internal Revenue for the district in which is located the claimant's principal place of business. The claim should be properly supported by the waiver required by section 6416 (e) of the Code and by evidence to establish that the chassis were sold by the manufacturer for export or for resale for export and that they were exported in due course.

Further manufacture of passenger automobile chassis and bodies into ambulances, funeral coaches, and combination funeral coach and ambulance. See Rev. Rul. 58–32, page 391.

Whether credit or refund is allowable where tax-paid tread rubber is damaged or destroyed in the recapping or retarding process. See Rev. Rul. 58–105, page 402.

Taxable articles may not be sold tax-free to a contractor for installation on vessels of war he is constructing for the United States Navy. See Rev. Rul. 58–171, page 428.

SECTION 6420.—GASOLINE USED ON FARMS

Rev. Rul. 58–118

A feed lot where livestock is held for an extended period of time during which there is an appreciable weight increase is considered to be a "farm," and any gasoline used within such a feed lot is considered to be gasoline used "on a farm for farming purposes," and payment may be made under section 6420 of the Internal Revenue Code of 1954.

Advice has been requested whether a feed lot is considered to be a farm and whether gasoline used in the operation of such a feed lot is considered to be gasoline used on a farm for farming purposes.

The feed lot consists of pens or lots where livestock are held and fed until such time as they are suitable for market. In some instances, it consists only of the area on which are located the pens and necessary equipment to grind and mix the feed for distribution to the livestock. In other cases, the lot may be part of a larger area where the feed used in the feeding operation is produced. The livestock in the feed lot may be owned by the operator of the lot, or they may be owned by others.

Under the provisions of section 6420(a) of the Internal Revenue Code of 1954, if gasoline is used on a farm for farming purposes, the ultimate purchaser is entitled to a payment in the amount determined by multiplying the number of gallons so used by the rate of tax on gasoline under section 4081 which applied on the date he purchased such gasoline.

Section 6420(c) (2) of the Code defines the term "farm" to include stock, dairy, poultry, fruit, fur-bearing animal, and truck farms,

plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards. Section 6420(c)(3)(A) of the Code provides, in part, that gasoline shall be treated as used for farming purposes if used by the owner, tenant, or operator of a farm in the raising, shearing, feeding, caring for, training, and management of livestock on a farm of which he is the owner, tenant, or operator.

It is held that a feed lot where livestock is held for an extended period of time during which there is an appreciable weight increase is considered to be a "farm" within the meaning of section 6420 of the Code. It is further held that any gasoline used within such a feed lot is considered to be gasoline used "on a farm for farming purposes." Accordingly, the owner, tenant, or operator of the feed lot is entitled to file a claim for payment provided under section 6420(a) of the Code. However, gasoline consumed in vehicles used on the highway in the transportation of livestock, feed, crops, or equipment is not considered to be gasoline used on a farm for farming purposes. Therefore, such gasoline may not be taken into consideration in computing the tax payment.

Rev. Rul. 58–119

Where gasoline is used by a custom operator in performing services for a farmer, the farmer on whose farm the services are performed is considered to be the ultimate purchaser of such gasoline and is entitled to file a claim for payment provided by section 6420(a) of the Internal Revenue Code of 1954.

Advice has been requested whether a company which uses gasoline in furnishing to farmers aerial custom service, such as crop dusting, is considered to be the ultimate purchaser of the gasoline and entitled to file a claim for payment with respect to the tax paid on such gasoline. The equipment used in performing such services is owned and operated by the aerial custom operator.

Under the provisions of section 6420(a) of the Internal Revenue Code of 1954, if gasoline is used on a farm for farming purposes, the ultimate purchaser is entitled to a payment in the amount determined by multiplying the number of gallons so used by the rate of tax on gasoline under section 4081 which applied on the date he purchased such gasoline. Section 6420(c)(3)(A) of the Code provides, in part, that gasoline shall be treated as used for farming purposes only if used by the owner, tenant, or operator of a farm in connection with cultivating the soil, or in connection with raising or harvesting agricultural or horticultural commodities, including the raising, shearing, feeding, caring for, training, and management of livestock, bees, poultry and fur-bearing animals and wildlife, on a farm of which he is the owner, tenant, or operator; except that if such use is by any other person, the owner, tenant, or operator of the farm shall be treated as the user and ultimate purchaser of such gasoline.

Accordingly, it is held that where gasoline is used by a custom operator in performing the operations described in section 6420(c)(3)(A) on a farm for farming purposes, the farmer on whose farm the services are performed is considered to be the user and ultimate purchaser of such gasoline. Therefore, in the instant case,

the farmer and not the aerial custom operator is entitled to file a claim for payment provided by section 6420(a) of the Code.

Rev. Rul. 58–174

Gasoline used by a paper manufacturing company in connection with the planting, cultivating, caring for, and cutting of trees, where such operations are not incidental to farming operations, is not considered to be gasoline used "on a farm for farming purposes," and no payment may be made under section 6420 of the Internal Revenue Code of 1954 with respect to gasoline so used.

Advice has been requested whether gasoline used by a paper manufacturing company in connection with the raising of trees for wood fiber is considered to be gasoline used on a farm for farming purposes.

In connection with the manufacturing of paper, a paper company is engaged in the planting, cultivating, caring for, and cutting of trees. These operations are carried on to assure a sustained supply of the wood fiber necessary to the operation of its paper manufacturing business. A crop of mature trees is cut annually, and a new crop is planted to replace the mature trees cut. A portion of the mature trees is used for making wood pulp, another portion is sold for milling into lumber, and the balance is exchanged for logs suitable for making pulp.

Under the provisions of section 6420(a) of the Internal Revenue Code of 1954, if gasoline is used on a farm for farming purposes, the ultimate purchaser is entitled to a payment determined by multiplying the number of gallons so used by the rate of tax on gasoline under section 4081 of the Code, which applied on the date he purchased such gasoline. Section 6420(c)(3)(C) of the Code provides that gasoline shall be treated as used for farming purposes if used by the owner, tenant, or operator of a farm, in connection with (i) the planting, cultivating, caring for, or cutting of trees, or (ii) the preparation (other than milling) of trees for market, incidental to farming operations.

Under the circumstances described above, it is held that the paper manufacturing company is not engaged in farming operations within the meaning of section 6420(c) of the Code, and the operations of the paper company in the planting, cultivating, caring for, cutting, or the preparation (other than milling) of trees for market are not considered to be operations "incidental to" farming operations. Accordingly, gasoline used in connection with these operations is not considered to be gasoline used "on a farm for farming purposes," and no payment may be made under section 6420(a) of the Code with respect to the use of such gasoline. However, section 6421 (a) of the Code, effective July 1, 1956, provides that the ultimate purchaser of gasoline is entitled to a payment equal to one cent for each gallon of gasoline which is used *otherwise* than as a fuel in a highway vehicle which (at the time of such use) is registered, or is required to be registered, for highway use under the law of any State or foreign country.

Rev. Rul. 58–219

The relief provided by section 6420(a) of the Internal Revenue Code of 1954 does not apply to gasoline used in spraying lawn areas and in cultivating the soil for seeding at schools, churches, institutions and private estates. However, the relief provision applies to gasoline used in spraying fruit orchards.

Advice has been requested whether the relief provided by section 6420(a) of the Internal Revenue Code of 1954, pertaining to gasoline used on a farm for farming purposes, applies to gasoline used by a company (1) in operating a hydraulic sprayer to spray fruit orchards and lawn areas, (2) in operating tractors to cultivate the soil for seeding at schools, churches, institutions, and private estates, and (3) in operating a fork lift to handle lumber in its lumber yard. The hydraulic sprayer, the tractors, and the fork lift are owned and operated by the company.

Under the provisions of section 6420(a) of the Code, if gasoline is used on a farm for farming purposes, the ultimate purchaser is entitled to a payment determined by multiplying the number of gallons so used by the rate of tax on gasoline which applied on the date he purchased such gasoline. Section 6420(c)(1) of the Code provides that gasoline shall be treated as used on a farm for farming purposes only if used (A) in carrying on a trade or business, (B) on a farm situated in the United States, and (C) for farming purposes.

Section 6420(c)(2) of the Code provides that the term "farm" includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards.

Section 6420(c)(3)(A) of the Code provides that gasoline shall be treated as used for farming purposes only if used by the owner, tenant, or operator of a farm in connection with cultivating the soil, or in connection with raising or harvesting any agriculture or horticulture commodity on a farm of which he is the owner, tenant, or operator. However, if such use is by any person other than the owner, tenant, or operator of such farm, the owner, tenant, or operator of the farm on which the gasoline is used shall be treated as the user and ultimate purchaser of such gasoline.

Accordingly, it is held that gasoline used by an owner, tenant, or operator of a farm for spraying fruit orchards is considered to be gasoline used on a farm for farming purposes. However, if gasoline for spraying the fruit orchards is used by any person other than the owner, tenant, or operator of the farm, the owner, tenant, or operator of the farm on which the service is perfromed is considered to be the user and ultimate purchaser of such gasoline. Therefore, in the instant case, the farmer, and not the company performing the custom service, is entitled to file a claim for the payment provided by section 6420(a) of the Code with respect to the gasoline used for spraying the fruit orchards.

It is further held that the relief provided by section 6420(a) of the Code does not apply to gasoline used to spray lawn areas, to cultivate the soil at schools, churches, institutions, and private estates, or to operate a fork lift to handle lumber in a lumber yard, since such gasoline is not used on a farm for farming purposes. However, section 6421(a) of the Code provides, in part, that the ultimate purchaser is entitled to a payment equal to one cent for each gallon of gasoline which is purchased on or after July 1, 1956, and which is used *otherwise* than as a fuel in a highway vehicle which (at the time of such use) is registered, or is required to be registered, for highway use under the laws of any state or foreign country. Accordingly, where the

tractors and the fork lift are not registered, and are not required to be registered for highway use under the laws of any state or foreign country, the company is entitled to a payment equal to one cent for each gallon of gasoline used in such tractors and fork lift.

Rev. Rul. 58–252

Gasoline used by a nursery in cultivating and raising trees, shrubs, evergreens, and vines is considered to be gasoline used "for farming purposes" and payment may be made under section 6420(a) of the Internal Revenue Code of 1954.

Advice has been requested whether the owner, tenant, or operator of a nursery qualifies for the payment authorized with respect to gasoline used on a farm for farming purposes, under the circumstances described below.

A nursery is engaged in growing and selling trees, shrubs, evergreens, and vines. These products are usually delivered and replanted for the customers. The nursery has no other activities which might be considered to be farming activities.

Under the provisions of section 6420(a) of the Internal Revenue Code of 1954, if gasoline is used on a farm for farming purposes, the ultimate purchaser is entitled to a payment in the amount determined by multiplying the number of gallons so used by the rate of tax on gasoline under section 4081 which applied on the date he purchased such gasoline. Section 6420(c)(2) of the Code defines the term "farm" as including plantations, ranches, nurseries, ranges, greenhouses, or other similar structures used primarily for the raising of agricultural or horticultural commodities. Section 6420(c)(3) of the Code provides, in part, that gasoline shall be treated as used on a farm for farming purposes if used by the owner, tenant, or operator of a farm, in connection with (1) the planting, cultivating, caring for, or cutting of trees, or (2) the preparation (other than milling) of trees for market, incidental to farming operations.

It is held that a nursery where trees, shrubs, evergreens, and vines are cultivated and grown is a "farm" within the meaning of section 6420(c)(2) of the Code; therefore, gasoline used for such operations is considered to be used "for farming purposes." Accordingly, the owner, tenant, or operator of such nursery is entitled to file a claim for payment provided under section 6420(a) of the Code. However, any gasoline consumed in vehicles used on the highways in the delivery of trees, shrubs, etc., or consumed in replanting those products for customers, is not used "on a farm for farming purposes" and may not be taken into consideration in computing the payment authorized under that section.

Rev. Rul. 58–289

Gasoline used in the transportation of agricultural or horticultural commodities on roads owned by a state and financed by a state road bond issue is not considered to be gasoline used "on a farm for farming purposes," and the relief provision under section 6420(a) of the Internal Revenue Code of 1954 does not apply to such gasoline.

Advice has been requested whether gasoline used in vehicles traveling on certain state-owned "farm-to-market" roads in the transportation of agricultural or horticultural commodities from the farm to

market is considered to be gasoline used "on a farm for farming purposes."

The roads in question are financed by a state bond issue. The state does not receive Federal aid for the building and maintenance of such roads. They are outside the boundaries of individual farms and are accessible to the general public.

Under the provisions of section 6420(a) of the Internal Revenue Code of 1954, if gasoline is used on a farm for farming purposes, the ultimate purchaser is entitled to a payment in the amount determined by multiplying the number of gallons so used by the rate of tax on gasoline under section 4081 which applied on the date he purchased such gasoline.

The roads described above are not considered to be private roads on individual farms. The fact that the state is not receiving Federal aid for the building and maintenance of certain public roads does not mean that such roads are not highways.

In view of the foregoing, it is held that any gasoline used in vehicles traveling on such roads is not gasoline used "on a farm for farming purposes" even though those vehicles are being used in the transportation of agricultural or horticultural commodities from the farm to market.

Accordingly, any gasoline consumed in this manner may not be taken into consideration in computing the tax payments authorized under section 6420(a) of the Code.

SECTION 6423.—CONDITIONS TO ALLOWANCE IN THE CASE OF ALCOHOL AND TOBACCO TAXES

Credits or refunds of tobacco taxes only to persons who have borne the ultimate burden of the tax. See P. L. 85–323, page 630.

CHAPTER 66.—LIMITATIONS

SUBCHAPTER A.—LIMITATIONS ON ASSESSMENT AND COLLECTION

SECTION 6501.—LIMITATIONS ON ASSESSMENT AND COLLECTION

(Also Sections 4001, 4011, 4021, 4031.) Rev. Rul. 58–274

If a retailer, who is liable for the retailers excise taxes imposed by two or more sections of the Internal Revenue Code, files a return on which he reports his liability for the tax imposed by one or more of those sections but makes no entry on the return concerning his liability for the tax imposed by any other section or sections, the return so filed will not constitute a return as to the tax imposed by the section or sections for which no entry was made. Accordingly, such tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

Advice has been requested concerning the applicability of the statute of limitations on assessment and collection under the circumstances described below.

A retailer was liable for payment of the retailers excise taxes imposed under two sections of the Internal Revenue Code of 1954, such as, for example, the tax imposed on jewelry and related items by section 4001 and the tax imposed on furs by section 4011. He filed a timely Form 720, Quarterly Federal Excise Tax Return, and correctly reported thereon his liability for the category of retailers excise tax imposed by one section. However, he made no report of his liability under the other section.

Section 6501(a) of the Code provides that the tax shall be assessed within three years after the return was filed. Section 6501(c)(3) provides that in the case of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

The retailers excise taxes imposed by different sections of the Code are separate and distinct taxes. The requirements for filing a return apply separately to each category, even though for convenience the return for all categories may be made on the same form.

Therefore, it is held that if a retailer, who is liable for the retailers excise taxes imposed by two or more sections of the Internal Revenue Code, files a return on which he reports his liability for the tax imposed by one or more of those sections but makes no entry on the return concerning his liability for the tax imposed by any other section or sections, he has filed no return for the category or categories of tax for which no entry was made. Accordingly, the tax for the category or categories for which no entry was made may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

CHAPTER 67.—INTEREST

SUBCHAPTER A.—INTEREST ON UNDERPAYMENTS

SECTION 6601.—INTEREST ON UNDERPAYMENT, NONPAYMENT OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

26 CFR 301.6601–1: Interest on underpayments.

Proper allocation of a partial payment toward tax, penalty and interest. See Rev. Rul. 58–239, page 94.

---

26 CFR 301.6601–1: Interest on underpayment.

Applicability of interest to so-called "collected" excise taxes where direct assessment is made against a taxpayer who refuses to pay the tax to a collecting agency. See Rev. Rul. 58–300, page 454.

CHAPTER 68.—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

SUBCHAPTER A.—ADDITIONS TO THE TAX AND ADDITIONAL AMOUNTS

SECTION 6651.—FAILURE TO FILE TAX RETURN

Applicability of penalty to so-called "collected" excise taxes where direct assessment is made against a taxpayer who refuses to pay the tax to a collecting agency. See Rev. Rul. 58–300, page 454.

SECTION 6655.—FAILURE BY CORPORATION TO PAY ESTIMATED INCOME TAX

26 CFR 1.6655–2: Exceptions to imposition of the addition to the tax in the case of corporations.

Regulations under the Internal Revenue Code of 1954 amended. See T. D. 6293, page 114.

CHAPTER 70.—JEOPARDY, BANKRUPTCY AND RECEIVERSHIPS

SUBCHAPTER A.—JEOPARDY

PART I.—TERMINATION OF TAXABLE YEAR

SECTION 6851.—TERMINATION OF TAXABLE YEAR

Rev. Rul. 58–7

Aliens in transit through the United States who schedule their departure from the United States not more than five days after their arrival are not required to obtain a Certificate of Compliance if there is no question of taxable income.

Revenue Ruling 55–468, C. B. 1955–2, 501, amplified.

Advice has been requested whether an alien in transit through the United States is required to obtain a Certificate of Compliance when there is no question of taxable income and in making continuing connections he schedules his departure and actually departs from the United States not more than five days after his arrival from a foreign country.

Section 6851(d) of the Internal Revenue Code of 1954 provides that no alien shall depart from the United States unless he first procures from the Secretary of the Treasury or his delegate a certificate that he has complied with all the obligations imposed upon him by the income tax laws.

Revenue Ruling 55–468, C. B. 1955–2, 501, pertaining to the procedures for the issuance of Certificates of Compliance to aliens departing from the United States, provides in section 7 thereof that aliens in transit through the United States or any of its possessions without stopover privileges, who, solely because of transportation difficulties in making continuing connections, are obliged to remain therein for a period not to exceed five days in any one trip, may depart without obtaining a Certificate of Compliance unless there is evidence available indicating taxable income.

In view of the above, it is held that aliens in transit through the United States who schedule their departure and actually depart from the United States not more than five days after their arrival are not required to obtain a Certificate of Compliance if there is no question of taxable income. Revenue Ruling 55–468, C. B. 1955–2, 501, amplified.

CHAPTER 75.—CRIMES, OTHER OFFENSES, AND FORFEITURES

SUBCHAPTER A.—CRIMES

PART I.—GENERAL PROVISIONS

SECTION 7213.—UNAUTHORIZED DISCLOSURE OF INFORMATION

(Also Section 6103.) Rev. Rul. 58–120

The disclosure to a taxpayer, by an officer or employee of the Internal Revenue Service, of information furnished the Service by the taxpayer's former spouse relative to amounts claimed for the support of their child would constitute a disclosure of confidential matters prohibited by section 7213(a)(1) of the Internal Revenue Code of 1954.

Advice has been requested whether there is a disclosure of confidential matters, within the meaning of section 7213(a)(1) of the Internal Revenue Code of 1954, where there is a disclosure to a former husband of information furnished the Internal Revenue Service by a former wife of amounts expended by her for the support of their child.

Section 7213(a)(1) of the Internal Revenue Code of 1954 provides that:

FEDERAL EMPLOYEES AND OTHER PERSONS.—It shall be unlawful for an 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 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 any person committing an offense against the foregoing provision shall be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than $1000, or imprisoned not more than 1 year, or both, together with the costs of prosecution; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment.

In view of the specific language of section 7213(a)(1), it is held that the disclosure to a taxpayer, by an officer or employee of the Internal Revenue Service, of information furnished to the Service by the taxpayer's former spouse relative to amounts expended for the support of their child constitutes a disclosure of confidential matters in violation of the above quoted provision of the statute. The taxpayer, in instances of this kind, may be informed only that the amount reported by him is not sufficient to establish that he has contributed the portion required to qualify the child as his dependent.

SECTION 7215.—OFFENSES WITH RESPECT TO COLLECTED TAXES

Penalties for failure to comply with the collection provision of section 7512. See P. L. 85–321, page 629.

CHAPTER 76.—JUDICIAL PROCEEDINGS

SUBCHAPTER B.—PROCEEDINGS BY TAXPAYERS

SECTION 7422.—CIVIL ACTIONS FOR REFUND

Refunds of tobacco taxes only to persons who have borne the ultimate burden of the tax. See P. L. 85–323, page 630.

CHAPTER 77.—MISCELLANEOUS PROVISIONS

SECTION 7502.—TIMELY MAILING TREATED AS TIMELY FILING

26 CFR 301.7502–1: Timely mailing treated as timely filing.

Regulations under the Internal Revenue Code of 1954 are amended. See T. D. 6292, page 476.

SECTION 7512.—SEPARATE ACCOUNTING FOR CERTAIN COLLECTED TAXES, ETC.

Accounting for the collection of taxes imposed by subtitle C or chapter 33. See P. L. 85–321, page 629.

PART II

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939 AND OTHER RELATED PUBLIC LAWS

SUBPART A.—RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939

Rulings and decisions published in Part II, Subpart A, of the Internal Revenue Bulletin are based on the application of provisions of the Internal Revenue Code of 1939 and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1954, or the Federal Firearms Act, or other public laws.

SUBTITLE A.—TAXES SUBJECT TO THE JURISDICTION OF THE BOARD OF TAX APPEALS

CHAPTER 1.—INCOME TAX

SUBCHAPTER B.—GENERAL PROVISIONS

PART II.—COMPUTATION OF NET INCOME

SECTION 22(a).—GROSS INCOME: GENERAL DEFINITION

REGULATIONS 118, SECTION 39.22(a)–1; What included in gross income.

Transfer from reserve for bad debts to earned surplus where reserve arose during years for which the taxpayer was not subject to Federal income tax. See Rev. Rul. 58–126, page 13.

Inclusion in gross income of lockout benefits paid by a union to its members as well as nonmembers. See Rev. Rul. 58–139, page 14.

REGULATIONS 118, SECTION 39.22(a)–3: Compensation paid other than in cash.

Amounts paid by employer for premiums on sickness and disability insurance policies for the benefit of employee where policies are not a part of a group insurance plan. See Rev. Rul. 58–90, page 88.

SECTION 22(b).—GROSS INCOME: EXCLUSIONS FROM GROSS INCOME

Proceeds from sickness and disability insurance policies where premiums are paid by employer, the policies not part of a group insurance plan. See Rev. Rul. 58-90, page 88.

SECTION 22(c).—GROSS INCOME: INVENTORIES

REGULATIONS 118, SECTION 39.22(c)-2: Valuation of inventories.

Treatment of amortization of emergency facilities as part of inventory costs. See Rev. Rul. 58-181, page 238.

SECTION 23(a).—DEDUCTIONS FROM GROSS INCOME: EXPENSES

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses. Ct. D. 1819

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF SUPREME COURT

1. INCOME TAX—DEDUCTIONS FROM GROSS INCOME—BUSINESS EXPENSES—FINES PAID BY TRUCKER FOR VIOLATION OF STATE MAXIMUM WEIGHT LAWS.

The owner of a fleet of trucks may not deduct fines paid for violations of state maximum weight laws regardless of whether the violations were willful or innocent, since in all cases the violations frustrated state policy. The fines were under the penal statutes enacted by the states to protect their highways from damage and to insure the safety of all persons using them and were not merely revenue tolls. It is immaterial that in 1955 Pennsylvania raised its maximum weight restrictions. Fines for both willful and innocent violations are nondeductivle since the maximum weight statutes made no distinction between innocent and willful violators and state policy would be as much thwarted in one instance as in the other.

2. JUDGEMENT AFFIRMED.

Judgement of the United States Court of Appeals for the Third Circuit, 242 F. 2d 14, affirmed.

SUPREME COURT OF THE UNITED STATES

Tank Truck Rentals, Inc., petitioner v. *Commissioner of Internal Revenue*

On writ of certiorari to the United States Court of Appeals for the Third Circuit

[March 17, 1958]

OPINION

MR. JUSTICE CLARK delivered the opinion of the Court.

In 1951 petitioner Tank Truck Rentals paid several hundred fines imposed on it and its drivers for violations of state maximum weight laws. This case involves the deductibility of those payments as "ordinary and necessary" business expenses under section 23(a)(1)(A) of the Internal Revenue Code of 1939.[1] Prior to 1950 the Commissioner had permitted such deductions,[2]

[1] "SEC. 23. DEDUCTIONS FROM GROSS INCOME.
"In computing net income there shall be allowed as deductions:
"(a) EXPENSES.—
"(1) TRADE OR BUSINESS EXPENSES.—
"(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *." 53 Stat. 12, as amended, 56 Stat. 819.

[2] IT: P: 2—WTL; 5 CCH, 1950 Fed. Tax Rep. ¶ 6134.

but a change of policy that year[3] caused petitioner's expenditures to be disallowed. The Tax Court, reasoning that allowance of the deduction would frustrate sharply defined state policy expressed in the maximum weight laws, upheld the Commissioner. 26 T. C. 427. The Court of Appeals affirmed on the same ground, 242 F. 2d 14, and we granted certiorari. 354 U. S. 920 (1957). In our view, the deductions properly were disallowed.

Petitioner, a Pennsylvania corporation, owns a fleet of tank trucks which it leases, with drivers, to motor carriers for transportation of bulk liquids. The lessees operate the trucks throughout Pennsylvania and the surrounding States of New Jersey, Ohio, Delaware, West Virginia, and Maryland, with nearly all the shipments originating or terminating in Pennsylvania. In 1951, the tax year in question, each of these States imposed maximum weight limits for motor vehicles operating on its highways.[4] Pennsylvania restricted truckers to 45,000 pounds, however, while the other States through which petitioner operated allowed maximum weights approximating 60,000 pounds. It is uncontested that trucking operations were so hindered by this situation that neither petitioner nor other bulk liquid truckers could operate profitably and also observe the Pennsylvania law. Petitioner's equipment consisted largely of 4,500–5,000 gallon tanks, and the industry rate structure generally was predicated on fully loaded use of equipment of that capacity. Yet only one of the commonly carried liquids weighed little enough that a fully loaded truck could satisfy the Pennsylvania statute. Operation of partially loaded trucks, however, not only would have created safety hazards, but also would have been economically impossible for any carrier so long as the rest of the industry continued capacity loading. And the industry as a whole could not operate on a partial load basis without driving shippers to competing forms of transportation. The only other alternative, use of smaller tanks, also was commercially impracticable, not only because of initial replacement costs but even more so because of reduced revenue and increased operating expense, since the rates charged were based on the number of gallons transported per mile.

Confronted by this dilemma, the industry deliberately operated its trucks overweight in Pennsylvania in the hope, and at the calculated risk, of escaping the notice of the state and local police. This conduct also constituted willful violations in New Jersey, for reciprocity provisions of the New Jersey statute subjected trucks registered in Pennsylvania to Pennsylvania weight restrictions while traveling in New Jersey.[5] In the remainder of the States in which petitioner operated, it suffered overweight fines for several unintentional violations, such as those caused by temperature changes in transit. During the tax year 1951, petitioner paid a total of $41,060.84 in fines and costs for 718 willful and 28 innocent violations. Deduction of that amount in petitioner's 1951 tax return was disallowed by the Commissioner.

It is clear that the Congress intended the income tax laws "to tax earnings and profits less expenses and losses," *Higgins* v. *Smith*, 308 U. S. 473, 477 (1940) [Ct. D. 1434, C. B. 1940–1, 127], carrying out a broad basic policy of taxing "net, not * * * gross income * * *." *McDonald* v. *Commissioner*, 323 U. S. 57, 66–67 (1944) [Ct. D. 1617, C. B. 1944, 94]. Equally well established is the rule that deductibility under section 23(a)(1)(A) is limited to expenses that are both ordinary and necessary to carrying on the taxpayer's business. *Deputy* v. *du Pont*, 308 U. S. 488, 497, (1940) [Ct. D. 1435, C. B. 1940–1, 118]. A finding of "necessity" cannot be made, however, if allowance of the deduction would frustrate sharply defined national or state policies proscribing particular types of conduct, evidenced by some governmental declaration thereof. *Commissioner* v. *Heininger*, 320 U. S. 467, 473 (1943) [Ct. D. 1596, C. B. 1944, 484]; see *Lilly* v. *Commissioner*, 343 U. S. 90, 97 (1952) [Ct D. 1741, C. B. 1952–1, 16]. This rule was foreshadowed in *Textile Mills Securities Corp.* v. *Commissioner*, 314 U. S. 326 (1941) [Ct. D. 1532, C. B. 1941–2, 200], where the Court, finding no congressional intent to the contrary, upheld the valdity of an income tax regulation reflecting an administrative distinction "between legitimate business expenses and those arising from that family of contracts to which the law has

---

[3] 1951—1 Cum. Bull. 15.

[4] Delaware, Del. Laws 1947, c. 86, section 2; Maryland, Flack's Md. Ann. Code, 1939 (Supp. 1947), Art. 66½, § 254, and Flack's Md. Ann. Code, 1954, Art. 66½, § 278; New Jersey, N. J. Rev. Stat. 1937, 39:3–84; Ohio, Page's Ohio Gen. Code Ann., 1938 (Supp. 1952), § 7248–1; Pennsylvania, Purdon's Pa. Stat. Ann., 1953, Tit. 75, § 453; West Virginia, W. Va. Code Ann., 1949, § 1546, and 1953 Supp., § 1721 (463).

[5] N. J. Rev. Stat., 1937 (Cum. Supp. 1948–1950), 39:3–84.3.

given no sanction." 314 U. S., at 339. Significant reference was made in *Heininger* to the very situation now before us; the Court stated, "Where a taxpayer has violated a federal or a state statute and incurred a fine or penalty he has not been permitted a tax deduction for its payment." 320 U. S., at 473.

Here we are concerned with the policy of several States "evidenced" by penal statutes enacted to protect their highways from damage and to insure the safety of all persons using them.[6] Petitioner and its drivers have violated these laws and have been sentenced to pay the fines here claimed as income tax deductions.[7] It is clear that assessment of the fines was punitive action and not a mere toll for use of the highways: the fines occurred only in the exception instance when the overweight run was detected by the police. Petitioner's failure to comply with the state laws obviously was based on a balancing of the cost of compliance against the chance of detection. Such a course cannot be sanctioned, for judicial deference to state action requires, whenever possible, that a State not be thwarted in its policy. We will not presume that the Congress, in allowing deductions for income tax purposes, intended to encourage a business enterprise to violate the declared policy of a State. To allow the deduction sought here would but encourage continued violations of state law by increasing the odds in favor of noncompliance. This could only tend to destroy the effectiveness of the State's maximum weight laws.

This is not to say that the rule as to frustration of sharply defined national or state policies is to be viewed or applied in any obsolute sense. "It has never been thought * * * that the mere fact that an expenditure bears a remote relation to an illegal act makes it nondeductible." *Commissioner* v. *Heininger*, *supra*, at 474. Although each case must turn on its own facts, *Jerry Rossman Corp.* v. *Commissioner*, 175 F. 2d 711, 713, the test of nondeductibility always is the severity and immediacy of the frustration resulting from allowance of the deduction. The flexibility of such a standard is necessary if we are to accommodate both the congressional intent to tax only net income, and the presumption against congressional intent to encourage violation of declared public policy.

Certainly the frustration of state policy is most complete and direct when the expenditure for which deduction is sought is itself prohibited by statute. See *Boyle, Flagg & Seaman, Inc.*, v. *Commissioner*, 25 T. C. 43. If the expenditure is not itself an illegal act, but rather the payment of a penalty imposed by the State because of such an act, as in the present case, the frustration attendant upon deduction would be only slightly less remote, and would clearly fall within the line of disallowance. Deduction of fines and penalties uniformly has been held to frustrate state policy in severe and direct fashion by reducing the "sting" of the penalty prescribed by the state legislature.[8]

There is no merit to petitioner's argument that the fines imposed here were not penalties at all, but merely a revenue toll. It is true that the Pennsylvania statute provides for purchase of a single trip permit by an over-weighted trucker; that its provision for forcing removal of the excess weight at the discretion of the police authorities apparently was never enforced; and that the fines were devoted by statute to road repair within the municipality or township where the trucker was apprehended. Moreover, the Pennsylvania statute was amended in 1955,[9] raising the maximum weight restriction to 60,000 pounds, making mandatory the removal of the excess, and graduating the amount of the fine by the number of pounds that the truck was overweight. These considerations, however, do not change the fact that the truckers were fined by the State as a penal measure when and if they were apprehended by the police.

Finally petitioner contends that deduction of the fines at least for the innocent violations will not frustrate state policy. But since the maximum weight

---

[6] Because state policy in this case was evidenced by specific legislation, it is unnecessary to decide whether the requisite "governmental declaration" might exist other than in an Act of the legislature. See Schwartz, Business Expenses Contrary To Public Policy, 8 Tax L. Rev. 241, 248.

[7] Unlike the rest of the States, Pennsylvania imposed the fines on the driver rather than the owner of the trucks. In each instance, however, the driver was petitioner's employee, and petitioner paid the fines as a matter of course, being bound to do so by its collective bargaining agreement with the union representing the drivers.

[8] See, *e. g.*, *United States* v. *Jaffray*, 97 F. 2d 488, aff'd *sub nom.* on other grounds, *United States* v. *Bertelsen & Petersen Engineering Co.*, 306 U. S. 276, (1939) [Ct. D. 1387, C. B. 1939-1, 271.]; *Tunnel R. Co.* v. *Commissioner*, 61 F. 2d 166; *Chicago, R. I. & P. R. Co.* v. *Commissioner*, 47 F. 2d 990, *Burroughs Bldg. Material Co.* v. *Commissioner*, 47 F. 2d 178; *Great Northern R. Co.* v. *Commissioner*, 40 F. 2d 372; *Davenshire, Inc.* v. *Commissioner*, 12 T. C. 958.

[9] Purdon's Pa. Stat. Ann., 1953 (Supp. 1957), Tit. 75, section 453.

statutes make no distinction between innocent and willful violators, state policy is as much thwarted in the one instance as in the other. Petitioner's reliance on *Jerry Rossman Corp.* v. *Commissioner, supra*, is misplaced. Deductions were allowed the taxpayer in that case for amounts inadvertently collected by him as OPA overcharges and then paid over to the Government, but the allowance was based on the fact that the Administrator, in applying the Act, had differentiated between willful and innocent violators. No such differentiation exists here, either in the application or the literal language of the state maximum weight laws.

Affirmed.

Ct. D. 1820

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF SUPREME COURT

1. INCOME TAX—DEDUCTIONS FROM GROSS INCOME—BUSINESS EXPENSES—OVERWEIGHT FINES PAID BY TRUCKERS.

Fines paid by interstate motor carriers for violations of state maximum weight laws are not deductible business expenses under section 23(a)(1)(A) of the 1939 Internal Revenue Code, since the payment of such fines was not "necessary" to the operation of taxpayer's business and since the allowance of the deduction would severely and directly frustrate state policy. Fines for both willful and innocent violations are nondeductible since the state statutes involved did not differentiate between innocent and willful violators.

2. DECISION FOLLOWED.

Tank Truck Rentals, Inc. v. *Commissioner* (U. S. Supreme Court Opinion dated March 17, 1958), followed.

3. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Sixth Circuit, 241 F. 2d 459, affirmed.

SUPREME COURT OF THE UNITED STATES

Hoover Motor Express Co., Inc., petitioner v. *United States of America*

On writ of certiorari to the United States Court of Appeals for the Sixth Circuit

[March 17, 1958]

OPINION

MR. JUSTICE CLARK delivered the opinion of the Court.

The sole issue here—the deductibility for tax purposes[1] of fines paid by a trucker for *inadvertent* violations of state maximum weight laws—is identical to one of the issues decided today in No. 109, *Tank Truck Rentals, Inc.* v. *Commissioner*, — U. S. — [Ct. D. 1819, page 25, this Bulletin].

Most of the overweight fines paid by petitioner during 1951–1953 inclusive, the tax years in question, were incurred in Tennessee and Kentucky, two of the nine States in which petitioner operated. During the relevant period, both Tennessee and Kentucky imposed maximum weight limitations of 42,000 pounds over-all and 18,000 pounds per axle,[2] considerably less than those in the other seven States. Petitioner's fines resulted largely from violations of the axle weight limits rather than violations in over-all truck weight. The District Court found that such violations usually occurred because of a shifting of the freight load during transit.

After paying the taxes imposed, petitioner sued in the District Court for a refund, claiming that no frustration of state policy would result from allow-

[1] "SEC. 23. DEDUCTIONS FROM GROSS INCOME.
"In computing net income there shall be allowed as deductions:
"(a) EXPENSES.—
"(1) TRADE OR BUSINESS EXPENSES.—
"(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *." 53 Stat. 12, as amended, 56 Stat. 819.

[2] Ky. Rev. Stat., 1953, § 189.222; Williams' Tenn. Code, 1934 (1952 Cum. Supp. to 1943 Repl. Vol.), § 1166.33.

ance of the deductions because (1) the violations had not been willful, and (2) all reasonable precautions had been taken to avoid the violations. The District Court held that even if petitioner had acted innocently and had taken all reasonable precautions, allowance of the deductions would frustrate clearly defined state policy. Judgment was entered for the Commissioner, 135 F. Supp. 818, and the Court of Appeals affirmed on the same reasoning. 241 F. 2d 459. We granted certiorari, 354 U. S. 920 (1957), in conjunction with the grant in No. 109, *Tank Truck Rentals, Inc.*, v. *Commissioner, supra*, and No. 119, *Commissioner* v. *Sullivan* [Ct. D. 1821, page 30, this Bulletin], both decided today.

Wholly apart from possible frustration of state policy, it does not appear that payment of the fines in question was "necessary" to the operation of petitioner's business. This, of course, prevents any deduction. *Deputy* v. *du Pont*, 308 U. S. 488 (1940) [Ct. D. 1435, C. B. 1940–1, 118]. The violations usually resulted from a shifting of the load during transit, but there is nothing in the record to indicate that the shifting could not have been controlled merely by tying down the load or compartmentalizing the trucks. Other violations occurred because petitioner relied on the weight stated in the bill of lading when picking up goods in small communities having no weighing facilities. It would seem that this situation could have been alleviated by carrying a scale in the truck.

Even assuming that petitioner acted with all due care and without willful intent, it is clear that allowance of the deduction sought by petitioner would severely and directly frustrate state policy. *Tank Truck Rentals, Inc.*, v. *Commissioner, supra.* As in *Tank Truck*, the statutes involved here do not differentiate between innocent and willful violators.

Affirmed.

Ct. D. 1821

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF SUPREME COURT

1. INCOME TAX—DEDUCTIONS FROM GROSS INCOME—BUSINESS EXPENSES—RENTS AND WAGES PAID BY BOOKMAKERS.

Amounts paid for rents and wages by bookmaking establishments which are illegal enterprises under the law of the state in which they operate are deductible as ordinary and necessary expenses of the business. The regulations make the federal excise tax on wagers deductible as an ordinary and necessary business expense and this seems to be recognition of a gambling enterprise as a business for federal tax purposes.

2. JUDGMENTS AFFIRMED.

Judgments of the United States Court of Appeals for the Seventh Circuit, 241, F. 2d 46 and 242 F. 2d 558, affirmed.

SUPREME COURT OF THE UNITED STATES

Commissioner of Internal Revenue, petitioner, v. *Neil Sullivan and Grace Sullivan; James Ross and Ann Ross; Sam Mesi*

On writ of certiorari to the United States Court of Appeals for the Seventh Circuit

[March 17, 1958]

OPINION

MR. JUSTICE DOUGLAS delivered the opinion of the Court.

The question is whether amounts expended to lease premises and hire employees for the conduct of alleged illegal gambling enterprises are deductible as ordinary and necessary business expenses within the meaning of section 23(a)(i)(A) of the Internal Revenue Code of 1939.[1]

[1] Section 23(a)(i)(A) provides:
"In computing net income there shall be allowed as deductions:
* * * * * * *
"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 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." 56 Stat. 819, 26 U. S. C. section 23(a)(i)(A).

The taxpayers received income from bookmaking establishments in Chicago, Ill. The Tax Court found that these enterprises were illegal under Illinois law,[2] that the acts performed by the employees constituted violations of that law, and that the payment of rent for the use of the premises for the purpose of bookmaking was also illegal under that law. The Tax Court accordingly held that the amount paid for wages and for rent could not be deducted from gross income since those deductions were for expenditures made in connection with illegal acts. 15 CCH TC Mem. Dec. 23, 25 T. C. 513. The Court of Appeals reversed, 241 F. 2d 46, 242 F. 2d 558, on the basis of its prior decision in *Commissioner* v. *Doyle*, 231 F. 2d 635. The case is here on a petition for certiorari, 354 U. S. 920, for consideration in connection with the companion cases *Hoover Motor Express Co.* v. *United States*, *ante*, p. 38 [Ct. D. 1820, page 505], and *Tank Truck Rentals, Inc.* v. *Commissioner*, *ante*, p. 30 [Ct. D. 1819, page 502] decided this day.

Deductions are a matter of grace and Congress can, of course, disallow them as it chooses. At times the policy to disallow expenses in connection with certain condemned activities is clear. It was made so by the Regulations in *Textile Mills Corp.* v. *Commissioner*, 314 U. S. 326 [Ct. D. 1532, C. B. 1941-2, 200]. Any inference of disapproval of these expenses as deductions is absent here. The Regulations, indeed, point the other way, for they make the federal excise tax on wagers deductible as an ordinary and necessary business expense.[3] This seems to us to be recognition of a gambling enterprise as a business for federal tax purposes. The policy that allows as a deduction the tax paid to conduct the business seems sufficiently hospitable to allow the normal deductions of the rent and wages necessary to operate it. We said in *Commissioner* v. *Heininger*, 320 U. S. 467, 474 [Ct. D. 1596, C. B. 1944, 484], that the "fact that an expenditure bears a remote relation to an illegal act" does not make it nondeductible. And see *Lilly* v. *Commissioner*, 343 U. S. 90 [Ct. D. 1741, C. B. 1952-1, 16]. If we enforce as federal policy the rule espoused by the Commissioner in this case, we would come close to making this type of business taxable on the basis of its gross receipts, while all other business would be taxable on the basis of net income. If that choice is to be made, Congress should do it. The amounts paid as wages to employees and to the landlord as rent are "ordinary and necessary expenses" in the accepted meaning of the words. That is enough to permit the deduction, unless it is clear that the allowance is a device to avoid the consequence of violations of a law, as in *Hoover Motor Express Co.* v. *United States*, *supra*, and *Tank Truck Rentals, Inc.*, v. *Commissioner*, *supra* or otherwise contravenes the federal policy expressed in a statute or regulation as in *Textile Mills Corp.* v. *Commissioner*, *supra*.

Affirmed.

REGULATIONS 118, SECTION 39.23(a)-4: Repairs.

Deductions for expenditures for poles driven into railway roadbed. See Rev. Rul. 58-278, page 92.

REGULATIONS 118, SECTION 39.23(a)-6: Compensation for personal services.

Amounts paid by employer as premiums on sickness and disability insurance policies for benefit of employees. See Rev. Rul. 58-90, page 88.

---

[2] Ill. Rev. Stats., 1945, c. 38, section 336.

[3] Regulations 118, section 39.23(a) 1; Rev. Rul. 54-219, 1954-1 Cum. Bull. 51.

"The Federal excise tax on wagers under section 3285 (d) of the Internal Revenue Code and the special tax under section 3290 of the Code paid by persons engaged in receiving wagers are deductible, for Federal income tax purposes, as ordinary and necessary business expenses under section 23(a) of the Internal Revenue Code, provided the taxpayer is engaged in the business of accepting wagers or conducting wagering pools or lotteries, or is engaged in receiving wagers for or on behalf of any person liable for the tax under section 3285(d) of the Code."

SECTION 23(c).—DEDUCTIONS FROM GROSS INCOME; TAXES GENERALLY

REGULATIONS 118, SECTION 23(c)-1: Taxes.

The motor vehicle fuel taxes imposed by the State of Nebraska. See Rev. Rul. 58-44, page 98.

REGULATIONS 118, SECTION 39.23(c)-1: Taxes.

Accrual of the deduction for foreign taxes where the liability for such foreign taxes is contested. See Rev. Rul. 58-55, page 266.

SECTION 23(x).—MEDICAL EXPENSE

Section 39.23 (x)-1: Medical, dental, etc., expenses.

Deductibility of the cost of special education, training, and treatment afforded a mentally retarded child in an institution. Consideration of the cost of meals, lodging, and ordinary education furnished a mentally retarded child attending a special school. See Rev. Rul. 58-280, page 157.

SECTION 25.—CREDITS OF INDIVIDUALS AGAINST NET INCOME

REGULATIONS 118, SECTION 39.25-2: Credits of individuals for the purpose of normal tax and surtax.

Fair rental value of lodging in determining support of a dependent. See Rev. Rul. 58-302, page 62.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SECTION 41.—GENERAL RULE

REGULATIONS 118, SECTION 39.41-1: Computation of net income. Ct. D. 1822

(Also Sections 293, 294; 39.294-1.)

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. RECONSTRUCTION OF TAXABLE INCOME—NET WORTH METHOD—ADEQUACY OF RECORDS—CASH ON HAND.

The Commissioner was justified in using the net worth method of reconstructing the income of an eye surgeon where his receipts books admittedly showed net fees, not gross income, and where it was impossible to determine from such books the amount of hospital and other expenses which had been deducted in arriving at the net amounts. The Tax Court was justified in refusing to believe that, at the beginning of the net worth period, taxpayer had a substantial amount of cash on hand received as an inheritance from an uncle abroad. Consistent failure to report substantial amounts of income is effective evidence of fraudulent intent.

2. PENALTIES—UNDERESTIMATE OF TAX—RECONSTRUCTED INCOME.

The taxpayer was not liable for penalties for underestimation of tax under section 294(d)(2) of the 1939 Code where his estimate for each of the years 1948, 1949, and 1951 was greater than the tax shown on the return for each preceding taxable year, although the tax based on the reconstructed income for each year was substantially greater than the tax shown on the returns.

3. DECISION OF THE TAX COURT, T. C. MEMO 1956–155. AFFIRMED IN PART AND REVERSED IN PART.

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

George Schwarzkopf, petitioner, v. *Commissioner of Internal Revenue, respondent*

On petition for review of the decision of the Tax Court of the United States

Argued April 16, 1957

Before GOODRICH, STALEY and HASTIE, Circuit Judges

[July 10, 1957]

OPINION

By STALEY, *Circuit Judge*

A challenge to the Commissioner's use of the net worth method of determining income is presented by this petition seeking review of a decision of the Tax Court of the United States.

Petitioner George Schwarzkopf, an oculist and eye surgeon was a resident of Atlantic City, New Jersey, during 1947 through 1951, the taxable years under review. His residence contained not only his living quarters but also his office, operating room, and hospital rooms. Taxpayer kept his own receipts book from which he reported his yearly income. He admitted that many of the sums entered on his receipts book represented not gross but net fees, after deducting certain hospitalization expenses. Taxpayer did not show any of the receipts from these expenses to the investigating agents, and most of the receipts from earlier years were admittedly destroyed.

Finding a substantial discrepancy between bank deposits and reported income, the Commissioner reconstructed the income of Schwarzkopf by resort to the net worth method, with the following comparative results:

Year	Net income reported	Net income as determined by respondent	Unreported taxable income determined by respondent
1946	$14, 688. 25	$49, 140. 24	$34, 451. 99
1947	14, 244. 31	31, 908. 91	17, 664. 60
1948	14, 200. 40	50, 744. 70	37, 544. 30
1949	16, 040, 59	34, 376. 53	19, 335. 94
1950	17, 000. 79	48, 125. 46	31, 124. 67
1951	21, 721. 06	175, 466. 96	153, 745. 90

The Commissioner then determined the taxpayer's deficiencies for the respective years and additions to tax under sections 293(b)[1] and 294(d)(2)[2] of the Internal Revenue Code of 1939 as follows:

Year	Deficiency	Additions to tax	
		§ 293 (b)	§ 294(d)(2)
1946	$20, 027. 69	$10, 208. 94	$1, 322. 46
1947	9, 356. 04	4, 678. 02	545. 66
1948	19, 942. 57	9, 971. 28	1, 157. 59
1949	9, 301. 21	4, 650. 60	586. 66
1950	17, 020. 85	8, 510. 42	984. 73
1951	125, 811. 42	62, 905. 71	7, 710. 98

Most of the amounts utilized in the Commissioner's net worth analysis were stipulated. Only undeposited cash on hand was disputed, and the Commissioner determined that there was none as of January 1, 1946 and $32,000 undeposited

[1] "*Fraud.*—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 3612(d)(2)." 26 U. S. C. 1952 ed. sec. 293(b).

[2] Section 294(d)(2) of Title 26 U. S. C., 1952 ed., provides for penalties for substantial underestimate of estimated tax.

cash as of December 31, 1951; these amounts were prorated over the years in question. The Tax Court however, found that taxpayer had $101,000 in undeposited cash as of January 1, 1946, and the following amounts thereafter:

December 31, 1946	$62,000
December 31, 1947	52,000
December 31, 1948	32,000
December 31, 1949	32,000
December 31, 1950	32,000
December 31, 1951	32,000

The Tax Court determination, of course, completely eliminated the 1946 deficiency and made certain changes in the deficiences of the other years involved. Finally, the Tax Court found that petitioner's income tax returns for 1947 through 1951 were false and fraudulent and were made with intent to evade tax, and that part of the deficiency for each of the years 1947 through 1951 was due to fraud with intent to evade tax.

The salient thrust of petitioner's principal argument is that the Commissioner's use of the net worth method of income reconstruction was unwarranted as his books of account were correct and adequate.

Holland v. United States, 348 U.S. 121 (1954), [CT. D. 1769, C. B. 1954–2, 215] has become the *fons et origo* of the law concerning the use of the net worth method of income reconstruction. In giving its approval to the net worth method the Supreme Court said at page 132:

> "* * * To protect the revenue from those who do not 'render true accounts,' the Government must be free to use all legal evidence available to it in determining whether the story told by the taxpayer's books accurately reflects his financial history."

This quoted portion of the Holland case is recognized by petitioner as sanctioning the use of the net worth method to test the accuracy and completeness of the books of account. Thus, the net worth method serves two purposes; first, it may be used to test the correctness of the books; secondly, it is cogent evidence of the amount of income which went unreported. The fact that the books on their face appear to be adequate does not preclude the use of the net worth method. Holland v. United States, supra at pages 131–132. In any event, the books involved here contained items of net income with hospital expenses already deducted. The disposal by the taxpayer of bills evidencing these expenses made the computation of their amount impossible, and thus left vague and unreported some unknown amount of income. The taxpayer's practice of cashing checks representing his patients' fees and receiving the money in large denominations rather than depositing the checks themselves made it impossible to test the accuracy of the books from that source. If taxpayer's contention is correct, everyone could keep a set of apparently accurate books, carefully destroy other evidences of the source and amount of income, and defend by an alien rule that the net worth method may not be used in those circumstances—and thus the government could be defrauded with impunity. However, it is when other methods of disclosing income fail that the net worth computation becomes especially important in the collection of revenue.

A favorite defense in net worth cases is that taxpayer had a large amount of undeposited cash on hand at the beginning of the investigation period. This may explain the disproportionate increase in net worth over the increase of taxable income. Petitioner here likewise contends that he had on hand a sizeable amount of undeposited cash at the beginning of the investigation period. Evidence as to the amount and source of this cash is questionable at best. Petitioner contends that the Tax Court committed clear error in refusing to find that a certain large sum came to him by way of an inheritance from an uncle who died in a land now occupied by Russia. Documentary proof of death and of the inheritance were not available because the records there were destroyed, and the only evidence of the inheritance were self-serving notations on the taxpayer's passports of the amounts he allegedly brought back from Europe. The fact that the Commissioner did not directly contradict this evidence would not compel the Tax Court to accept it in the circumstances of this case. The Tax Court, evaluating witness credibility, simply did not believe the story.[3] We think it was eminently proper to use the net worth method here.

[3] For example, the taxpayer admitted that he held $60,000 belonging to his brother, who was at the time a German citizen and an enemy alien, without making the necessary report to the government, even though he was well aware of the requirement of reporting money belonging to an enemy alien.

The burden of proving fraud is, of course, upon respondent. Section 1112 of the Internal Revenue Code of 1939, 26 U. S. C. 1952 ed., section 1112. Petitioner contends that respondent failed to sustain his burden. This point shall not long detain us. Even if this case were devoid of the usual indicia of fraud, the consistent failure to report substantial amounts of income over a number of years, standing alone, is effective evidence of fraudulent intent. See Holland v. United States, supra at page 139; Lipsitz v. Commissioner, 220 F. 2d 871 (C. A. 4, 1955). Over a period of five years, petitioner failed to report over $200,000 of taxable income.

Finally, petitioner argues that he is not liable for penalties for underestimation of tax based upon Section 294(d)(2) of the 1939 Code for the years 1948, 1949, and 1951. We agree with petitioner's contention. The section in issue provides an exception from its penalty provisions for those years in which there has been a timely payment of estimated tax in an amount at least as great as it was "on the basis of the facts shown on his return for the preceding taxable year." Petitioner's estimated taxes for 1948, 1949, and 1951 were $4,000, $3,600, and $4,000 respectively. Each amount was greater than the amount of tax shown on taxpayer's returns for the preceding taxable years. If, as the Commissioner contends, Congress meant to compare the estimated tax with the tax based upon the reconstructed income, it should have so provided. The penalties under Section 294(d)(2) should not have been assessed for 1948, 1949, and 1951.

The cause will be remanded to the Tax Court for an adjustment of the penalties under Section 294(d)(2) and, as adjusted in accordance with this opinion, the decision will be affirmed.

SECTION 44.—INSTALLMENT BASIS

REGULATIONS 118, SECTION 39.44–5: Gain or loss upon disposition of installment obligations. Rev. Rul. 58–189

The filing of an income tax bond for the purpose of deferring gain from installment obligations transmitted at death, under section 44(d) of the Internal Revenue Code of 1939, is applicable where a tax exempt organization is the recipient of the installment obligations.

Advice has been requested whether the filing of an income tax bond, for the purpose of deferring gain from the disposition of installment obligations under section 44(d) of the Internal Revenue Code of 1939, is applicable to cases where the recipient is an exempt organization.

Section 44(d) of the Code provides that gain or loss shall result from the disposition, otherwise than by sale or exchange, of an installment obligation measured by the difference between the basis of the obligation and the fair market value of the obligation at the time of disposition. However, an exception is made in the case of a decedent who dies possessed of an installment obligation and it is transmitted at death. In such a case, the income ordinarily required to be reported by the decedents estate will be deferred if a proper income tax bond is filed with the Commissioner under the procedure prescribed in Section 39.44–5(c) of Regulations 118, which states in part as follows:

In the case of a decedent who dies possessed of installment obligations, no gain on account of the transmission at death of such obligation is required to be

reported as income in the return of the decedent for the year of his death, if the executor or administrator of the estate of the decedent or any of the next of kin or legatees files with the Commissioner a bond on Form 1132 conditioned upon the return as income, by any person receiving any payment in satisfaction of such obligations, of the same proportion of such payment as would be returnable as income by the decedent if he had lived and received such payment. The bond shall be subject to the approval of the Commissioner, shall be in an amount sufficient in his judgment to insure collection of the tax resulting from the fulfillment of the conditions stated in the bond, and shall be filed at the time of filing the return for the decedent for the year of his death or at such later time as may be specified by the Commissioner.* * *.

The issue of whether section 44(d) of the Code is applicable where the recipient is an exempt organization appears to have been raised for the first time in the case of *Archie R. Conner, Administrator of the Estate of Lucy Radulovich, Deceased* v. *Commissioner*, 37 B. T. A. 890, Acq. C. B. 1938–2, 7. The Government in that case advanced the argument that the provisions of section 44(d) requiring the filing of a bond in order to exclude the unpaid installments from decedent's income was inapplicable where a charitable organization was the transferee. The court in an opinion adverse to the Government held that since a tax exempt organization is a "person" within the meaning of section 44(d) the Commissioner's failure to approve an income tax bond was an arbitrary abuse of discretion.

The court, after a general discussion of the history of section 44(d), pointed out that to hold that a charitable organization is not a person for purposes of section 44(d) because it is not required to file an income tax return, or pay a tax, would be to read into the last sentence of section 44(d) something that is not there and limit the word "person" to taxable person. "Such an interpretation," said the court, "is not in harmony with the statutory definition of the word 'person' found in section 801(a)(1). * * * In our opinion the term 'person' as used in the last sentence of section 44(d) includes any corporation, * * *."

In *President and Directors of Manhattan Company, and Joseph F. Poeg, Executors, Estate of Jacob F. Haubeil, Deceased* v. *Commissioner*, 41 B. T. A. 1244, the court, following its reasoning in the *Connor* case, rejected the contentions of the petitioner and held that an installment obligation passing at death of petitioner's decedent to a charitable organization was subject to inclusion in the decedent's income for the last year of his life as to installments not yet returned by him as income since no bond had been filed by the executors of the decedent's estate as required by section 44(d). See also *Estate of Francis T. Ingraham, Deceased, Guaranty Trust Company of New York, Executor* v. *Commissioner*, T. C. 701.

It is clear from the foregoing that the requirement imposed by section 44(d) of the Code, for filing a bond in order to defer the reporting of gain from installment obligations transmitted at death, is equally applicable to cases where the recipients are tax exempt organizations.

Sections 453(d)(3) and 691(a)(4)(A) of the 1954 Code, the counterpart of section 44(d) of the 1939 Code, which eliminated the requirement of filing a bond to defer gain on installment obligations transmitted at death, are applicable with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954,

and do not affect or authorize the release of bonds executed under section 44(d) of the 1939 Code. See Rev. Rul. 55-627, C. B. 1955-2, 550.

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT B.—COMPUTATION OF NET INCOME

SECTION 112(b).—RECOGNITION OF GAIN OR LOSS: EXCHANGES SOLELY IN KIND

REGULATIONS 118, SECTION 39.112(b)(1)-1:
Property held for productive use in trade or business or for investment.

Exchanges of oil payment rights for interests in real property. See Ct. D. 1823, page 516.

SECTION 113(b).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: ADJUSTED BASIS

REGULATIONS 118, SECTION 39.113(b)(1)-1: Rev. Rul. 58-62
Adjusted basis.
(Also Section 141(b); Regulations 89, Article 38.)

> Where an affiliated railroad corporation, which joined in the filing of a consolidated income tax return for the taxable year 1935 on which a net operating loss was reported, erroneously deducted and was allowed depreciation on property used in its business in excess of the amount allowable, for which neither it nor the affiliated group obtained any Federal income tax benefit, the corporation, pursuant to an election properly and timely made under section 113(d) of the Internal Revenue Code of 1939, will not be required to reduce the basis of the property by the amount of the excessive depreciation allowed for such year.

Advice has been requested whether the basis of depreciable property used by a railroad corporation in its business should be reduced, in accordance with the provisions of section 113(b)(1)(B) of the Internal Revenue Code of 1939, by the amount of excessive depreciation erroneously deducted in a prior year for which a consolidated income tax return was filed.

For the taxable years 1934, 1935 and 1936, the taxpayer, an affiliated railroad corporation, joined with its parent-corporation in the filing of consolidated returns, each of which disclosed a net loss. The return for the year 1935 reflected a deduction for depreciation of $5,000 in excess of the amount allowable on property used by the taxpayer in its business. This excessive deduction represented additional depreciation for prior years which was added to its reserve for depreciation in 1935 at the direction of the Interstate Commerce Commission. The deduction did not result in the reduction of the tax liability of the taxpayer, or that of any member of the affiliated group, for any taxable year. However, had the taxpayer not filed a con-

solidated return, the excessive depreciation would have diminished the taxpayer's taxable income by $5,000, resulting in a tax benefit to it. In 1952, the taxpayer filed an election under section 113(d) of the Code to adjust the basis of its depreciable property, in accordance with the provisions of clause (ii) of section 113(b)(1)(B) of the Code, by the amount of the excessive depreciation claimed and allowed for the year 1935. Separate income tax returns were filed by the taxpayer for all taxable years subsequent to 1936. The question of adjustment to the basis of the property, under the above circumstances, was raised because of the apparent conflict with the provisions of Article 38 of Regulations 89, applicable to the determination and adjustment of basis in the case of affiliated railroads filing consolidated returns.

Section 113(b) of the Code provides, in part, as follows:

(b) ADJUSTED BASIS.—The adjusted basis for determining the gain or loss from the sale or disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) GENERAL RULE.—Proper adjustment in respect of the property shall in all cases be made—

* * * * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent of the amount—

(i) allowed as deductions in computing net income under this chapter or prior income tax laws, and

(ii) resulting (by reason of the deductions so allowed) in a reduction for any taxable year of the taxpayer's taxes under this chapter * * *,

but not less than the amount allowable under this chapter or prior income tax laws. Clause (ii) of this subparagraph shall not apply in respect of any period since February 28, 1913, and before January 1, 1952, unless an election has been made under subsection (d). * * *

Section 3 of Public Law 539, 66 Stat. 629, 26 U. S. C. 113, 82nd Cong., 2nd Sess., approved July 14, 1952, C. B. 1952-2, 358, which enacted clause (ii) of section 113(b)(1)(B) of the Code, states as follows:

The amendments made by this Act shall apply in respect of taxable years beginning after December 31, 1938. Provisions having the effect of such amendments shall be deemed to have been included in the revenue laws respectively applicable to taxable years ending after December 31, 1931 and beginning before January 1, 1939.

Article 38 of Regulations 89, relating to consolidated returns of affiliated railroad corporations for taxable years beginning after December 31, 1933, provides that the determination of the basis of property is required to be made as though no affiliation existed. Section (a) of Article 38 reads as follows:

(a) GENERAL RULE.

Subject to the provisions of paragraphs (b) and (c) and except as otherwise provided in article 34, the basis during a consolidated return period for determining the gain or loss from the sale or other disposition of property, or upon which exhaustion, wear and tear, obsolescence, and depletion are to be allowed, shall be determined and adjusted in the same manner as if the corporations were not affiliated (see sections 111 to 115, inclusive, of the Act), whether such property was acquired before or during a consolidated return period. Such basis immediately after a consolidated return period (whether the affiliation has been broken or whether the privilege to make a consolidated

return is not exercised) shall be the same as immediately prior to the close of such period.

In *Corporation of America* v. *Commissioner*, 4 T. C. 566, acquiescence C. B. 1945, 2, a corporation recovered in 1939 amounts which it paid for documentary stamp taxes in 1930 and which it deducted in determining its net income for that year. However, the corporation joined in the filing of a consolidated income tax return for that year which showed a large consolidated net operating loss. The total recoveries secured by all corporations in the affiliated group did not equal their consolidated net loss for 1930.

In deciding the case under section 22(b)(12) of the 1939 Code, as amended by section 116 of the Revenue Act of 1942, relating to the exclusion from gross income of recoveries of bad debts, prior taxes, and delinquency amounts, the court said that the ultimate question was whether the taxpayer received any tax benefit from the deduction of the prior year taxes, rather than whether it would have enjoyed that benefit if a consolidated return had not been filed. The court stated in its opinion that the concept of an affiliated group of corporations filing a consolidated income tax return is that the affiliated group is considered as a taxable unit; and that the tax liability, and hence the tax for that year, as contemplated by the recovery exclusion statute, was the tax of the group of which the petitioner was an integral part. The court held that, since the consolidated group reported a consolidated loss for the year 1930, the taxpayer, by reason of its affiliation with other corporations in 1930, had no tax liability and no tax for that year. The taxpayer, therefore, received no tax benefit from its deduction and is entitled to exclude from its gross income for the year 1939 the amount of documentary stamp taxes so recovered.

In the instant case the consolidated return for 1935 disclosed a consolidated net operating loss which considerably exceeded the taxpayer's depreciation deduction; therefore, the taxpayer had no tax liability for that year. Applying the rationale of the *Corporation of America* case, there was therefore no reduction of the "taxpayer's taxes," as required by clause (ii) of section 113(b)(1)(B) of the Code, attributable to the excessive depreciation deduction. In the circumstances described, the provisions of section 113(b)(1)(B) of the Code are not in conflict with the rule set forth in Article 38 of Regulations 89, *supra*.

Therefore, it is held that where an affiliated railroad corporation, which joined in the filing of a consolidated income tax return for the taxable year 1935 on which a net operating loss was reported, erroneously deducted and was allowed depreciation on property used in its business in excess of the amount allowable, for which neither it nor the affiliated group obtained any Federal income tax benefit, the corporation, pursuant to an election properly and timely made under section 113(d) of the Code, is not required to reduce the basis of the property by the amount of the excessive depreciation allowed for such year.

SECTION 117(a).—CAPITAL GAINS AND LOSSES: DEFINITIONS

REGULATIONS 118, SECTION 39.117(a)-1: Meaning of terms. (Also Section 112 (b); 39.112(b)(1)-1.) Ct. D. 1823

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT.

1. CAPITAL GAIN VS. ORDINARY INCOME—TRANSFERS OF OIL AND SULPHUR PAYMENT RIGHTS.

The proceeds from the assignments of oil payment rights and a sulphur payment right by the owners of royalty or larger depletable interests are taxable as ordinary income subject to depletion rather than capital gain, since they represented assignments of the transferors' rights to receive future income. Although agreeing that the mineral rights were interests in land under local law, the Supreme Court of the United States held that the amounts received for their transfer were conditioned on expected and reasonably ascertainable future income from the mineral property.

2. TAX-FREE EXCHANGE OF LIKE PROPERTY—"OIL PAYMENT" FOR REALTY.

The assignment of "oil payment" in exchange for interests in realty is not a nontaxable exchange of like-for-like property under section 112(b)(1) of the 1939 Code, since the transferred "oil payments" represent future income from oil leases and are thus a different kind or class of "property" from the realty received.

3. DECISION REVERSED.

Decision of the United States Court of Appeals for the Fifth Circuit, 241 F. 2d 65-84, reversed.

SUPREME COURT OF THE UNITED STATES

Commissioner of Internal Revenue, et al., Petitioners v. *P. G. Lake, Inc., et al.*

On writ of certiorari to the United States Court of Appeals for the Fifth Circuit.

[April 14, 1958.]

OPINION

MR. JUSTICE DOUGLAS delivered the opinion of the Court.

We have here, consolidated for argument, five cases involving an identical question of law. Four are from the Tax Court whose rulings may be found in 24 T. C. 1016 (the *Lake* case), 24 T. C. 818 (the *Fleming* case), 24 T. C. 1025 (the *Weed* case). (Its findings and opinion in the *Wrather* case are not officially reported.) Those four cases involved income tax deficiencies. The fifth, the *O'Connor* case, is a suit for a refund originating in the District Court. 143 F. Supp. 240. All five are from the same Court of Appeals, 241 F. 2d 71, *id.*, p. 65, *id.*, p. 78, *id.*, p. 84, *id.*, p. 69. The cases are here on petitions for certiorari which we granted because of the public importance of the question presented. 353 U. S. 982.

The facts of the *Lake* case are closely similar to those in the *Wrather* and *O'Connor* cases. Lake is a corporation engaged in the business of producing oil and gas. It has a seven-eighths working interest[1] in two commercial oil and gas leases. In 1950 it was indebted to its president in the sum of $600,000 and in consideration of his cancellation of the debt assigned him an oil payment right in the amount of $600,000, plus an amount equal to interest at 3 percent a year on the unpaid balance remaining from month to month, payable out of 25 percent of the oil attributable to the taxpayer's working

[1] An oil and gas lease ordinarily conveys the entire mineral interest less any royalty interest retained by the lessor. The owner of the lease is said to own the "working interest" because he has the right to develop and produce the minerals.

In *Anderson* v. *Helvering*, 310 U. S. 404 [Ct. D. 1456, C. B. 1940-1, 404], we described an oil payment as "the right to a specified sum of money, payable out of a specified percentage of the oil, or the proceeds received from the sale of such oil, if, as and when produced." *Id.*, at 410. A royalty interest is "a right to receive a specified percentage of all oil and gas produced" but, unlike the oil payment, is not limited to a specified sum of money. The royalty interest lasts during the entire term of the lease. *Id.*, at 409.

interest in the two leases. At the time of the assignment it could have been estimated with reasaonable accuracy that the assigned oil payment right would pay out in three or more years. It did in fact pay out in a little over three years.

In its 1950 tax returns Lake reported the oil payment assignment as a sale of property producing a profit of $600,000 and taxable as a long-term capital gain under section 117 of the Internal Revenue Code of 1939. The Commissioner determined a deficiency, ruling that the purchase price (less deductions not material here) was taxable as ordinary income, subject to depletion. The *Wrather* case has some variations in its facts. In the *O'Connor* case the assignors of the oil payments owned royalty interests [2] rather than working interests. But these differences are not material to the question we have for decision.

The *Weed* case is different only because it involves sulphur rights, rather than oil rights. The taxpayer was the owner of a pooled overriding royalty in a deposit known as Boling Dome.[3] The royalty interest entitled the taxpayer to receive $0.00966133 per long ton of sulphur produced from Boling Dome, irrespective of the market price. Royalty payments were made each month, based on the previous month's production.

In 1947, the taxpayer, in order to obtain a sure source of funds to pay his individual income taxes, agreed with one Munro, his tax advisor, on a sulphur payment assignment. The taxpayer assigned to Munro a sulphur payment totaling $50,000 and consisting of 86.254514 percent of his pooled royalty interest, which represented the royalty interest on 6,000,000 long tons of the estimated remaining 21,000,000 long tons still in place. The purchase price was paid in three installments over a three-year period. Most of the purchase price was borrowed by Munro from a bank with the sulphur payment assignment as security. The assigned sulphur payment right paid out within 28 months. The amounts received by the taxpayer in 1948 and 1949 were returned by him as capital gains. The Commissioner determined that these amounts were taxable as ordinary income, subject to depletion.

The *Fleming* case is a bit more complicated and presents an additional question not in the other cases. Here oil payment assignments were made, not for cash but for real estate. Two transactions are involved. Fleming and others with whom he was associated made oil payment assignments, the rights and interests involved being held by them for productive use in their respective businesses of producing oil. Each oil payment was assigned for an interest in a ranch. Each was in an amount which represented the uncontested fair value of the undivided interest in the ranch received by the assignor, plus an amount equal to the interest per annum on the balance remaining unpaid from time to time. The other transaction consisted of an oil payment assignment by an owner of oil and gas leases, held for productive use in the assignor's business, for the fee simple title to business real estate. This oil payment assignment, like the ones mentioned above, was in the amount of the uncontested fair market value of the real estate received, plus interest on the unpaid balance remaining from time to time.

First, as to whether the proceeds were taxable as long term taxable gains under section 117 [4] or as ordinary income subject to depletion. The Court of Appeals

---

[2] See note 1, *supra*.

[3] Boling Dome is a tract composed of various parcels of land. The owners of the royalty interests in sulphur produced from the separate parcels entered into a pooling agreement by which royalties from sulphur produced anywhere in Boling Dome were distributed pro rata among all the royalty interest holders. In that sense was the interest of each "pooled."

[4] Section 117(a)(1) provides in relevant part:
"The term 'capital assets' means property held by the taxpayer (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 to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l) . . . or real property used in the trade or business of the taxpayer." 53 Stat. 50, as amended, 56 Stat. 845.

Section 117(a)(4) provides:
"The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income." 53 Stat. 51, as amended, 56 Stat. 843.

Section 117 (b) provides:
"In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:
"100 per centum if the capital asset has been held for not more than 6 months;
"50 per centum if the capital asset has been held for more than 6 months." 53 Stat. 843.

started from the premise, laid down in Texas decisions, see especially *Tennant* v. *Dunn*, 130 Tex. 285, 110 S. W. 2d 53, that oil payments are interests in land. We too proceed on that basis; and yet we conclude that the consideration received for these oil payment rights (and the sulphur payment right) was taxable as ordinary income, subject to depletion.

The purpose of section 117 was "to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." See *Burnet* v. *Hormel*, 287 U. S. 103, 106. And this exception has always been narrowly construed so as to protect the revenue against artful devices. See *Corn Products Refining Co.* v. *Commissioner*, 350 U. S. 46, 52 [T. D. 1787, C. B. 1955–2, 511].

We do not see here any conversion of a capital investment. The lump sum consideration seems essentially a substitute for what would otherwise be received at a future time as ordinary income. The pay-out of these particular assigned oil payment rights could be ascertained with considerable accuracy. Such are the stipulations, findings, or clear inferences. In the *O'Connor* case, the pay-out of the assigned oil payment right was so assured that the purchaser obtained a $9,990,350 purchase money loan at 3½ percent interest without any security other than a deed of trust of the $10,000,000 oil payment right, he receiving 4 percent from the taxpayer. Only a fraction of the oil or sulphur rights were transferred, the balance being retained.[5] Except in the *Fleming* case, which we will discuss later, cash was received which was equal to the amount of the income to accrue during the term of the assignment, the assignee being compensated by interest on his advance. The substance of what was assigned was the right to receive future income. The substance of what was received was the present value of income which the recipient would otherwise obtain in the future. In short, consideration was paid for the right to receive future income, not for an increase in the value of the income-producing property.

These arrangements seem to us transparent devices. Their forms do not control. Their essence is determined not by subtleties of draftsmanship but by their total effect. See *Helvering* v. *Clifford*, 309 U. S. 331 [Ct. D. 1444 C. B. 1940–1, 105]; *Harrison* v. *Schaffner*, 312 U. S. 579 [Ct. D. 1503, C. B. 1941–2, 321]. We have held that if one, entitled to receive at a future date interest on a bond or compensation for services, makes a grant of it by anticipatory assignment, he realizes taxable income as if he had collected the interest or received the salary and then paid it over. That is the teaching of *Helvering* v. *Horst*, 311 U. S. 112 [Ct. D. 1472 C. B. 1940–2, 206], and *Harrison* v. *Schaffner*, *supra;* and it is applicable here. As we stated in *Helvering* v. *Horst*, *supra*, 117, "The taxpayer has equally enjoyed the fruits of his labor or investment and obtained the satisfaction of his desires whether he collects and uses the income to procure those satisfactions, or whether he disposes of his right to collect it as the

[5] Until 1946 the Commissioner agreed with the contention of the taxpayers in these cases that the assignment of an oil payment right was productive of a long-term capital gain. In 1946 he changed his mind and ruled that "consideration (not pledged for development) received for the assignment of a short-lived in-oil payment carved out of any type of depletable interest in oil and gas in place (including a larger in-oil payment right) is ordinary income subject to the depletion allowance in the assignor's hands." G. C. M. 24849, 1946–1 Cum. Bull. 66, 69. This ruling was made applicable "only to such assignments made on or after April 1, 1946," I. T. 3895, 1948–1 Cum. Bull. 39. In 1950 a further ruling was made that represents the present view of the Commissioner. I. T. 4003, 1950–1 Cum. Bull. 10, 11, reads in relevant part as follows:

"After careful study and considerable experience with the application of G. C. M. 24849, *supra,* it is now concluded that there is no legal or practical basis for distinguishing between short-lived and long-lived in-oil payment rights. It is, therefore, the present position of the Bureau that the assignment of any in-oil payment right (not pledged for development), which extends over a period less than the life of the depletable property interest from which it is carved, is essentially the assignment of expected income from such property interest. Therefore, the assignment for a consideration of any such in-oil payment right results in the receipt of ordinary income by the assignor which is taxable to him when received or accrued, depending upon the method of accounting employed by him. Where the assignment of the in-oil payment right is donative, the transaction is considered as an assignment of future income which is taxable to the donor at such time as the income from the assigned payment right arises.

"Notwithstanding the foregoing, G. C. M. 24849, *supra,* and I. T. 3935, *supra,* do not apply where the assigned in-oil payment right constitutes the entire depletable interest of the assignor in the property or a fraction extending over the entire life of the property."

The pre-1946 administrative practice was not reflected in any published ruling or regulation. It therefore will not be presumed to have been known to Congress and incorporated into the law by re-enactment. See *Helvering* v. *N. Y. Trust Co.*, 292 U. S. 455, 467–468 [Ct. D. 840, C. B. XIII–1, 188]. Cf. *United States* v. *Leslie Salt Co.*, 350 U. S. 383, 389–397 [Ct. D. 1792, C. B. 1956–1, 677]. Moreover, prior administrative practice is always subject to change "through exercise by the administrative agency of its continuing rule-making power." See *Helvering* v. *Reynolds*, 313 U. S. 428, 432 [Ct. D. 1515, C. B. 1941–1, 371].

means of procuring them." There the taxpayer detached interest coupons from negotiable bonds and presented them as a gift to his son. The interest when paid was held taxable to the father. Here, even more clearly than there, the taxpayer is converting future income into present income.

Second, as to the *Fleming* case. The Court of Appeals in the *Fleming* case held that the transactions were taxfree under section 112(b)(1) which provides:

> "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." 53 Stat. 37.

In the alternative and as a second ground, it held that this case, too, was governed by section 117.

We agree with the Tax Court, 24 T. C. 818, that this is not a tax-free exchange under section 112(b)(1). Treasury Regulations 111, promulgated under the 1939 Act, provide in section 39.112(b)(1)–1 as respects the words "like kind," as used in section 112(b)(1), that "One kind or class of property may not . . . be exchanged for property of a different kind or class." The exchange cannot satisfy that test where the effect under the tax laws is a transfer of future income from oil leases for real estate. As we have seen, these oil payment assignments were merely arrangements for delayed cash payment of the purchase price of real estate, plus interest. Moreover, section 39.112(a)–1 states that the "underlying assumption of these exceptions is that the new property is substantially a continuation of the old investment still unliquidated." Yet the oil payment assignments were not conversions of capital investments, as we have seen.

Reversed.

SECTION 117(g).—CAPITAL GAINS AND LOSSES: GAINS AND LOSSES FROM SHORT SALES, ETC.

REGULATIONS 118, SECTION 39.117(g)(1): Gains and losses from short sales.

Taxable status of gain or loss arising in connection with the execution of "put" and "call" option transactions. See Rev. Rul. 58–234, page 279.

SECTION 117(k).—CAPITAL GAINS AND LOSSES: GAIN OR LOSS IN THE CASE OF TIMBER OR COAL

REGULATIONS 118, SECTION 39.117(k)–1: Gain or loss upon the cutting and disposal of timber and the disposal of coal. Rev. Rul. 58–135

> For purposes of determining capital gain or loss, timber is considered cut in the year in which, in the ordinary course of business, the quantity of timber felled is first definitely determined, rather than at the time of felling.

Advice has been requested whether the term "timber cut" referred to in section 117(k)(1) of the Internal Revenue Code of 1939 includes all timber cut or felled during the taxable year or whether the term may be construed as being applicable only when the quantity is first definitely determined.

Section 117(k)(1) of the Code provides in part that a taxpayer, under certain circumstances, may elect upon his return for a taxable year to treat the cutting of timber for sale or use in his trade or busi-

ness as a sale or exchange of such timber cut during such year. In case such an election has been made gain or loss to the taxpayer is recognized in an amount equal to the difference between the adjusted basis for depletion of such timber in the hands of the taxpayer and its fair market value as of the first day of the taxable year in which such timber is cut.

Although section 117(k)(1) limits the application of the section to timber actually cut or felled, for practical timber operations it is generally impossible to obtain a reasonably accurate measurement of quantity at the time the timber is cut or felled.

The problem of ascertaining when timber is cut during the taxable year appears to have been given specific consideration in section 39.23(m)–21(c) of Regulations 118, relating to depletion allowance of timber. This section states that "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 felled is first definitely determined."

Thus, it has been the general practice in the timber industry to determine the quantity of the timber cut during a taxable year for depletion purposes when in the process of exploitation, the timber is first actually measured. This determination usually takes place at the log landing, river bank or at the mill and also serves as the point when the quantity of logs is inventoried, since it is generally impractical to obtain a reasonably accurate measurement of quantity at the time timber is felled. This is due partly to the fact that timber when first felled, cannot be turned for inspection of defects and damage in falling and the additional fact that the logs may be lost, damaged or destroyed in the course of handling, transportation and dumping.

It is the opinion of the Internal Revenue Service that the treatment provided in the regulations under section 23(m) of the 1939 Code in determining depletion is equally applicable to section 117(k)(1) in determining capital gain or loss. Therefore, it is held that, for purposes of section 117(k)(1) of the Internal Revenue Code of 1939 timber shall be considered cut at the time when, in the ordinary course of business, the quantity of timber felled is first definitely determined, rather than at the time of felling. Taxpayers are required to hold to a consistent scaling practice and may not shift the scaling point to obtain a tax advantage.

There has been included in the regulations under section 631(a) of the Internal Revenue Code of 1954 (which corresponds to section 117(k)(1) of the 1939 Code) a provision under which the position here set forth is made equally applicable under the 1954 Code. See section 1.631–1(a)(2) of the Income Tax Regulations.

Rev. Rul. 58–266

Direct expenses incurred in connection with the disposal of coal or timber subject to the provisions of section 117(k)(2) of the Internal Revenue Code of 1939 reduce the amount received for the purpose of computing gain or loss from such disposal of coal or timber. Whether any expense is a "direct expense" is a matter to be determined largely on the strength or persuasiveness of the

facts of each particular case and how closely related are the activities in connection with which the expense is incurred to the disposal of the coal or timber.

Advice has been requested as to the Federal income tax treatment of expenditures which are directly attributable to the disposal of coal or timber under the provisions of section 117(k)(2) of the Internal Revenue Code of 1939.

The taxpayer in this case is a corporation which is the owner and lessor of coal lands. Substantially all of its income is derived from the disposal of coal within the purview of section 117(k)(2) of the Code. In connection with and directly attributable to the disposal of coal so as to produce the maximum income therefrom, the taxpayer expends substantial amounts for checking the lessee's records for accounting and billing purposes, for mining engineers to insure that the maximum amount of coal will be mined by modern methods, for supervisory safety measures, etc.

Section 117(k)(2) of the Code, as amended by the Revenue Act of 1951, 65 Stat. 452, 26 U. S. C. 117, provides, in part, as follows:

In the case of the disposal of timber or coal (including lignite), held for more than 6 months prior to such disposal, by the owner thereof under any form or type of contract by virtue of which the owner retains an economic interest in such timber or coal, the difference between the *amount received* for such timber or coal and the adjusted basis thereof shall be considered as though it were a gain or loss, as the case may be, upon the sale of such timber or coal. Such owner shall not be entitled to the allowance for percentage depletion provided for in section 114(b)(4) with respect to such coal. * * * (Italics supplied.)

The specific question, therefore, is whether the words "amount received," as used in section 117(k)(2) of the Code mean the gross amount received or whether these words are to be interpreted to mean the gross amount reduced by the direct expenses incident to the transaction.

Section 117(k)(2) of the Code was originally added to the Code by section 127(a) of the Revenue Act of 1943, C. B. 1944, 756 at 773, and, as enacted at that time, was applicable only with respect to the disposal of timber.

Senate Report No. 627, 78th Cong., First Session, C. B. 1944, 973 at 993, on the Revenue Act of 1943 states:

Your committee is of the opinion that various timber owners are seriously handicapped under the Federal income and excess profits tax laws. The law discriminates against taxpayers who dispose of timber by cutting it as compared with those who sell timber outright. The income realized from the cutting of timber is now taxed as ordinary income at full income and excess profits tax rates and not at capital gain rates. In short, if the taxpayer cuts his own timber he loses the benefit of the capital gain rate which applies when he sells the same timber outright to another. Similarly, owners who sell their timber on a so-called cutting contract under which the owner retains an economic interest in the property are held to have leased their property and are therefore not accorded under present law capital-gain treatment of any increase in value realized over the depletion basis.

It is apparent that, in the above statement, a comparison was being made of economic income from sale versus economic income from cutting or lease. The impact of income tax upon a taxpayer deriving income from cutting or lease discriminated against such taxpayer as compared with the impact of the lower capital gain rate applicable to a taxpayer deriving income from a sale.

It has been the consistent position of the Internal Revenue Service, in connection with transactions qualifying for capital gain or loss treatment, that selling expenses are treated as an offset to the selling price. I. T. 2305, C. B. V-2, 108 (1926); (*Mrs.*) *E. A. Griffin* v. *Commissioner*, 19 B. T. A. 1243; *Therese C. Johnson* v. *Commissioner*, 7 T. C. 465, acquiescence C. B. 1946-2, 3. Since the selling expenses in a sale of a capital asset are considered in arriving at income subject to capital gain tax, it would seem reasonable to give like consideration to direct expenses in connection with income from leases. In this way the comparison set forth in the above Committee Report would constitute a comparison of like concepts and afford a basis for a sound determination as to a finding of discrimination between similarly situated taxpayers. The fact that selling expenses may be of a recurring nature has been held not to affect their treatment as an adjustment to the selling price. *General Spring Corporation* v. *Commissioner*, Tax Court Memorandum Opinion, entered July 27, 1953.

Section 112(a) of the Code provides in general that, upon the sale or exchange of property, the entire amount of gain or loss determined under section 111 of the Code shall be recognized. Section 111 of the Code provides, in part:

(a) COMPUTATION OF GAIN OR LOSS.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) AMOUNT REALIZED.—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.

There is no essential difference between the words "amounts received" found in section 117(k)(2) of the Code and "money received" as used in section 111. Under section 117(k)(2), since the transaction is considered as though it were a gain or loss upon the sale of such timber or coal, and under appropriate circumstances, as provided by section 117(j), gain is considered as long-term capital gain, the direct expenses incident to the transaction should constitute a reduction of the "amount received" in the same manner that selling expenses reduce the sales price.

The words "amounts received" are found in section 117(f) of the Code. Section 117(f) of the Code provides:

RETIREMENT OF BONDS, ETC.—For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes or certificates or other evidence of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

The effect of this section is to convert ordinary income or loss to capital gain or loss, without any reference however to section 117(j) of the Code. Section 117(f) has been a part of the Code since its enactment in 1939.

In the case of *Edward A. Atlas* v. *Commissioner*, Tax Court Memorandum Opinion, entered January 27, 1945, two of the questions in issue were whether the taxpayer realized taxable income in 1940 when he surrendered bonds purchased at a discount and whether the gain, if any, is taxable in part as a long-term capital gain. In accordance with the provisions of section 117(f) of the Code, the court held:

We think that the surrender of the $61,000 bonds, Series M–1184, for the Fort Hubbard Apartments was the equivalent of the retirement of the bonds by the Bankers Trust Co. The gain to the petitioner upon such transaction was the difference between the cost of the bonds, $23,430.77, and the stipulated fair market value of the Fort Hubbard Apartments received, $70,000, less the fees, commissions and expenses amounting to $1,795.50, or a net gain of $44,773.73.

"The amount of the gain attributable to each period is the difference between the cost of the bonds acquired in such period and an aliquot portion of the net amount received upon surrender of the bonds, $70,000 less $1,795.50, or $68,204.50."

In the case of a corporation deriving substantially all its income from coal or timber leases, to which section 117(k)(2) of the Code is applicable, the tax relief intended by the Congress in enacting this section would be largely lost if the direct expenses attributable to the lease were not considered in arriving at the gain which would be treated as long-term capital gain. Under such circumstances, the corporation would either derive no tax benefit from these expenses, if the alternative tax under section 117(c)(1) of the Code was applicable, or it would derive no tax benefit under section 117(k)(2) if its direct expenses were so large as to make the alternative tax under section 117(c)(1) inapplicable.

On the other hand, in the case of a corporation realizing appreciable ordinary income, as well as income from section 117(k)(2) leases, if the direct expenses are not considered in arriving at the gain computed under this section, the gross profit from the lease (gross amount received less cost depletion) will be subject to a maximum tax at substantially lower long-term capital gain rates, whereas the direct expenses will in turn offset the ordinary income subject to the higher corporate normal and surtax rates. There appears to be no basis for concluding that section 117(k)(2) was intended to operate in such a manner as to favor corporations deriving both ordinary income and section 117(k)(2) income as against corporations deriving only section 117(k)(2) income.

Accordingly, it is held that direct expenses incurred in connection with the disposal of coal or timber subject to the provisions of section 117(k)(2) of the Code reduce the amount received for the purpose of computing gain or loss from such disposal of coal or timber. Whether any expense is a "direct expense" is a matter to be determined largely on the strength or persuasiveness of the facts of each particular case and how closely related are the activities in connection with which the expense is incurred to the disposal of the coal or timber.

Gain or loss where a taxpayer has a proprietary interest in timber cut by himself. See Rev. Rul. 58–295, page 249.

SECTION 118.—LOSS FROM WASH SALES OF STOCK OR SECURITIES

REGULATIONS 118, SECTION 39.118–1: Losses from wash sales of stock or securities. (Also Part I, Section 1091; 26 CFR 1.1091–1.) Rev. Rul. 58–210

United States Treasury 2½ percent bonds maturing September 15, 1972, but callable on and after September 15, 1967, at par (face amount) and accrued interest, not redeemable at par and accrued

interest for application in payment of Federal estate taxes due from a deceased owner's estate, and eligible for unrestricted investment by commercial banks, were, when purchased by a taxpayer on June 17, 1953, not "substantially identical," within the meaning of section 118 (a) of the Internal Revenue Code of 1939 (now section 1091 (a) of the Internal Revenue Code of 1954), to United States Treasury 2½ percent bonds, of equal face (principal) amount, maturing December 15, 1972, but callable on and after December 15, 1967, at par and accrued interest, redeemable at par and accrued interest for application in payment of Federal estate taxes due from a deceased owner's estate, and not eligible until on and after December 15, 1962, for unrestricted investment by commercial banks, when the latter bonds were sold by the taxpayer on May 18, 1953. Therefore, deduction of a loss sustained upon such sale is not prohibited by section 118 (a) of the Code.

I. T. 1365, C. B. I–1, 151 (1922) is clarified and amplified. I. T. 2672, C. B. XII–1, 72 (1933), and G. C. M. 21496, C. B. 1939–2, 169 are clarified.

Advice has been requested whether a loss sustained by a taxpayer upon the sale on May 18, 1953, of United States Treasury 2½ percent bonds of December 15, 1967–72 is nondeductible, under section 118 (a) of the Internal Revenue Code of 1939 (now section 1091 (a) of the Internal Revenue Code of 1954), where the taxpayer on June 17, 1953, purchased an equal face (principal) amount of United States Treasury 2½ percent bonds of September 15, 1967–72.

Section 39.118–1(a) of Regulations 118, promulgated under section 118(a) of the Code, provides, in part, as follows:

A taxpayer cannot deduct any loss claimed to have been sustained from the sale or other disposition of stock or securities if, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date (referred to in this section as the 61-day period), he has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, *substantially identical* stock or securities. However, this prohibition does not apply (1) in the case of a taxpayer, not a corporation, if the sale or other disposition of stock or securities is made in connection with the taxpayer's trade or business, or (2) in the case of a corporation, a dealer in stock or securities, if the sale or other disposition of stock or securities is made in the ordinary course of its business as such dealer. [Italics supplied.]

Inasmuch as the date of the purchase involved, in relation to the date of the sale involved, is clearly within the period prescribed in section 118(a) of the Code, and section 39.118–1(a) of Regulations 118, the question presented is whether the bonds purchased were, within the meaning of such sections, "substantially identical" to the bonds sold.

In Rev. Rul. 58–211, page 529, it is stated *inter alia:*

Generally, respective bonds are "substantially identical," within the meaning of section 118(a) of the Code, if they are not substantially different in any material feature (unaffected by any related material feature, or as affected by such other feature or features), or because of differences in several material features considered together. On the other hand, they are not "substantially identical," within such meaning, if they are substantially different in any material feature (unaffected by any related material feature, or as affected by such other feature or features), or because of differences in several material features considered together (*i. e.*, even though each of such differences considered alone might not be regarded as substantial). In determining whether or not bonds purchased were substantially identical with bonds sold, the bonds purchased must, of course, be compared as they existed when purchased with the bonds sold as they existed when sold.

The fact that bonds of one series have the same, or approximately the same, market value on a particular day, or days, as bonds of another series of the

same obligor, equally secured, and bearing interest at the same rate, does not necessarily establish that the respective bonds are "substantially identical," for that market situation can occur even if such respective series of bonds have substantially different maturity dates (unaffected, or as affected, by earlier call provisions) but, where they so differ, their market prices often are substantially higher on the substantially longer term series (than on the substantially shorter term series) when the market for the bonds is strong (usually during periods of generally low interest rates) and the reverse frequently occurs when the market for the bonds is weak (usually during periods of generally high interest rates).

The United States Treasury 2½ percent bonds sold by the taxpayer on May 18, 1953, are dated November 15, 1945, and bear interest from that date, payable on a semiannual basis June 15 and December 15, until their principal becomes payable. They mature December 15, 1972, but may be redeemed, at the option of the United States, on and after December 15, 1967, in whole or in part, at par (face amount) and accrued interest, on any interest day or days, on four months' notice. They are redeemable, at the option of the representative of a deceased owner's estate, for application in payment of Federal estate taxes due therefrom, at par and accrued interest. In Revenue Ruling 156, C. B. 1953–2, 253, such redemption-application of United States Treasury bonds so redeemable is illustrated and procedure for obtaining and effecting it is set forth. Under their original issuance terms, they were not eligible before December 15, 1962, for unrestricted investment by "commercial banks" (defined for this purpose as banks accepting demand deposits), but, under Treasury Department Circular No. 942, dated December 22, 1954, 19 F. R. 9298 such restriction was removed effective January 1, 1955. Bonds of this series were issued in interchangeable denominations of $500, $1,000, $5,000, $10,000, $100,000, and $1,000,000. Treasury Department Circular No. 776, dated October 29, 1945, 10 F. R. 13777. The taxpayer had purchased them in a prior year at par. He sold them on the market at $91^{24}/_{32}$ (dollars per $100 face amount). Thus, he sustained a loss upon such sale.

The United States Treasury 2½ percent bonds purchased by the taxpayer on June 17, 1953, are dated October 20, 1941, and bear interest from that date, payable on a semiannual basis March 15 and September 15, until their principal becomes payable. They mature September 15, 1972, but may be redeemed, at the option of the United States, on and after September 15, 1967, in whole or in part, at par and accrued interest, on any interest day or days, on 4 months' notice. They are not redeemable, at the option of the representative of a deceased owner's estate, for application in payment of Federal estate taxes due therefrom, at par and accrued interest. They are eligible for unrestricted investment by commercial banks, and were so eligible immediately upon being issued. Bonds of this series were issued in interchangeable denominations of $50, $100, $500, $1,000, $5,000, $10,000, and $100,000; but, under Treasury Department Circular No. 789, dated June 10, 1946, 11 F. R. 6494, a $1,000,000 donomination was also made available in this series. Treasury Department Circular No. 670, dated October 9, 1941, 6 F. R. 5150. The taxpayer purchased them on the market at $91^{16}/_{32}$.

I. T. 1365, C. B. I–1, 151 (1922), holds that 4¼ percent Second Liberty Loan bonds and 4¼ percent Fourth Liberty Loan bonds were not "substantially identical property," within the meaning of section

214(a)5 of the Revenue Act of 1921. At the time of publication of that ruling, such bonds were widely owned and their call and maturity dates and market values were generally well known and readily available; and it was intimated in the ruling that the market values and maturity dates of the respective Liberty bond issues were substantially different without specifically stating such values and dates or the differences therein. Also, in that ruling, certain statements, which were made by Dr. Adams (Treasury Department tax advisor) and two United States Senators at a hearing before the Senate Finance Committee in reference to section 214(a)5 of the Revenue Bill of 1921, were quoted as setting forth application of the part of section 214(a)5 of the Revenue Act of 1921 under consideration in the ruling without definitely indicating that, when those statements were made (October 2, 1921), section 214(a)5 of the then-proposed Revenue Bill of 1921 contained the words "identical property" (see H. R. Report No. 350, 67th Cong. C. B. 1939–1 (Part 2), 168 at 177; and Senate Report No. 275, 67th Cong., C. B. 1939–1 (Part 2), 181 at 191) instead of the words "substantially identical property" later embodied therein (October 8, 1921) as ultimately enacted as a part of the Revenue Act of 1921 (H. R. Conference Report No. 486, 67th Cong., C. B. 1939–1 (Part 2), 206 at 214, 222), and no statements were quoted or mentioned that were made when the word "substantially" was inserted in the legislation. Therefore, I. T. 1365, *supra*, is clarified and amplified as follows:

(1) The fourth paragraph of the ruling is restated to read as follows:

"Substantially identical property" does not include all of one kind or class of property, the meaning given to "property of a like kind" under section 202(c)1, Revenue Act of 1921, but is limited to property which is substantially the same in all important particulars. Important features of securities include their earning power or interest rate; value of assets, tangible or intangible, or security; and conditions of retirement, or, in the case of bonds, maturity dates and earlier call provisions. The respective market values, maturity dates, and earlier call dates of the second Liberty loan 4¼ per cent bonds and the fourth Liberty loan 4¼ per cent bonds are different; the differences in the latter two particulars being very substantial in view of the relatively short periods the bonds may run before they cease to bear interest. The second Liberty loan 4¼ per cent bonds, dated May 9, 1918, mature November 15, 1942, but are callable on and after November 15, 1927, in whole or in part, at par (face amount) and accrued interest, on any interest day or days, on six months' notice, whereas the fourth Liberty loan 4¼ per cent bonds, dated October 24, 1918, mature October 15, 1938, but are callable on and after October 15, 1933, in whole or in part, at par and accrued interest, on any interest day or days, on six months' notice. (Treasury Department Circulars Nos. 114 and 121, dated May 9, 1918, and September 28, 1918, respectively). This of itself shows that there is no substantial identity between those respective bonds.

(2) At the end of the fifth paragraph of the ruling, the following is added (as a part of such paragraph):

The above-quoted statements were made (October 2, 1921) in reference to section 214(a)5 of the Revenue Bill of 1921 (as then proposed) when it contained the words "identical property." Later (October 8, 1921), when the words "substantially identical property" were substituted in section 214(a)5 as ultimately enacted as a part of the Revenue Act of 1921, Dr. Adams (Treasury Department tax advisor) commented, Part 2, page 387:

The [proposed] statute now uses the word "identical." It has been suggested from many quarters that unless you wish to make that very rigid you had better put in "substantially identical."

I. T. 2672, C. B. XII–1, 72 (1933), with respect to the first issue therein, holds that a $1,000 four percent municipal bond maturing "in 1977," sold by the taxpayer "subsequent to June 6, 1932," for $770 and accrued interest, and a $1,000 four percent bond of the same municipality maturing "in 1980," purchased by the taxpayer "on the same date" for $777.50 and accrued interest, were not "substantially identical securities," within the meaning of section 118 of the of the Revenue Act of 1932. It was stated in the ruling that the bond purchased was "of the issue of 1930 and matures in 1980" with interest "payable on October 1 and April 1 of each year," and that it "was issued more than three years after the other" (sold) which was "of the issue of 1927 * * * and matures in 1977" with interest "payable on May 1 and November 1 of each year." Hence, it appears that the bond sold matures May 1, 1977, and that the bond purchased matures October 1, 1980. Accordingly, there was a difference between their respective maturity dates of three years and five months. It is evident that such difference was not very great in relation to the long periods which remained (when the sale and purchase involved were made) before the respective maturity dates, namely, about forty-five and forty-eight years, respectively. Since there was no other major difference set forth or indicated as to the respective bonds, the ruling must be regarded as borderline, although the Internal Revenue Service will continue to follow it in like cases. Compare the holding on Issue 1 in *Marie Hanlin, et al., Executors of the Estate of Belle C. Hershman Martinek* v. *Commissioner*, 38 B. T. A. 811, affirmed 108 Fed. (2d) 429, discussed in Revenue Ruling 58–211 *supra*. Insofar as disclosed in I. T. 2672, *supra*, the difference between the respective bond values indicated therein ($770 and $777.50) merely reflected the market value effect, on the particular day involved, of the difference between then-remaining terms of the respective bonds concerned.

However, in that ruling reference was made, in its syllabus, to the "different dates of issue" and, in its body, it was pointed out that one of the respective bonds "was issued more than three years after the other." It is believed that those apparently deliberate references to issue dates as material factors were inappropriate and may be misleading. Manifestly, issue dates of bonds are not material features or particulars thereof at all in determining whether or not respective issues or series sold and purchased were "substantially identical securities," within the meaning of the "wash sales" statutory provisions, unless some material factor or factors are dependent upon such dates, a situation which does not appear in the ruling. Also, in that ruling, reference was made, in its syllabus, to "different interest payments" and, in its body, it was pointed out that "The interest on the two bonds is payable on different dates." It is believed that those apparently deliberate references to interest payment dates as material factors too were inappropriate, on the basis of the pertinent facts appearing in the ruling, and likewise may be misleading. The stated interest payment dates were, as to the bond sold, "May 1 and November 1 of each year" and, as to the bond purchased, "October 1 and April 1 of each year." In other words, as to both bonds, the interest was payable on the same basis, *i. e.*, semiannually. Thus, the differences in the interest payment dates of the respective bonds involved

in the ruling, which had maturity dates extending about forty-five years and forty-eight years, respectively, in the future from the date of the sale and purchase involved, were so largely formal and relatively insubstantial, whether considered by themselves or together with some other difference or differences in the bonds, as also not to be material factors. Therefore, in order to clarify the ruling, the references therein to the differences in the dates of issue and interest payment dates involved as material factors should be disregarded.

For the same reasons, in order to clarify G. C. M. 21496, C. B. 1939–2, 169, similar references therein to issuance and interest payment dates as material factors should be disregarded. In that ruling, it was held that 26*x* dollars *M* Company seven percent convertible notes which matured September 1, 1932, and were in default as to principal and interest, purchased by the taxpayer on January 5, 1938, and 26*x* dollars *M* Company five percent first and refunding bonds which mature in 1966, sold by him on the same day, were not "substantially identical securities," within the meaning of section 118 of the Revenue Act of 1938, even though the entire issue of the notes was secured by a pledge of *y* dollars of the *M* Company five percent first and refunding bonds of 1966.

In *Marjorie K. Campbell* v. *Commissioner*, 39 B. T. A. 916, Issue 3, acquiescence C B. 1939–2, 6, it was held that certain corporate stock of the City of New York (considered as the equivalent of bonds) sold on one day and certain other corporate stock of the same City (also considered as the equivalent of bonds) purchased on the next day were not "substantially identical," within the meaning of section 118 of the Revenue Act of 1932, where *inter alia*, their respective maturity dates differed at least five years and four months with the nearest such date about twenty-three years and four months from the sale and purchase dates involved.

In the instant case, the respective United States Treasury bonds involved were identical as to interest rates. As hereinbefore indicated, since the interest on all the bonds involved is payable on the same basis, namely semiannually, and they had about fourteen or more years to run, the fact that such interest payment dates are June 15 and December 15 as to the bonds sold and March 15 and September 15 as to the bonds purchased is considered to be so largely formal and relatively insubstantial as to be immaterial here. Also, the differences between the denominations in which the respective series of bonds involved were issued and available are considered to be so formal and nominal as to be immaterial here; for, otherwise, form would be exalted where substance should prevail. The difference between the price received for the bonds sold and that paid for the bonds purchased, namely $^{8}/_{32}$ point, is so small that is could represent a single day's fluctuation in the market value of either of the respective issues of bonds and is manifestly very nominal. Hence, it is comparatively insignificant and clearly does not denote any substantial difference in the respective bonds, either by itself or coupled with the differences in their earliest call dates and maturity dates. The respective bonds differed only three months in earliest call dates and in maturity dates and such dates are over fourteen years and nineteen

years, respectively, in the future from the sale and purchase dates involved, which periods of time are considered to be sufficiently long to make the three-month differences in the respective earliest call dates and respective maturity dates, although material, relatively insubstantial by themselves. Compare Rev. Rul. 58–211, *supra*. However, the respective bonds differed in two other material respects. The bonds sold are redeemable at par and accrued interest for application in payment of Federal estate taxes due from a deceased owner's estate, whereas the bonds purchased are not so redeemable; and the bonds sold were then not eligible until on and after December 15, 1962, for unrestricted investment by commercial banks (defined as above stated), whereas the bonds purchased were already so eligible. Without deciding here whether or not each of those two differences considered by itself renders the respective bonds substantially different, it is concluded that all of the material differences involved considered together render the respective bonds substantially different.

In view of the foregoing, it is held that United States Treasury 2½ percent bonds maturing September 15, 1972, but callable on and after September 15, 1967, at par and accrued interest, not redeemable at par and accrued interest for application in payment of Federal estate taxes due from a deceased owner's estate, and eligible for unrestriced investment by commercial banks, were, when purchased by a taxpayer on June 17 1953, not "substantially identical," within the meaning of section 118(a), of the Code, to United States Treasury 2½ percent bonds, of equal face amount, maturing December 15, 1972. These latter bonds are callable on and after December 15, 1967, at par and accrued interest, redeemable at par and accrued interest for application in payment of Federal estate taxes due from a deceased owner's estate, and not eligible until on and after December 15, 1962, for unrestricted investment by commercial banks, when the latter bonds were sold by the taxpayer on May 18, 1953. Therefore, deduction of a loss sustained upon such sale is not prohibited by section 118 (a) of the Code.

Although the instant ruling is made under the 1939 Code, the principles thereof are equally applicable under the 1954 Code.

Rev. Rul. 58–211

United States Treasury 2¼ percent coupon (bearer) bonds maturing December 15, 1962, but callable on and after December 15, 1959, at par (face amount) and accrued interest, were, when purchased by a taxpayer on June 24, 1953, "substantially identical," within the meaning of section 118(a) of the Internal Revenue Code of 1939 (now section 1091(a) of the Internal Revenue Code of 1954), to United States Treasury 2¼ percent registered bonds, of equal face (principal) amount, maturing June 15, 1962, but callable on and after June 15, 1959, at par and accrued interest, when the latter were sold by the taxpayer on July 24, 1953. Therefore, under that section, a loss sustained upon such sale is nondeductible, unless (1) incurred in trade or business by a taxpayer other than a corporation, or (2) the taxpayer is a corporation and dealer in securities and made the sale in the ordinary course of its business as such dealer.

Advice has been requested whether or not a loss sustained by a taxpayer upon the sale on July 24, 1953, of United States Treasury 2¼

percent registered bonds of June 15, 1959–62 is nondeductible, under section 118(a) of the Internal Revenue Code of 1939 (now section 1091(a) of the Internal Revenue Code of 1954), where the taxpayer on June 24, 1953, had purchased an equal face (principal) amount of United States Treasury 2¼ percent coupon (bearer) bonds of December 15, 1959–62.

Section 39.118–1(a) of Regulations 118, promulgated under section 118(a) of the Code, provides, in part, as follows:

> A taxpayer cannot deduct any loss claimed to have been sustained from the sale or other disposition of stock or securities if, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date (referred to in this section as the 61-day period), he has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, *substantially identical* stock or securities. However, this prohibition does not apply (1) in the case of a taxpayer, not a corporation, if the sale or other disposition or stock or securities is made in connection with the taxpayer's trade or business, or (2) in the case of a corporation, a dealer in stock or securities, if the sale or other disposition of stock or securities is made in the ordinary course of its business as such dealer. (Italics supplied.)

Inasmuch as the date of the purchase involved, in relation to the date of the sale involved, is clearly within the period prescribed in section 118(a) of the Code and section 39.118–1(a) of Regulations 118, the question presented is whether or not the bonds purchased were, within the meaning of such sections, "substantially identical" to the bonds sold.

Generally, respective bonds are "substantially identical," within the meaning of section 118(a) of the Code, if they are not substantially different in any material feature (unaffected by any related material feature, or as affected by such other feature or features), or because of differences in several material features considered together. On the other hand, they are not "substantially identical," within such meaning, if they are substantially different in any material feature (unaffected by any related material feature, or as affected by such other feature or features), or because of differences in several material features considered together (*i. e.*, even though each of such differences considered alone might not be regarded as substantial). In determining whether or not bonds purchased were substantially identical to bonds sold, the bonds purchased must, of course, be compared as they existed when purchased with the bonds sold as they existed when sold.

The fact that bonds of one series have the same, or approximately the same, market value on a particular day, or days, as bonds of another series of the same obligor, equally secured, and bearing interest at the same rate, does not necessarily establish that the respective bonds are "substantially identical," for that market situation can occur even if such respective series of bonds have susbstantially different maturity dates (unaffected, or as affected, by earlier call provisions) but, where they so differ, their market prices often are substantially higher on the substantially longer term series (than on the substantially shorter term series) when the market for the bonds is strong (usually during periods of generally low interest rates) and the reverse frequently occurs when the market for the bonds is weak (usually during periods of generally high interest rates).

Although redemption under many prematurity call provisions is at par (face amount) and accrued interest, under others it is at a stipulated amount that is above par and accrued interest; and in some of the latter such amount is (1) an unconditional prematurity "general redemption price" or (2) a lower prematurity "special redemption price" applicable only in specified contingent events. See Rev. Rul. 56–398, C. B. 1956–2, 984.

The United States Treasury 2¼ percent registered bonds sold by the taxpayer on July 24, 1953, are dated June 1, 1945, and bear interest from that date, payable on a semiannual basis June 15 and December 15, until their principal becomes payable. They mature June 15, 1962, but may be redeemed, at the option of the United States on and after June 15, 1959, in whole or in part, at par and accrued interest, on any interest day or days, on four months' notice. They are redeemable, at the option of the representative of a deceased owner's estate, for application in payment of Federal estate taxes due therefrom, at par and accrued interest. They were not acceptable before June 15, 1952, to secure deposits of public moneys, but became so acceptable on and after that date. They were not eligible before June 15, 1952, for unrestricted investment by "commercial banks" (defined for this purpose as banks accepting demand deposits), but became so eligible on and after that date. Bonds of this series were issued in bearer form with interest coupons attached or registered as to principal and interest, and in denominations of $500, $1,000, $5,000, $10,000, $100,000, and $1,000,000, with provision for the interchange of bonds of different denominations and of coupon and registered bonds, and for the transfer of registered bonds. Treasury Department Circular No. 769, dated May 14, 1945, 10 F. R. 4268. The taxpayer had bought them in a prior year at 98 (dollars per $100 face amount). He sold them at 95. Thus, he sustained a loss upon such sale.

The United States Treasury 2¼ percent bearer bonds purchased by the taxpayer on June 24, 1953, are dated November 15, 1945, and bear interest from that date, payable on a semiannual basis June 15 and December 15, until their principal becomes payable. They mature December 15, 1962, but may be redeemed, at the option of the United States, on and after December 15, 1959, in whole or in part, at par and accrued interest, on any interest day or days, on four months' notice. They are redeemable, at the option of the representative of a deceased owner's estate, for application in payment of Federal estate taxes due therefrom, at par and accrued interest. They are acceptable to secure deposits of public moneys, and were so acceptable immediately upon being issued. They were not eligible before December 15, 1952, for unrestricted investment by "commercial banks" (defined for this purpose as banks accepting demand deposits), but became so eligible on and after that date. Bonds of this series also were issued in bearer or registered form and in denominations of $500, $1,000, $5,000, $10,000, $100,000 and $1,000,000, with provision for the interchange of bonds of different denominations and of bearer and registered bonds, and for the transfer of registered bonds. Treasury Department Circular No. 777, dated October 29, 1945, 10 F. R. 13778. The taxpayer purchased them at 95$^{6}/_{32}$.

Under Issues 1 and 2 in the case of *Marie Hanlin et al., Executors of the Estate of Belle C. Hershman Martinek* v. *Commissioner*, 38 B. T. A.

811, affirmed 108 Fed. (2d) 429, the Commissioner's determinations that the following respective bonds were "substantially identical" securities, under corresponding provisions of section 118(a) of the Revenue Act of 1932, were approved:

1. City of Philadelphia bonds of the same respective par (face) amounts, sold and purchased (in December 1932) at the same respective unit prices, and bearing interest at the same rate, and differing only from four to ten months in respective maturity dates which were approximately sixteen years in the future from the dates of the sales and purchases involved.

2. Federal Land Bank of Omaha bonds of the same respective par (face) amounts, sold and purchased at the same respective unit prices, and bearing interest at the same rate, and, although differing two and one-half years in respective maturity dates (July 1, 1953, and January 1, 1956), such dates were approximately twenty and one-half and twenty-three years, respectively, in the future from the date of the sale and purchase involved (December 14, 1932) and all the bonds involved were redeemable, at the obligor's option (presumably at par and accrued interest), simultaneously (on or after July 1, 1933) only six and one-half months after the sale and purchase date and until their maturity. The United States Board of Tax Appeals stated that such (early, uniform, and continuous) redeemability was a "much more important" element in determining whether or not the respective bonds involved were "substantially identical" than the difference between their ultimate maturity dates.

Noteworthy discussions relating to the history, purpose, and intent of the "wash sales" statutory provisions are contained in the opinions on the case, especially that of the Board.

In the case of *Helen C. Frick* v. *Driscoll*, decided January 11, 1941, the United States District Court, Western District, Pennsylvania, citing the *Hanlin* (*Martinek*) decision, *supra*, sustained the Commissioner's determination that respective City of Philadelphia bonds of the same respective par (face) amounts, sold and purchased (in December 1932) at the same respective unit prices, and bearing interest at the same rate, and, although differing about four years in respective maturity dates (1967 and 1971), such dates were about thirty-five and thirty-nine years, respectively, in the future from the dates of the sales and purchases involved and all the bonds involved were redeemable, at the option of the obligor, in the same year (1948) about sixteen years after the sale and purchase dates, were "substantially identical" securities, under section 118(a) of the Revenue Act of 1932.

In *Merchants National Bank* v. *Commissioner*, 9 T. C. 68, the Commissioner was sustained in determining that Central Railroad of New Jersey general mortgage registered bonds of a par (face) amount of $11,000 purchased January 30, 1942, for $1,567.50 were "substantially identical," under section 118(a) of the 1939 Code, to Central Railroad of New Jersey general mortgage coupon bonds having the same maturity date (July 1, 1987), bearing interest at the same rate (four percent), identically secured, and of the same par amount sold on the same day for $1,519.96, which had been purchased in 1935 for $9,700.

In the instant case, the respective United States Treasury bonds involved were identical as to interest rates and, at the time of the sale and purchase involved and thenceforth, as to both acceptability to secure deposits of public moneys and eligibility for unrestricted investment by commercial banks (defined as above stated). The respective bonds differed only six months in earliest call dates and in maturity dates, and such dates are nearly six years and nine years, respectively, in the future from the sale and purchase dates involved. The latter periods of time are considered to be sufficiently long to make the six-month differences in the respective earliest call dates and respective maturity dates, although material (pertinent), relatively insubstantial by themselves. The difference between the price received for the bonds sold and that paid for the bonds purchased, namely $\frac{6}{32}$ point, is so small that it could represent a single day's fluctuation in the market value of either of the respective issues of bonds, and is manifestly very nominal. Hence, it is comparatively insignificant and clearly does not denote any substantial difference in the respective bonds, either by itself or coupled with the differences in their earliest call dates and maturity dates. The fact that bonds sold were in registered form whereas those purchased were bearer bonds is considered to be immaterial in determining whether or not the respective bonds were "substantially identical" securities, especially where, as here, interchange and transfer of registered and bearer bonds were provided with respect to both of the series of bonds involved.

In view of the foregoing, it is held that United States Treasury 2¼ percent bonds maturing December 15, 1962, but callable on and after December 15, 1959, at par and accrued interest, were, when purchased by a taxpayer on June 24, 1953, "substantially identical," within the meaning of section 118(a) of the Code, to United States Treasury 2¼ percent bonds, of equal face amount, maturing June 15, 1962, but callable on and after June 15, 1959, at par and accrued interest, when the latter were sold by the taxpayer on July 24, 1953. Therefore, under that section, a loss sustained upon such sale is nondeductible, unless (1) incurred in trade or business by a taxpayer other than a corporation, or (2) the taxpayer is a corporation and dealer in securities and made the sale in the ordinary course of its business as such dealer.

Compare Revenue Ruling 58–210, page 523, wherein, based on certain differences in several of their material features, two other respective series of United States Treasury bonds are held to be not "substantially identical," within the meaning of section 118(a) of the Code.

Although that ruling and the instant ruling are made under the 1939 Code, the principles thereof are equally applicable under the 1954 Code.

475254°—58——35

SUPPLEMENT C.—CREDITS AGAINST TAX

SECTION 131(c).—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES: ADJUSTMENTS ON PAYMENT OF ACCRUED TAXES

REGULATIONS 118, SECTION 39.131(c)-1: Redetermination of tax when credit proves incorrect. Rev. Rul. 58-237
(Also Part I, Section 905(c); 26 CFR 1.905-3.)

A taxpayer paid an income tax in British pounds to the United Kingdom in 1944 and on his Federal income tax return claimed the dollar amount of such tax as a credit against his United States income tax for that year, to the extent allowable by section 131(b) of the Internal Revenue Code of 1939. In 1954, he received a refund in British pounds of part of such income tax, at which time the rate of exchange for the British pound was less than it had been in 1944. He was required, by section 131(c) of the 1939 Code, to report the amount of such refund in order that a redetermination might be made of the amount of credit allowable for 1944. *Held*, in computing the dollar value of a refund of foreign income taxes for which a foreign tax credit had been allowed, the rate of exchange in effect at the date of such refund should be used in converting the foreign currency in which the refund is paid into United States currency. The amount of tax paid for 1944 as redetermined will be the dollar amount of tax previously paid at the exchange rate then in effect, less the amount refunded converted into dollars at the exchange rate prevailing at the date of such refund.

SECTION 131(d).—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES: YEAR IN WHICH CREDIT TAKEN

REGULATIONS 118, SECTION 39.131(d)-1: When credit for taxes may be taken.

Accrual of foreign tax for the purpose of the foreign tax credit in cases where the liability for the foreign tax is contested. See Rev. Rul. 58-55, page 266.

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX

SECTION 141(b).—CONSOLIDATED RETURNS: REGULATIONS

REGULATIONS 89, ARTICLE 38: Basis of property.

Adjustment to basis of decreciable property where an affiliated railroad corporation erroneously deducted excessive depreciation in a consolidated income tax return showing a net operating loss. See Rev. Rul. 58-62, page 513.

SECTION 145.—PENALTIES

REGULATIONS 118, SECTION 39.145–1: Penalties. Ct. D. 1814

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. CRIMINAL PROSECUTION FOR TAX EVASION—PROCEDURE—EVIDENCE

After denial of a motion to suppress evidence on the basis of an alleged voluntary disclosure, the principal officers of the corporation were convicted of willfully attempting to evade income taxes. The Court of Appeals found that taxpayers had made timely and bona fide voluntary disclosure of delinquency and held that under the Treasury Department's policy at that time of granting immunity from criminal prosecution in such cases the disclosed evidence should be suppressed. Upon the basis of newly discovered evidence which cast the "darkest shadow" over the truthfulness of testimony as to the alleged voluntary disclosure and which, if true, indicated that there was in fact no voluntary disclosure but a conspiracy to "fix" the tax case, possibly involving corruption of government officials, and entailing an attempt to perpetrate a fraud on the courts, the Supreme Court granted the government's motion to remand the case to the trial court for further proceedings before the Trial Judge on the suppression issue. The court granted the motion as necessary to "the integrity of the judicial process" holding that it will not pass on lower court decisions where there is a convincing showing that a tainted or polluted record exists.

2. Judgment of United States Court of Appeals for the Seventh Circuit (225 F. 2d 394) vacated and case remanded to District Court for further proceedings on the suppression issue.

SUPREME COURT OF THE UNITED STATES

United States of America, Petitioner, v. *The Shotwell Manufacturing Company, Byron A. Cain, and Harold E. Sullivan*

On writ of certiorari to the United States Court of Appeals for the Seventh Circuit

[December 16, 1957]

OPINION

MR. JUSTICE HARLAN delivered the opinion of the Court.

This case presents an unusual question involving the integrity of a criminal trial in the federal courts.

The Solicitor General has filed a motion in this Court to remand the case to the District Court for further proceedings. This motion is based on a proffer of evidence alleged to have come into the possession of the Government after the United States had petitioned for certiorari to review a decision of the Court of Appeals setting aside the conviction of the respondents. It is claimed that such evidence shows that the decision of the Court of Appeals was based upon a perjurious record attributable to the fraud of the respondents.

A clear appreciation of both the proceedings in the lower courts and the peculiar circumstances in which the Government's motion arises is essential to an understanding of why we believe the motion to remand must be granted.

In 1953 the respondents and Frank J. Huebner, after a jury trial in the United States District Court for the Northern District of Illinois, were convicted of willfully attempting to evade the 1945 and 1946 federal corporate income taxes of the Shotwell Manufacturing Company.[1] Prior to trial they moved for dismissal of the indictment on the ground that their voluntary and timely disclosure of these tax derelictions to the taxing authorities entitled them to immunity from prosecution under the Treasury's former "voluntary disclosure

[1] Internal Revenue Code of 1939, section 145(b), 53 Stat. 63. The Shotwell Company manufactured candy and marshmallows. Cain was President, Sullivan, Executive Vice President and General Counsel, and Huebner, Vice President. Huebner is no longer a respondent here. See notes 6 and 7, *infra*.

policy."[2] This motion was denied by the District Court after a pretrial hearing. Respondents and Huebner then moved, on the same ground, for suppression of the evidence obtained from them by the taxing authorities as a result of their alleged disclosure. After a further pretrial hearing, the District Court also denied this motion, later filing an opinion in which it found that the disclosure was not made in good faith.[3]

On appeal, the Court of Appeals affirmed as to the dismissal motion but reversed as to the suppression motion, set aside the convictions, and remanded the case for a new trial. 225 F. 2d 394.[4] The Court of Appeals found that the respondents' disclosure was bona fide, and also ruled that the disclosure was timely, an issue which the District Court had not reached.[5] The Government petitioned us for certiorari on the suppression issue and the respondents and Huebner cross-petitioned on the dismissal issue.[6] Thereafter, the Government filed its motion to remand, on which, as later amended and supplemented, respondents and Huebner joined issue by the filing of answers.[7] Considering that the matters presented by the motion to remand raised an important issue affecting the proper administration of justice in the federal courts, we granted the Government's petition for certiorari, "limited to the issues raised in the amended motion to remand and supplement thereto and the respondents' answer to the amended motion to remand."[8] 352 U. S. 997. We denied the cross-petition for certiorari. 352 U. S. 998.

For an understanding of the significance of the newly discovered evidence[9] proffered by the Government some knowledge is required of the position taken by the defendants in the District Court on the suppression issue. The substance of that position was presented by Leon J. Busby, Shotwell's accountant, who testified at both the hearing on the motion to suppress and at the trial. He stated that the Shotwell Company in each of the years 1945 and 1946 had received substantial cash payments for black-market candy sales above O. P. A. ceiling prices;[10] that these receipts were not recorded on Shotwell's books and were not reported in its income tax returns; that he first learned of these facts in the course of conversations with H. Stanley Graflund, Shotwell's comptroller, during a trip they took to New York early in January 1948; that immediately upon his return to Chicago he discussed the matter with respondents Cain and Sullivan; that he recommended disclosing the omissions to the taxing authorities; and that, at the direction of respondents, he revealed the entire affair to Ernest J. Sauber, Deputy Collector in Chicago, in a series of conferences beginning in the latter part of January 1948, at one or more of which conferences he was accompanied by Cain. He also testified that thereafter, acting

[2] Under that policy, first announced by the Treasury Department in 1945, the Department did not refer to the Department of Justice for prosecution cases of intentional income tax evasion where they taxpayers had made a clean breast of things to the Treasury before any investigation had been initiated by the Revenue Service. This policy was set forth in various informal announcements by Treasury officials, but was never formalized by statute or regulation. The policy was abandoned in January 1952.

[3] The propriety of this pretrial procedure is not before us.

[4] The Court of Appeals did not poss on other contentions made by the respondents in support of a reversal of their conviction.

[5] More specifically, the Court of Appeals held that there was an effective voluntary disclosure and that the Government's use of the evidence thereby obtained from the respondents violated their rights under the Self-Incrimination Clause of the Fifth Amendment. The District Court simply held that the alleged voluntary disclosure was defective, and did not discuss the Fifth Amendment. In the present posture of this case we do not reach the correctness of these rulings of the two lower courts, or any other question going to the merits of the respondents' conviction.

[6] We deferred consideration of the petition and cross-petitions for certiorari for some months on the basis of representations made by the Solicitor General in his letters of December 6, 1955 and June 1, 1956, which culminated in the filing of the Government's motion to remand. See 351 U. S. 980. As originally filed, the cross-petition was conditional on the Government's petition being granted. After the Government moved to remand, respondents withdrew the conditional limitation, and Huebner withdrew his cross-petition in its entirety.

[7] Huebner later withdrew his answer and consented to the Government's motion.

[8] Respondents point out that this limitation of our writ in effect amounted to a denial of the Government's petition for certiorari, and therefore that the motion to remand, which was not before the Court of Appeals, must be regarded as an attempt to invoke an original jurisdiction which we do not possess. We shall dispose of respondents' point by vacating our limited writ and granting, *nunc pro tunc*, the Government's petition for certiorari, without restriction. This removes all question as to our jurisdiction, 28 U. S. C. section 2106; *Mesarosh* v. *United States*, 352 U. S. 1, and prejudices neither party because we shall decide only the issues raised by the motion to remand.

[9] Respondents have made no such showing in opposition to the Government's motion as would justify our questioning the accuracy of the Solicitor General's representation that the Government's proffered evidence is "newly discovered."

[10] The Government puts the figure at some $380,000; the respondents' figure is about $160,000.

under Sauber's instructions and assurances that only a civil liability was involved, he and his staff, with the assistance of Cain, Huebner and Graflund, conducted an exhaustive investigation over a period of several months to reconstruct the Shotwell figures on the black-market transactions. He said that these figures were furnished in August 1948 to a revenue agent for scrutiny.

Sauber and Cain gave similar testimony, except that Sauber fixed Busby's first visit to him at about the middle of March 1948. Cain's explanation of Shotwell's failure to report the black-market receipts in its income tax returns was that he believed such receipts were not taxable since they were used by Shotwell to purchase black-market supplies [11] and therefore gave rise to no profit.[12]

In support of its motion the Government has filed with the Court the affidavits of Huebner and Graflund, which they executed after the Government filed its petition for certiorari. These affidavits paint a sharply different picture of the entire affair; indeed, they flatly contradict the tale unfolded on behalf of the respondents in the District Court. More specifically: (1) Graflund swears that the first time he discussed the black-market transactions with Busby was at Busby's home in late June 1948, at which time Busby gave no indication that he had previously known of these transactions; [13] (2) Graflund and Huebner swear that at no time prior to a meeting held in July 1948 were they ever advised or led to believe by respondents that Shotwell's black-market receipts had been disclosed to the Treasury; (3) Huebner swears that it was at this July 1948 meeting that Cain first told him that a voluntary disclosure would be made, and that Cain also gave him to understand that it had been "agreed" that the date of the disclosure "would be set at June 15, 1948"; [14] (4) Graflund and Huebner swear that prior to the middle of July 1948 no work was done by anyone to assemble records or data for the purpose of making a disclosure to the tax authorities, and that the alleged offsetting payments for black-market supplies were in fact concocted "out of thin air" at the July meeting; and (5) Huebner swears that in July and August 1948 he gave Cain $10,000 which Cain said he needed "to fix the tax difficulty we were in." [15] Huebner says in his affidavit that he was not asked to testify in the District Court "because I had stated I would not lie on the stand."

It is obvious that the Government's new evidence casts the darkest shadow upon the truthfulness of the disclosure testimony given by or on behalf of the respondents in the District Court. If true, it indicates that what the respondents have sought to represent in the District Court, the Court of Appeals, and in this Court as a voluntary disclosure, made in a timely manner and in good faith, was instead but a further step in a conspiracy to "fix" Shotwell's tax difficulties, possibly involving the corruption of government officials,[16] and certainly entailing an attempt to perpetrate a fraud upon the courts. Were

[11] Except for the amount of $6,000 which was reported in the Shotwell returns.

[12] Although the Treasury policy at the time denied deductibility to such black-market expenditures, the courts later held that this kind of expenditure was deductible. See *Sullenger* v. *Commissioner*, 11 T. C. 1076.

[13] According to Graflund's affidavit, it would appear that the respondents were spurred into action after Sam Krane, a Special Agent of the Internal Revenue Service, visited the Shotwell office on June 21, 1948. The affidavit states that Krane requested records and information relating to Shotwell's transactions with one David G. Lubben, from whom Shotwell had been receiving large sums of money which were not recorded in its regular books; that Graflund made certain records available to Krane and was "criticized" by the respondents for having done so; and that Graflund conferred with Busby within a few days after Krane's visit.

[14] In his affidavit Huebner states: "On November 13, 1952, Sauber testified at the hearing on the defendant's motion to suppress evidence that Busby and Cain had contacted him in March 1948. After hearing Sauber testify, I told Cain I thought the voluntary disclosure date was supposed to be June 15, 1948. Cain said to me, 'Ssshhh There is nobody that knows anything about this. Keep quiet.' "

[15] The Solicitor General represents that if the motion to remand is granted Revenue Agent Joseph M. Lima will testify that on July 30, 1948 he was instructed by his Group Supervisor, Ralph Johnson, to make an immediate audit of Shotwell's 1946 return; that thereafter he was instructed by Johnson to allow (as offsets) over-ceiling purchases totaling more than $300,000, which were wholly unsubstantiated and whose allowance was contrary to the existing Revenue Service policy; and that he then prepared a report showing a tax deficiency for 1945 and 1946 of about $20,000, which report he destroyed at Johnson's direction in September 1948, after the Intelligence Unit of the Service had made inquiries about the case. In this connection Huebner states in his affidavit:

"Cain also told me, sometime in about late July, 1948, that he was about to settle the tax case. Shortly thereafter, Cain told me he had settled the tax case for a tax deficiency of $20,000.00.

"In October, 1948, Busby told me that there had been a meeting in the fraud division at the Internal Revenue office and that hell had broken loose; that some Internal Revenue people had a heck of a time destroying papers that had been made up for the purpose of billing Shotwell for taxes."

[16] See note 15, *supra*.

we to undertake to review the Court of Appeals upon a record as suspect as this, we might very well be lending ourselves to the consummation of a fraud which may already have made the Court of Appeals its unwitting victim. In these circumstances it is imperative that the case be remanded to the District Court for a full exploration of where the truth lies before the case is allowed to proceed further. The integrity of the judicial process demands no less.

The path to our decision is clearly marked by this Court's actions and pronouncements in two recent cases, *Communist Party* v. *Subversive Activities Control Board*, 351 U. S. 115, and *Mesarosh* v. *United States*, 352 U. S. 1. In each case the Court refused to consider the questions presented for review in the face of a challenge to the integrity of the record based on newly discovered evidence. In *Communist Party* the Court remanded the case to the Board with directions to resolve the charges of taint, and to make a fresh determination on the merits, if taint were found.[17] In *Mesarosh* the Court, believing that the record clearly demonstrated that a key government witness had been wholly discredited, took more drastic action by reversing the convictions of the petitioners and remanding the case to the District Court for a new trial. The basic reason for the Court's action in both cases was made manifest in its opinions. In *Communist Party*, *supra*, at pp. 124–125, the Court said:

> "The untainted administration of justice is certainly one of the most cherished aspects of our institutions. Its observance is one of our proudest boasts. This Court is charged with supervisory functions in relation to proceedings in the federal courts. See *McNabb* v. *United States*, 318 U. S. 332. Therefore, fastidious regard for the honor of the administration of justice requires the Court to make certain that the doing of justice be made so manifest that only irrational or perverse claims of its disregard can be asserted. . . . We cannot pass upon a record containing such challenged testimony. We find it necessary to dispose of the case on the grounds we do, not in order to avoid a constitutional adjudication but because the fair administration of justice requires it."

In *Mesarosh*, *supra*, at p. 14, the Court said:

> "This is a federal criminal case, and this Court has supervisory jurisdiction over the proceedings of the federal courts. [Citing McNabb, *supra*, in a footnote.] If it has any duty to perform in this regard, it is to see that the waters of justice are not polluted. Pollution having taken place here, the condition should be remedied at the earliest opportunity."

A convincing showing is of course necessary to bring these principles into play. We think that such a showing has been made here. The newly discovered evidence contained in the affidavits from the prospective witnesses Graflund and Huebner cuts to the very heart of the testimony adduced by respondents to show that they made a timely and bona fide disclosure to the Treasury, the sole issue involved in the suppression hearings and the issue on which the outcome of the case in the Court of Appeals turned. It is plain that either the testimony in the District Court was untrue or these affidavits themselves are the product of fraud. This is a matter for the District Court to determine. One thing is clear. This Court cannot be asked to review the decision of the Court of Appeals until these charges have been resolved.

In both the *Communist Party* and *Mesarosh* cases, *supra*, the action of the Court enured to the benefit of the defendants. In this instance the further proceedings below may work to the advantage of the Government.[18] In the circumstances of this case we think that the distinction makes no difference. Because they were found guilty by the jury, respondents concede, as they must, that the motion to remand involves no question of double jeopardy. See *United States* v. *Ball*, 163 U. S. 662, 672. Their objection that it is "unfair" to allow the Government at this stage of the proceedings to "bolster" the record relating to the suppression issue is likewise unacceptable. It is undeniable, of course, that upon appellate reversal of a conviction the Government is not

[17] Section 14(a) of the Subsersive Activities Control Act expressly authorizes courts of appeals to remand cases to the Board for the taking of further evidence. 64 Stat. 987, at 1001–1002. Our authority to act in similar fashion is found in the broad provisions of 28 U. S. C. section 2106, which grants us power, incident to our appellate jurisdiction, to "vacate . . . any judgment" brought before [us] for review" and to "require such further proceedings to be had as may be just under the circumstances."

[18] The Government does not concede the correctness of the Court of Appeals' decision upon the existing record. Cf. *United States* v. *Johnson*, 327 U. S. 106, 111, 112.

limited at a new trial to the evidence presented at the first trial, but is free to strengthen its case in any way it can by the introduction of new evidence. We think that in the peculiar circumstances of this case the fair administration of justice requires that the Government should have a similar opportunity here. For if the Government's evidence is found to be true, it would then appear that the Court of Appeals' decision setting aside the verdict was obtained by the respondents on a corrupt record attributable to their own fraud. In the further proceedings in the District Court the respondents will of course have a reciprocal opportunity to sustain the validity of their asserted voluntary disclosures.

We should not lose sight of the fact that the Government's new showing does not relate to an issue submitted to the jury in the proceedings below, but rather to a preliminary question as to the admissibility of evidence.[19] Hence, to grant the Government's motion is not to permit it to "bolster" the evidence upon which the verdict of guilty was returned by the jury in this case. That verdict clearly must stand or fall on the sufficiency of the evidence already introduced at the trial.

In these circumstances, acceptance of the respondents' position on this motion would be tantamount to sanctioning a rule which would prohibit appellate review upon a record suspect of taint, if the taint might operate to the disadvantage of the defendants, but which would nevertheless require review if the taint might operate to their advantage. We cannot subscribe to that quixotic result. The fair administration of justice is not such a one-way street.

The respondents contend that the motion to remand should originally have been addressed to the Court of Appeals, and that we should now send the Government back to that court.[20] This contention is essentially one addressed to our discretion, and in the circumstances of this case we find it unavailing. The Government was not in a position to make the motion until after its petition for certiorari had been filed in this Court. The course of this litigation has already been protracted. We are abundantly satisfied that the charges as to the integrity of the record must be fully aired, and that the proper forum for this is the District Court because of its intimate familiarity with the record and its facilities for sifting controverted facts. In this state of affairs we think that it would be both unnecessary and wasteful to remit the Government to the Court of Appeals. Cf. *Mesarosh, supra*, at p. 13.

We conclude with a word about the nature of the further proceedings in the District Court. The additional evidence to be presented by both sides will be confined to the suppression issue. The District Court will make such new findings of fact on this issue as may be appropriate in light of the further evidence and the entire existing record (see *Carroll* v. *United States*, 267 U. S. 132, 162), including findings on the question of the timeliness of respondents' alleged disclosures.[21] If the District Court decides, on the basis of its new findings, to adhere to its original decision on the motion to suppress, it will then enter new final judgments based upon the record as supplemented by its new findings, thereby preserving to all parties the right to seek further appellate review, including respondents' right to have reviewed by the Court of Appeals alleged errors in the original trial which that court did not reach in the previous appeal. If, on the other hand, the District Court concludes after the further proceedings that the motion to suppress should have been granted, it would then become its duty to accord the respondents a new trial.

---

[19] Respondents did not urge below, nor do they suggest here, that the question of admissibility of the disputed evidence was properly an issue for the jury. Rather their contention has been that the *judge* should have sustained the motion to suppress.

[20] It has also been suggested that these charges of fraud could be dealt with at the new trial which the Court of Appeals has ordered. But as the Court of Appeals has directed suppression of the evidence obtained by the Government as a result of the alleged voluntary disclosure, it seems clear that at the new trial the Government could not use that evidence, or the fruits thereof, unless the "suppression" aspect of the judgment of the Court of Appeals is vacated. We think that the sound administration of justice precludes that course because, if the Government's evidence is true, the net effect would be to grant the respondents a new trial, not otherwise justified, procured by their own fraud.

[21] Respondents have contended that the Government's new evidence is irrelevant to the issue of timeliness because, even assuming its truth, the disclosure was timely since no formal investigation was initiated by the Revenue Service until after July 1948, the time that the Government's new evidence indicates that the respondents first communicated with the Treasury. We find it unnecessary to deal with this contention because the new evidence is in any event clearly relevant to the question whether a bona fide disclosure was in fact ever made. Moreover, in the present state of the record this Court should not pass on respondents' argument as to timeliness because (a) the District Court has not yet made a finding on this issue, and (b) the Treasury "voluntary disclosure policy" was never formulated with sufficient precision to enable us to apply it mechanically.

In accordance with the views set forth in this opinion, we make the following disposition of this case: (1) this Court's order of February 25, 1957, which granted with limitations the Government's petition for certiorari, is vacated and such petition is granted without restriction; (2) the judgment of the Court of Appeals is vacated; and (3) the case is remanded to the District Court for further proceedings consistent with this opinion.

It is so ordered.

MR. JUSTICE BLACK, with whom THE CHIEF JUSTICE and MR. JUSTICE DOUGLAS concur, dissents by separate opinion.

(Also Section 3793.) Ct. D. 1817

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. CRIMINAL PROSECUTION FOR TAX EVASION AND CONSPIRACY TO EVADE TAXES—LEGALITY OF EVIDENCE PRODUCED BEFORE GRAND JURY—WAIVER OF OBJECTIONS TO RECEIPT IN EVIDENCE OF DOCUMENTS TAINTED WITH ILLEGALITY—SUFFICIENCY OF EVIDENCE TO SUSTAIN CONVICTIONS.

Indictments returned by a grand jury in 1952 against defendants charging income tax evasion and conspiracy to evade taxes were dismissed on the ground that evidence produced by the defendants before the grand jury had been obtained in violation of their constitutional rights. In 1953 a second grand jury returned an indictment against the defendants charging substantially similar offenses. Defendants moved for a preliminary hearing to determine whether the Government had made direct or derivative use of materials produced before the 1952 grand jury in procuring the later indictment. The motion was submitted on affidavits which included an affidavit of the Government's attorney that no such use of the materials had been made, nor would such materials be used at the trial. Defendants' motion was denied. Upon trial the defendants were convicted. During the trial certain documents which had been produced before the 1952 grand jury were received in evidence against one of the defendants after his counsel stated there was no objection to their receipt. Defendants were permitted to examine and cross examine witnesses in attempting to show derivative use at the trial of evidence produced by the defendants before the 1952 grand jury, but were not permitted to examine witnesses in attempting to show direct or derivative use of such evidence before the 1953 grand jury. In sustaining the convictions the Supreme Court held (1) that the defendants were not entitled to a preliminary hearing to satisfy their unsupported suspicions that the 1953 grand jury may have made direct or derivative use of materials produced by them before the 1952 grand jury; (2) that the defendant against whom the evidence was offered was not denied due process by the receipt in evidence of documents tainted with illegality by reason of their production before the 1952 grand jury when the record showed that his counsel consciously and intentionally waived objection to their receipt; (3) that the defendants were not denied due process by the trial court's refusal to permit examination of witnesses for the purpose of showing direct or derivative use before the 1953 grand jury of documents tainted by their production before the 1952 grand jury thus attacking only the procedural validity of the indictment when the record showed that defense counsel were permitted to examine witnesses for the purpose of showing illegal source of evidence produced at the trial; and (4) the evidence was sufficient to support the convictions.

2. JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT, 234 F. 2d 589, AFFIRMED.

SUPREME COURT OF THE UNITED STATES

Howard Lawn, Petitioner, v. *United States of America; William Giglio and Frank Livorsi, Petitioners*, v. *United States of America*

On writ of certiorari to the United States Court of Appeals for the Second Circuit

[January 13, 1958]

OPINION

MR. JUSTICE WHITTAKER delivered the opinion of the Court.

On July 23, 1953, a 10-count indictment was returned in the United States District Court for the Southern District of New York charging petitioners and others with evading, and conspiring to evade, assessment and payment of a large amount of federal income taxes for the year 1946 in violation of the internal revenue laws (sections 145(b) and 3793(b) of the Internal Revenue Code of 1939)[1] and of the general conspiracy statute (18 U. S. C. section 371). After a protracted trial before a jury petitioners were found guilty as charged.[2] On appeal the Court of Appeals found that there was substantial evidence that petitioners, operating through the media of several partnerships and corporations[3] conspired to evade, and by a variety of means did evade, both the assessment[4] and the payment[5] of more than $800,000 of individual and corporate federal income taxes for the year 1946[6] upon income derived from the World War II black market in sugar and that petitioners Giglio and Livorsi, who owned equal interests in the several enterprises of which Giglio was the chief executive, were the principals in the conspiracy, but Roth, an accountant, and Lawn, a lawyer,[7] provided the accounting and legal services required to carry out the conspiracy. It found that the evidence amply sustained the verdicts and that no prejudicial error was committed at the trial, and it affirmed the judgments of conviction. 234 F. 2d 589. Upon petition by Lawn in No. 9, and by Giglio and Livorsi in No. 10, we granted certiorari. 352 U. S. 865. Because the challenged convictions resulted from a common trial at which petitioners were represented by the same

---

[1] 26 U. S. C. (1952 ed.) secs 145(b) and 3793(b).

The first five counts named only petitioner Giglio and Louis J. Roth as defendants. Since Giglio does not here contest the adequacy of the evidence to sustain those or any of the other counts against him, and since Roth pleaded guilty to all counts of the indictment and was a principal witness for the prosecution at the trial, those counts are not here summarized.

The remaining counts in essence charged as follows:

Count 6 charged that Livorsi and Roth, on or about September 15, 1947, willfully attempted to evade assessment of income taxes of Livorsi for the calendar year 1946 by filing a fraudulent return.

Count 7 charged that Giglio, Lawn and Roth, from about September 1, 1947, to the date of filing of the indictment, willfully attempted to evade payment of Giglio's income taxes for the calendar year 1946 by concealing his assets.

Count 8 charged that Livorsi, from about September 1, 1947, to the date of filing of the indictment, willfully attempted to evade payment of his income taxes for the calendar year 1946 by concealing his assets.

Count 9 charged that Giglio, Livorsi, Lawn and Roth, from about January 1, 1946, to the date of filing of the indictment, willfully attempted to evade payment of income taxes of American Brands Corporation for the calendar year 1946 by converting and diverting its assets.

Count 10 charged that Giglio, Livorsi, Lawn, Roth and American Brands Corporation, from about July 1, 1945, to the date of filing of the indictment, willfully conspired to commit the substantive offenses charged in Counts 1 through 9 of the indictment.

Count 10 of the indictment was dismissed by the court as to American Brands Corporation after the jury failed to report as to it.

[2] Lawn was sentenced to a year and a day on each of Counts 7, 9 and 10, the sentences to run concurrently. Giglio was sentenced to a total of 15 years. Livorsi was sentenced to 5 years on each of Counts 6, 9 and 10 to run consecutively, and was sentenced to 5 years on Count 8 to run concurrently with the sentence on Count 6.

[3] The principal organizations were: Tavern Fruit Juice Company, a partnership owned by Giglio and Livorsi; Eatsum Food Products Co., Ltd., a partnership owned 25% by Giglio, 25% by Livorsa, and 50% by one Lubben until March 8, 1946, when he left the enterprise and sold his "distributive share" in the profits thereof to Giglio and Livorsi; and a series of corporations bearing in some combination the word "American" which were created in early 1946 to drain off the profits of Eatsum through the use of fraudulent invoices and were to be dissolved before their income taxes became due.

[4] The Court of Appeals found that generally three means of evasion of tax assessment were used: (1) the fraudulent allocation of income among the various companies and individuals in the conspiracy; (2) the fraudulent overstatement of expenses; and (3) the failure to disclose income.

[5] The evasion of payment was in general accomplished by delaying disclosure of income tax liabilities through the filing of returns from 5 to 15 months late; by failing to withhold income taxes on salaries; by concealment of the individual assets of Giglio and Livorsi; and by the misappropriation, conversion and diversion of corporate assets.

[6] Of the total, $573,683.73 was admitted to be owing to Giglio, Livorsi and American Brands Corporation in the long-overdue returns they filed, and only $16,735.95 was paid.

[7] They were full-time employees of the several Giglio and Livorsi enterprises.

counsel, and because several of the questions presented in each case are similar, the two cases will be decided in one opinion.

Petitioners ask this Court to reverse their convictions upon four main grounds. First, they contend, Lawn only tangentially, that they were deprived of due process in violation of the Fifth Amendment by the refusal of the District Court to conduct a full-dress hearing to determine whether testimony or documents obtained from them in a prior grand jury investigation, or evidence derived from leads and clues furnished thereby, was considered by the grand jury that returned the present indictment. Second, petitioner Lawn contends that receipt in evidence at the trial of a photostatic copy of a canceled check and its corresponding check-stub, obtained from him in a prior grand jury investigation, deprived him of due process in violation of the Fifth Amendment. Third, petitioners contend they were denied an opportunity to examine and cross-examine witnesses at the trial to determine whether evidence derived from leads and clues furnished by testimony and documents obtained from petitioners in a prior grand jury investigation was used by the prosecution at the trial, and that this deprived them of due process in violation of the Fifth Amendment. And fourth, petitioners Lawn and Livorsi contend that the evidence does not support their convictions.

Understanding of petitioners' first and second contentions, and to a lesser extent their third contention, requires a review of the underlying facts upon which they are based. Revenue agents began an investigation in 1948 of petitioners' income tax liabilities, and on September 14, 1950, three criminal informations were filed charging them with violation of the federal income tax laws. Those informations were not brought to trial because the Government had not completed its investigation and later concluded that "much more serious crimes [were] involved." In early July 1952, petitioners and Roth were served with subpoenas *duces tecum* commanding them to appear and testify before a grand jury on July 14, 1952, and to produce certain partnership and corporate records of the Giglio and Livorsi enterprises. They appeared and testified, but were not warned of their constitutional privilege against self-incrimination. Lawn produced three canceled checks made by Tavern Fruit Juice Co. payable to his order and the checkbook stub corresponding to the second check. Those instruments were there marked "G. J. Ex. [1, 2, 3 and 4, respectively] 7/15/52 L. F. G." and were photostated by the United States Attorney and returned to Lawn. Giglio produced a quantity of records, including some partnership records, but stated that "practically all of these companies and corporations turned over their books and records to the Internal Revenue Department on some date in 1949." On October 20, 1952, the grand jury returned six indictments against petitioners charging them with offenses similar to those charged in the present indictment. Petitioners moved to dismiss those indictments upon the ground that they had been procured, in part at least, upon evidence obtained from petitioners in violation of their Fifth Amendment rights. The District Court held that to require petitioners to testify and produce partnership and personal records before the grand jury, while criminal informations charging tax evasions were pending against them, without warning them of their constitutional privilege against self-incrimination, violated their Fifth Amendment rights. It therefore dismissed the indictments and directed the Government "to return, to the respective defendants, the partnership and personal records produced by them in response to the subpoenas." *United States* v. *Lawn*, 115 F. Supp. 674. The Government appealed from that order but the appeal was dismissed as untimely on October 19, 1953. *United States* v. *Roth*, 208 F. 2d 467.[8] While that appeal was pending the Government caused a new investigation to be made of petitioners' federal income tax liabilities by another grand jury, before whom petitioners did not appear, and on July 23, 1953, that grand jury returned the present indictment which was sealed. After the Government's appeal from the order dismissing the 1952 indictment had been dismissed (*United States* v. *Roth, supra*) the new sealed indictment was opened, and soon afterward petitioners moved (1) to dismiss the indictment, and in that connection (2) to have a hearing to determine whether the Government had used testimony given and documents produced by petitioners before the 1952 grand jury, or evidence obtained through leads and clues furnished thereby, in procuring the indictment, and (3) to inspect the minutes of the grand jury and, if the motion to dismiss

[8] In their brief on that appeal petitioners had argued that the Government's notice of appeal was not timely filed, but they did not move to dismiss the appeal until after the period of limitations had run in late September 1953.

the indictment be denied, (4) to suppress the use at the trial of all testimony and documents procured from petitioners in the 1952 grand jury proceeding and all evidence derived therefrom. These motions were submitted to the court upon affidavits.[9] After considering them and hearing extensive arguments of counsel, the court found that the affidavits left no room for an inference that the Government had used illegally obtained materials in securing the present indictment, that petitioners' claim did not have the "solidity" required to justify the holding of such a hearing, and that to do so "on the basis of the showing made by the defendants and the government would indeed be subordinating 'the need for rigorous administration of justice to undue solicitude for potential . . . disobedience of the law by the law's officers.' [*Nardone* v. *United States*, 308 U. S. 338, 342.]" *United States* v. *Giglio*, 16 F. R. D. 268, 270. The court declined to hold the requested hearing and denied the motion to inspect the grand jury minutes and the motion to dismiss the indictment. The court also denied the motion to suppress.[10] but in that connection said: "Of course, if during the course of the trial defendants have reason to believe that illegally obtained material is being or may be used against them, they can object at that time and it will be incumbent upon the trial judge to rule on their objections." *United States* v. *Giglio*, *supra*, at 271.

Pursuant to order of the court the Government produced for inspection by petitioners, before the trial, the corporate records delivered by Giglio to the 1952 grand jury in compliance with its subpoena, the documents which had been abandoned by petitioners and examined by the Government, and the documents relating to petitioners' businesses obtained from the New Jersey receiver. At the beginning of the trial petitioners renewed the above-mentioned motions which were again denied. In the course of the trial the Government furnished petitioners a transcript of their testimony before the 1952 grand jury.

I.

As stated, petitioners first contend that they were deprived of due process by the refusal of the court to conduct the requested full-dress hearing to enable them to attempt to determine whether materials obtained from them in the 1952 grand jury proceeding, or evidence derived therefrom, was considered by the 1953 grand jury. We believe there is no merit in this contention. The District Court's order dismissing the 1952 indictment because of the use of such evidence before that grand jury, though final, could not in any way determine that any direct or derivative use of such evidence was made by the 1953 grand jury that returned the present indictment. The affidavits submitted in support of and in opposition to the motion for the requested hearing disclosed, as found by the trial court and the Court of Appeals, with which findings we agree, that petitioners had no reason, beyond suspicion, to believe that the 1953 grand jury

[9] In support of their motions petitioners filed a number of affidavits reciting in essence that the 1952 indictment was returned after the Government had secured testimony and documents from the petitioners in violation of their constitutional rights; that the present indictment is "very similar" to the prior one, and that a revenue agent had implied that some of his computations were based on documents stored in a room in which the documents obtained from petitioners were also kept.

In opposition to the motions the Government filed affidavits made by all of the revenue agents who had conducted investigations leading to the indictment and by all the United States Attorneys who had been responsible for the prosecution of the case. In essence they recited that after the District Court dismissed the 1952 indictment a conference was called, by an assistant United States Attorney, of all revenue agents who had conducted the investigations; that they were there told that it would be necessary to obtain a new indictment which was not to be based in any way, however remote, upon testimony or personal or partnership documents obtained from petitioners in the 1952 grand jury proceedings, and any doubts about the use of any evidence were to be resolved in favor of exclusion; that none of the testimony or personal or partnership records, produced by petitioners before the 1952 grand jury, was in any way used in obtaining the present indictment; and that long before 1952 the Government had in its possession copies and microfilm enlargements of bank checks, bank statements and books and records pertaining to petitioners' transactions, which had been secured from banks, third persons, a New Jersey receiver, government agencies, and abandoned books and records relating to petitioners' businesses. The affidavit of the Assistant United States Attorney in charge of the case unequivocally recited that none of the materials obtained from petitioners in the 1952 grand jury proceeding would be used in the future course of the case.

[10] The court stated as its reasons: "The United States Attorney has sworn that this material will not be used in the future course of this case, and at this stage of the proceedings that oath is sufficient. The granting of defendant's motion to suppress at this time would necessitate an investigation of all of the government's evidence. Such an investigation would entail a great deal of useless effort because much of this material which has been collected since 1948, will not be used at the trial." *United States* v. *Giglio*, 16 F. R. D., at 270, 271.

considered any of the materials produced by petitioners before the 1952 grand jury. These facts make clear that petitioners laid no foundation for the holding of a protracted preliminary hearing (at which they would, in effect, take the depositions of the Government's witnesses) to determine whether there was any substance to their suspicion that some direct or derivative use may have been made by the 1953 grand jury of materials produced by petitioners before the 1952 grand jury.

Moreover, this Court has several times ruled that an indictment returned by a legally constituted nonbiased grand jury, like an information drawn by a prosecutor, if valid on its face, is enough to call for a trial of the charge on the merits and satisfies the requirements of the Fifth Amendment. In *Holt* v. *United States*, 218 U. S. 245, this Court was required to decide whether an indictment should be quashed because procured in part by incompetent evidence of an admission by the accused, aside from which "there was very little evidence against the accused." *Id.*, at 247. This Court refused to hold that such an indictment should be quashed, stating: "The abuses of criminal practice would be enhanced if indictments could be upset on such a ground." *Id.*, at 248. In *Costello* v. *United States*, 350 U. S. 359, this Court squarely faced and decided the question, saying:

> "If indictments were to be held open to challenge on the ground that there was inadequate or incompetent evidence before the grand jury, the resulting delay would be great indeed. The result of such a rule would be that before trial on the merits a defendant could always insist on a kind of preliminary trial to determine the competency and adequacy of the evidence before the grand jury. This is not required by the Fifth Amendment. An indictment returned by a legally constituted and unbiased grand jury, like an information drawn by the prosecutor, if valid on its face, is enough to call for trial of the charge on the merits. The Fifth Amendmnt requires nothing more." *Id.*, at 363.

This Court was urged in that case to "establish a rule permitting defendants to challenge indictments on the ground that they are not supported by adequate or competent evidence," *id.*, at 364, but the Court declined to do so, saying:

> "It would run counter to the whole history of the grand jury institution, in which laymen conduct their inquiries unfettered by technical rules. Neither justice nor the concept of a fair trial requires such a change. In a trial on the merits, defendants are entitled to a strict observance of all the rules designed to bring about a fair verdict. Defendants are not entitled, however, to a rule which would result in interminable delays but add nothing to the assurance of a fair trial." *Ibid.*

It should be unnecessary to say that we are not here dealing with the use of incompetent or illegal evidence in a trial on the merits, nor with the right to decline to give incriminating testimony in legal proceedings or to suppress the direct or derivative use at the trial of evidence illegally obtained. We deal here only with the question whether petitioners, in the circumstances of this case, were entitled to a preliminary hearing to enable them to satisfy their unsupported suspicions whether the 1953 grand jury that returned this indictment made any direct or derivative use of the materials which they produced before the 1952 grand jury. We hold that they were not.

II.

We come now to petitioner Lawn's contention that receipt in evidence at the trial of a photostatic copy of a canceled check and its corresponding check-stub, obtained from him in the 1952 grand jury proceeding, deprived him of due process in violation of the Fifth Amendment. As earlier stated, Lawn, pursuant to subpoena, produced before the 1952 grand jury, a canceled check of Tavern Fruit Juice Co. payable to his order in the amount of $15,000, endorsed by him, and the corresponding stub, which were marked on their face "G. J. Ex. 2 7/15/52 L. F. G." and "G. J. Ex. 4 7/15/52 L. F. G.," respectively, and were photostated by the United States Attorney and returned to Lawn. Those photostats were offered in evidence—it appears inadvertently—by the prosecution at the trial, as Exhibits 61–A and 61–B. However, before those exhibits were offered, Exhibit 58–A, being a statement of assets, liabilities, income, profit and loss and supporting schedules of Tavern Fruit Juice Company prepared some time after Tavern's fiscal year had ended on March 31, 1946, and Exhibit 7, being Tavern's information tax return for

1946 which was filed on September 15, 1947, had been received in evidence without objection. The former contained an item of "legal expenses $16,600.00," while the latter recited "legal fees $1,600.00." Roth, in explanation, testified that "sometime during the operation of the partnership a check for $15,000.00 was drawn by Howard Lawn," and that a question had arisen about how to enter it on the books. After discussing the matter with Giglio, Roth charged it to legal expense. Months later Lawn asked Roth how the item was carried on Tavern's books and Roth told him that it was carried as a legal expense. Lawn advised Roth that this handling was incorrect as the item was a loan from Giglio and not a legal expense of Tavern. Thereupon, after consulting Giglio, Roth altered Tavern's books by removing the item from legal expense and charging it to Giglio. Roth did not remember just when the alteration of the books was made, except that it was after the preparation of Exhibit 58–A and prior to the filing of Exhibit 7.

It is important to note that at this stage of the trial there was thus clear evidence before the jury, corroborated by Exhibits 58–A and 7, all admitted without objection, showing that Lawn had received the $15,000 check from Tavern, but an issue existed whether it was an innocent loan from Giglio or an incriminatory payment by Tavern in the guise of a legal fee. The prosecution then offered in evidence Exhibits 61–A and 61–B, being the $15,000 check and corresponding stub. Petitioners' able and experienced counsel (now deceased) then asked, and was granted, permission to examine the witness Roth preparatory to a possible objection to those exhibits. He then questioned the witness at some length about the handwriting on the check and stub,[11] and concluded by asking the witness: "Q. And under that check-stub or in that No. 640 [the number of the check-stub], which corresponds with the check itself, there is a parenthetical statement, 'Bill G'? A. Yes, sir. Q. Indicating it is for Mr. Giglio's account? A. Yes, sir." And petitioners' counsel then stated, "No objection," and the exhibits were received. This examination and use of those exhibits (showing on their face that they had been exhibits before the 1952 grand jury) by petitioners' able counsel to show that the check was an innocent loan by Giglio and not an incriminatory payment by Tavern in the guise of a legal fee—his only opportunity to drive that point home to the jury if petitioners were not to take the stand, as they did not—and his affirmative statement that he had "no objection" to receipt of the exhibits shows, we believe, a conscious and intentional waiver of all objections to receipt of those documents in evidence.

Lawn argues that the denial, before the trial, of petitioners' motion to suppress, and the unequivocal affidavit of the United States Attorney in charge of the case stating that materials obtained from petitioners pursuant to subpoena in the 1952 grand jury proceeding would not be used in the future course of the case, preserved his objections to these exhibits and made it unnecessary again to object to them at the trial. It is quite true generally that the overruling of a pretrial motion to suppress the use at the trial of particular evidence preserves the point and renders it unnecessary again to object when such evidence is offered at the trial. *Cogen* v. *United States*, 278 U. S. 221, 223; *Gouled* v. *United States*, 255 U. S. 298, 312, 313; *Waldron* v. *United States*, 219 F. 2d 37, 41; and compare *Keen* v. *Overseas Tankship Corp.*, 194 F. 2d 515. But the rule is one of practice and is not without exceptions, nor is it to be applied as a hard-and-fast formula to every case regardless of its special circumstances. *Cogen* v. *United States*, *supra*, at 223, 224; *Gouled* v. *United States*, *supra*, at 312, 313. It will be remembered that the court in passing on the motion to suppress said, respecting the affidavit of the United States Attorney, that "at this stage of the proceeding that oath is sufficient" (*United States* v. *Giglio*, 16 F. R. D., at 271), but he expressly left the matter of suppression of evidence to the trial court and admonished petitioners that if during the course of the

[11] "Q. In whose handwriting are the entries on government's exhibit 61–B for identification? I think you said it is the stub book. A. To the best of my recollection are Mr. Cerone's.

"Q. How do you spell Cerone? A. C-E-R-O-N-E.

"Q. He was one of your employees, Mr. Roth? A. No, he was a bookkeeper employed by Tavern Fruit Juice.

"Q. Would the same be true with regard to the check, the face of the check, payee of the check? A. The payee of the check and the amount?

"Q. The handwriting is what I am talking about. A. The handwriting, that looks like William Giglio's handwriting.

"Q. The maker of the check [for] the $15,000? A. Yes, the signature.

"Q. They look like his handwriting, do they? A. Yes, sir.

"Q. And this 61–B for identification, you have told me that that looks like the printing or writing of Mr. Cerone, did you not? A. Yes, sir."

trial they "have reason to believe that illegally obtained material is being or may be used against them, they can object at that time and it will be incumbent upon the trial judge to rule on their objections." *Id.*, at 271. The record shows that petitioners' counsel was fully aware of all this when Exhibits 61–A and 61–B were offered in evidence, and when after using them for his purposes, he affirmatively said he had "no objection" to them.

The Government argues that, had its attention been called to the fact that these particular photostatic copies had been exhibits before the 1952 grand jury by an objection to them, it could and would have produced other copies obtained from other sources before the 1952 grand jury proceeding was commenced. In that connection it has filed here what is said to be a transcript of a hearing accorded to Lawn at his request on May 12, 1952, which it says contains photostatic copies of the check and check-stub in question voluntarily produced by Lawn. Lawn has moved to strike that transcript and the portions of the Government's brief relating thereto. That motion must be sustained as we must look only to the certified record in deciding questions presented. *McClellan* v. *Carland*, 217 U. S. 268.

We believe that the facts from the certified record, above discussed, show that petitioners' counsel, after using the check and check-stub to make his point before the jury that the check was an innocent loan from Giglio and not an incriminatory payment by Tavern in the guise of a legal fee, wisely (as, we believe, every impartial and experienced trial lawyer would agree) said that he had "no objection" to those exhibits, and thus consciously and intentionally waived any objection to their receipt in evidence.

III.

Petitioners argue that they were denied an opportunity to examine and cross-examine witnesses at the trial to determine whether evidence derived from leads and clues furnished by materials obtained from them in the 1952 grand jury proceedings, was used by the prosecution at the trial, and that this deprived them of due process in violation of the Fifth Amendment. It cannot be doubted that petitioners had that right in the circumstances of this case. *Nardone* v. *United States*, 308 U. S. 338, 341, 342, and the Government does not otherwise contend. Moreover, as earlier stated, the District Court, in ruling the pretrial motion to suppress, expressly left this subject open to inquiry at the trial. *United States* v. *Giglio*, 16 F. R. D., at 271. The contention is wholly factual, and a thorough study of the record discloses that petitioners were accorded that right. The court did not sustain objections to petitioners' examination or cross-examination of witnesses attempting to show derivative use at the trial of any evidence produced by petitioners before the 1952 grand jury, but only sustained objections to questions attacking the procedural validity of the indictment.[12] At no time did counsel for petitioners point specifically to any evidence offered at the trial which they claimed was derived from materials furnished by petitioners before the 1952 grand jury. Near the close of the Government's case, the court stated that, so far as he could detect, there had been no direct or derivative use of any tainted evidence by the Government at the trial, and he requested counsel for petitioners, on two occasions, to submit a memorandum of any evidence offered by the Government which he believed was obtained through leads or clues from materials produced by petitioners before the 1952 grand jury. No such memorandum was ever furnished.

Petitioners point to three instances where they say the trial court denied them the right to examine witnesses about the source of evidence offered by the Government at the trial. First, they say that in cross-examining the Government's

[12] Though at times, in colloquies with the court, counsel for petitioners was equivocal, the following is typical of the position taken by him:

"Counsel. I really don't see how I can get adjudicated the question of the illegality of the indictment before you without calling all these people who made affidavits before Judge Palmieri. Now, that obviously would be, well, very disruptive of your trial. I would never think of doing it, if . . . it didn't seem to me that was all I had. . . . [H]ave I made it plain?

The Court. I think you have, but I want to be sure. Now, the whole purpose of this is to go to the procedural validity of the indictment.

"Counsel. That is it, yes, sir. That is it, that is just it exactly.

"The Court. And it is a question, really, of what happened before the grand jury.

"Counsel. That is it, really, just that.

"The Court. Rather than its effect upon what you might call the substantive issues of the case or the guilt or innocence of these defendants, let us say.

"Counsel. My answer is an unequivocal yes, and I don't have to look at a record to answer it."

witness Roth they sought to question him concerning an affidavit he had made in support of the motion to dismiss the 1953 indictment, but the court sustained an objection to the question. It is clear that the ruling was made upon the ground, as petitioners' counsel stated at the time, that the purpose of the interrogation was to "go into the question of what evidence was used to obtain this indictment," rather than to show the use by the Government of tainted evidence at the trial. Second, they point to the fact that during the cross-examination of Treasury Agent Present, their counsel asked him whether, in his audits, he had examined any other books or records about which counsel had failed to ask; and they argue that the purpose of the question was to determine whether tainted evidence had been or was being used by the Government at the trial, and that they were denied an answer to the questions. But examination of the record discloses that counsel's announced purpose in asking the question was not to determine whether tainted evidence had been or was being used at the trial, but was, rather, to determine whether tainted evidence was "used by the grand jury that found this indictment." [13] Third, petitioners argue that in examining their own witness, United States Attorney Leone, they were denied an opportunity to show derivative use of tainted evidence by the Government at the trial. The record shows that there is no basis whatever for this contention.[14]

IV.

Petitioners Lawn and Livorsi argue that the evidence is insufficient to sustain their convictions. In support of Count 10, the conspiracy count, the record contains evidence tending to show that Lawn, formerly Chief of the Criminal Division of the United States Attorney's Office for the District of New Jersey, was employed by Giglio and Livorsi because "he had a terrific entry with some of the highest government offices," "was a part of the organization" and was "there to prevent any trouble." He was frequently in Giglio's private office, which adjoined his own. Lawn was present in Giglio's office when it was decided that Eatsum would purchase corn at blackmarket prices and have it refined into syrup to be sold for over-ceiling prices, and Lubben began the handling of those matters. But Lawn later told him that he "had terrific connections" with a syrup company and with a prominent political figure in the midwest and that he could procure the corn and syrup more advantageously, and Lawn then took over the handling of those matters. Lubben was called into Giglio's office in September 1945, where Giglio, Roth and Lawn were present, and Giglio stated "that the profits from [Tavern's] candy business and primarily [Eatsum's] corn syrup business were becoming terrific, and that he wasn't interested in paying a lot of income taxes and something had to be done, and done quick"; that "it had been decided to form a number of companies" to siphon off the profits of the partnerships through "phony invoices"; and that the companies would "be dissolved . . . before it came time to pay the income tax." Soon afterward Lawn was instrumental in the creation of a number of corporations bearing in some combination the word "American." Lawn was an officer and nominal stockholder in several of these corporations, and owned 25% of the stock of one of them which had been given to him by Giglio and Livorsi, and Lawn received substantial payments from the Giglio and Livorsi enterprises in addition to his salary. In September 1947, near the time the delinquent income tax returns were filed for the year 1946 by

[13] The record shows that, although there was no objection to the question, counsel for the Government stated to the court, out of the hearing of the jury, that prior to the dismissal of the 1952 indictment the witness had examined partnership records produced by petitioners before the 1952 grand jury, and said: "If counsel elicits testimony now about those facts there is going to be before this court evidence which Judge Goddard held improper * * *. If counsel wishes to examine into this field I think he should do it outside the presence of the jury, because it might be prejudicial error even if he voluntarily does it." Counsel for petitioners then made plain that his purpose was to determine whether tainted evidence was "used by the grand jury that found this indictment," and he further said, "I have no other way * * * than to do it here." Counsel for the Government then said to the court: "Now, the question specifically presented to the witness was broad and includes partnership records illegally produced and partnership records legally obtained. There can't be objection to the second part, but the question is too broad." Counsel for petitioners replied: "Well, I am not going into something half-way * * *." The court then said: "All right, I think that is the way I should rule." It is obvious that none of this constitutes any support for petitioners' claim that they were denied an opportunity to cross-examine the witness to determine whether tainted evidence had been or was being used by the Government at the trial.

[14] In fact, all petitioners sought to show by this witness was that when he caused petitioners to be subpoenaed to appear before the 1952 grand jury he knew that criminal informations charging tax evasions were then pending against them, and that these prosecutions were instituted in "bad faith."

Giglio, Livorsi and their several corporations, a meeting was held in Lawn's private office with Giglio and Roth where it was agreed that Giglio would transfer his home to Roth so that the Government "would not be able to take the house," and Lawn said the arrangement "would save Mr. Giglio's home." Soon afterward the transfer was made. There was other evidence tending to show Lawn's participation in the conspiracy, but we believe the above-recited evidence, with the legitimate inferences that might be drawn therefrom by the jury, was clearly sufficient to support the verdict on the conspiracy count.

Lawn also contests the sufficiency of the evidence to support the verdicts against him on Counts 7 and 9, but since the sentences upon those counts run concurrently with the sentence on Count 10, which we have found sustained by the evidence, it is unnecessary for us to consider those contentions. *Sinclair* v. *United States*, 279 U. S. 263, 299; *Hirabayashi* v. *United States*, 320 U. S. 81; *Pinkerton* v. *United States*, 328 U. S. 640.[15]

Petitioner Livorsi argues that the evidence was not sufficient to support the verdicts against him. As to Count 6, which charged him with attempting to evade assessment of his income taxes for the year 1946 by filing a fraudulent return, the record shows that his return disclosed income from Eatsum for that year of $101,123.88. However, the Government introduced evidence showing that his income from that source in that year was $228,288.58, and that his income from Tavern for that year was understated by more than $40,000. During the trial an issue arose concerning the proper "distributive shares" of Giglio and Livorsi in the profits of Eatsum for the year 1946, by reason of the sale by Lubben of his "distributive share" in the profits of that partnership to Giglio and Livorsi (on March 8, 1946) prior to the close of its accounting year on May 31, 1946. Because of that complication the court, in an effort to simplify the matter, gave a supplemental charge to the jury in which, among other things, he said: [W]hen you get to counts 5 and 6, *where it was claimed that the income received from Eatsum wasn't fully reported* by the defendant Giglio and by the defendent Livorsi, in connection with their individual returns, I say because of that distributive share difficulty, don't consider Eatsum at all. . . . Livorsi now contends that the effect of that charge was to eliminate the $101,123.88 of income which he had reported in his sworn return as received from that source in that year and to give him a credit in that amount which more than offset his understatement of income from other sources, and, thus, established that there was no deficiency in his reporting of income. This contention need not detain us long. While, of course, a conviction upon a charge of attempting to evade assessment of income taxes by the filing of a fraudulent return cannot stand in the absence of proof of a deficiency, the court's charge did not create the credit claimed by Livorsi. It only withdrew from the jury's consideration the Government's claim that his income from Eatsum in that year was $127,164.70 more than he had reported in his return. That meaning of the charge could not have been misunderstood by the jury.

Count 9 charged Livorsi and others with attempting to evade payment of income taxes of American Brands Corporation for the calendar year 1946 by converting and diverting its assets. Livorsi argues that there is no evidence to support his conviction on that count. We must disagree. The evidence disclosed that Livorsi owned half of the capital stock of that corporation and frequently conferred with Giglio, who owned the other half of its capital stock,

---

[15] Petitioner Lawn also contends that a statement made by the Government's attorney in his closing summation to the jury, saying, in pertinent part, "[W]e vouch for [Roth and Lubben] because we think they are telling the truth," deprived him of a fair trial. No objection was made to the statement at the trial. The Government's attorney did not say nor insinuate that the statement was based on personal knowledge or on anything other than the testimony of those witnesses given before the jury, and therefore it was not improper. Cf. *Henderson* v. *United States*, 218 F. 2d 14, 19; *United States* v. *Holt*, 108 F. 2d 365, 370; *Tuckerman* v. *United States*, 291 F. 958, 969. Moreover, petitioners' counsel in his summation to the jury had argued that the Government's case was a persecution of petitioners, had been instituted in bad faith at the instance of a group of revenue agents, and was supported "solely" by the testimony of Roth and Lubben who were admitted perjurers, and that the United States Attorney and his assistant in charge of the case "had been instructed, or in my opinion they never would have done this." These comments clearly invited the reply which petitioner Lawn now attacks. Cf. *Gridley* v. *United States*, 44 F. 2d 716, 739; *United States* v. *Battiato*, 204 F. 2d 717. In addition, the court in his charge to the jury, after telling them that they were the sole judges of the credibility of the witnesses, called particular attention to the fact that Roth was an accomplice and said: "You have got to be particularly careful in scrutinizing his testimony to see whether to save his own skin he lied to hurt somebody else or whether he had some other motive for lying to hurt somebody else." As to Lubben, the charge continued: "I am going to tell you to be just as careful with his testimony as you would with an accomplice, and look and scrutinize it carefully." We think the foregoing shows clearly that there is no merit in Lawn's contention.

concerning the operations of the corporation and was familiar with its affairs; that no income tax was withheld by the corporation from his salary; and that from January 1, 1946, to June 16, 1947, he withdrew from the corporation more than $122,000, including salary, while the corporation had a federal income tax liability for the year 1946 of more than $100,000, as shown by its own return, of which only $300 had been paid. This evidence, with the legitimate inferences that might be drawn therefrom by the jury, was clearly sufficient to support the verdict on Count 9.

Livorsi's contention that there was not sufficient evidence to support the verdict against him on Count 10, the conspiracy count, when viewed in the light of all the foregoing facts, and those found by the Court of Appeals, which we find are supported by the record, is entirely without merit.

Livorsi also contends that the evidence was not sufficient to support the verdict against him on Count 8, but since the sentence on that count runs concurrently with the sentence on Count 6, which we have affirmed, it is unnecessary to consider his contentions concerning Count 8. *Sinclair* v. *United States, supra; Hirabayashi* v. *United States, supra,* and *Pinkerton* v. *United States, supra.*[16]

Several other points raised by petitioners have been carefully considered and are found to be without merit. The judgment in each case must be

Affirmed.

Mr. Justice Harlan, whom Mr. Justice Frankfurter and Mr. Justice Brennan join, concurring in part and dissenting in part, in a separate opinion.

SUPPLEMENT G.—INSURANCE COMPANIES

SECTION 201(c).—LIFE INSURANCE COMPANIES: OTHER DEFINITIONS

REGULATIONS 118, SECTION 39.201–7: Net income and deductions.

Treatment of interest collected in advance on an annual basis, by insurance companies, in accordance with a loan agreement. See Rev. Rul. 58–225, page 258.

SUPPLEMENT L.—ASSESSMENT AND COLLECTION OF DEFICIENCIES

SECTION 276(a).—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION—EXCEPTIONS: FALSE RETURN OR NO RETURN

CT. D. 1825

INCOME TAX—INTERNAL REVENUE CODE OF 1939.—DECISION OF COURT

1. PLEADING AND PRACTICE.—AUTHORITY OF TAX COURT TO REQUIRE COMMISSIONER TO IDENTIFY ITEMS IN NET WORTH STATEMENT.

The Tax Court did not exceed its authority or abuse its discretion when it struck the Commissioner's answer alleging fraud for his

[16] Petitioners Giglio and Livorsi contend that the trial court erred in refusing their motion, made after several days of cross-examination of Lubben at the trial, for production of Lubben's federal income tax return for 1946, all testimony given by Lubben "before the grand jury that found this indictment or found any other indictment against these defendants," and all written statements made by Lubben to any agent of the Government. This issue was not raised in the Court of Appeals. Only in exceptional cases will this Court review a question not raised in the court below. *Duignan* v. *United States,* 274 U. S. 195, 200; *Husty* v. *United States,* 282 U. S. 694, 701, 702. There are no exceptional circumstances here. Cf. *United Brotherhood of Carpenters* v. *United States,* 330 U. S. 395, 412. Moreover, the question was not mentioned in the petition for certiorari filed in this Court. Our Rule 23(1)(c) provides, in pertinent part: "Only the questions set forth in the petition or fairly comprised therein will be considered by the court." The question is not properly here. Cf. *Irvine* v. *California,* 347 U. S. 128, 129.

refusal to furnish the names of banks, description of securities, and specific identification of automobiles, personal property, and real estate, all of which played a part in his net worth computation on which he relied to prove fraudulent understatement of income. The Court held that the Tax Court had conducted the proceeding in accordance with its rules. While the court indicated that the Commissioner's argument against disclosing his evidence because criminal proceedings were pending in the District Court should not affect the exercise of the Tax Court's discretion in deciding whether or not a more detailed statement of a pleading is required, it made clear that its affirmance was not a ruling that the Tax Court should from now on make an order, such as was here granted, in all net worth cases.

2. DECISION AFFIRMED.

Tax Court Order and decision, 15 T. C. M. 998 and 15 T. C. M. 862, affirmed.

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Commissioner of Internal Revenue, Petitioner, v. Peter Licavoli, Respondent

On petition for Review of the Decision of the Tax Court of the United States

[February 14, 1958]

DECIDED

Before MARTIN, MCALLISTER and MILLER, Circuit Judges.

MILLER, Circuit Judge. The Commissioner seeks review of the Decision of the Tax Court resulting from a ruling in a proceeding by the respondent taxpayer to review a deficiency assessment, which in practical effect struck from the record the Commissioner's answer, because of his failure or refusal to comply with the Court's order to file an amended answer making a more complete statement of his defense. Following the ruling, the Tax Court rendered its Decision of no deficiency. The nature of the issue requires a somewhat detailed review of the pleadings.

The taxpayer filed this action in the Tax Court on May 27, 1955, contesting an income tax deficiency for 1947 in the amount of $42,733.86, together with a fraud penalty of $21,366.93. In addition to alleging that the Commissioner erroneously increased his net income for the taxable year, the petition stated that the deficiency assessment, notice of which was dated March 1, 1955, was barred by the Statute of Limitations.

The Commissioner filed an Answer on July 15, 1955, in which it was stated that the deficiency was due to fraud with intent to evade, and that, accordingly, it could be assessed at any time in accordance with Section 276(a) of the Internal Revenue Code of 1939. The Answer further alleged that for the taxable year in question the taxpayer reported net income of $27,066.68 and a tax of $8,839.12, when in truth and in fact, his correct net income and tax liability were $88,342.08 and $51,572.98, respectively, that taxpayer's books and records made available to the Commissioner were inadequate to correctly reflect his correct taxable income, and that an analysis of the taxpayer's net worth for the taxable years ending December 31, 1946, and December 31, 1947, showed a net increase in net worth and taxable income for 1947 as follows:

	12-31-46	12-31-47
Total Assets	$168,015.68	$236,147.31
Total Liabilities	59,793.24	60,059.48
Net Worth	$108,222.44	$176,087.83
Increase in net worth		$ 67,865.39
Add: Personal Expenditures, Income Taxes Paid and Living Expenses		47,918.61
Total Income (Corrected Taxable Income)		$115,784.00

The answer further stated that the assets so listed consisted of bank balances, bonds, stocks, automobiles, personal and real property, business investments, loans and mortgages receivable.

On September 23, 1955, the taxpayer filed a motion that, because the allegations were so general in nature, the Commissioner be ordered to make the answer more definite and certain by supplying the following information: the names and locations of the banks and amount on deposit in each bank; that the stocks and bonds be identified by name and amount together with the purchase price or market value, whichever method of computation was being used; the make, purchase price or value of the automobiles; what the personal property consisted of and its value or market price; the location, purchase price and value of the real estate; that he identify the business investments and the amounts invested in each; the nature, date and amount of loans receivable; and the amount and the date of the mortgages and the persons to whom the money was loaned.

On September 28, 1955, the Tax Court ordered the Commissioner to file an Amended Answer setting forth the items making up the net worth alleged in the original Answer or show cause why the proceeding insofar as it related to the fraud issue, should not be dismissed for failure properly to prosecute.

On November 4, 1955, the Commissioner filed an amendment to the Answer to which was attached a schedule which, among other things, gave a breakdown of assets at cost as of December 31, 1946, and December 31, 1947. This gave total amounts for each of the separate items of bank balances, United States Government bonds, stocks, automobiles, personal property, real estate, mortgages and receivables, and business investments. It did not give the requested information about the names of the banks, a description of the bonds or stocks, or any information about the particular items comprising the automobiles, personal property and real estate.

On December 19, 1955, the taxpayer moved to dismiss the issue of fraud for the alleged failure of the Commissioner to comply with the order of September 28, 1955. Following a hearing, the motion was granted on January 18, 1956. On February 24, 1956, the Commissioner filed a motion for reconsideration. On March 2, 1956, the Tax Court vacated its order of January 18, 1956, and ordered the Commissioner to file an Amended Answer in which he would identify the banks and the balances in each, the United States Government bonds and stocks, the automobiles, the personal property and the real estate and the amounts which he related to each, or show cause on or before March 28, 1956, why the allegations relating to fraud should not be stricken.

After having obtained an extension of time within which to file the Amended Answer, the Commissioner on May 23, 1956, filed an Amended Answer, to which was attached the same exhibit which was attached to the first Amended Answer of November 4, 1955, and which did not give the detailed information which was required by the Tax Court's order.

On June 14, 1956, the Tax Court entered its order striking from the Answer, as amended, the allegations of fraud. In the absence of fraud the deficiency assessment was barred by the Statue of Limitations. In order to put the case in position for appellate review, the Commissioner moved for a decision in the proceeding on the basis of the pleadings, and on August 21, 1956, the Tax Court entered its Decision of no deficiency, now being reviewed.

In making the ruling the Judge of the Tax Court filed a Memorandum to Accompany Order in which he recognized that the net worth method upon which the Commissioner proposed to rely in his effort to prove fraud was one frequently used for that purpose. He stated, however, that one of the purposes of the rules of the Tax Court was to bring about an orderly, fair and time-conserving disposition of the issues, that the taxpayer was entitled to know what the facts were upon which the Commissioner relied to prove fraud so that he could prepare his defense and not be taken by surprise, and that it was essential that the facts be pleaded in sufficient detail that each allegation might be admitted or denied and the area of disagreement as to the facts reduced in that fashion to a minimum, thus conserving the time, effort and expense of all concerned, including the Court. He pointed out that this was particularly true in Tax Court pleadings, since no discovery or pre-trial procedure was expressly provided under which the taxpayer might gain the same information which is sought through the pleading. He stated that proper pleading and the factual details necessary would vary with circumstances and excessive detail should be avoided, but in the present case the Commissioner refused to break down any category shown in the net worth statement, that the Court was impressed with the taxpayer's argument that he should have further information in regard to net worth facts upon which the Commissioner was relying in support of the fraud issues,

and that, in the exercise of his discretion, he had ordered the Commissioner to plead the items going to make up the net worth statement in greater detail.

The Commissioner contends that the Tax Court erred in requiring him to plead basic evidentiary details in an Answer in which he affirmatively alleged fraud, both for the purpose of imposing the 50% addition to tax and to preclude the bar to Statute of Limitations. The taxpayer contends that the Tax Court was authorized under its rules to order the Commissioner to file a further and better statement of his defense to the action and that it was not an abuse of discretion on its part to require that an Amended Answer be filed giving the detailed information specified therein.

Section 7453, Internal Revenue Code of 1954, provides that the proceedings of the Tax Court shall be conducted in accordance with such rules of practice and procedure as the Tax Court may prescribe. This authority to prescribe its own rules of practice is not contested by the Commissioner. Rules 14(b), 17(c)(1) and 17(c)(3) of the Rules of Practice so prescribed by the Tax Court are the rules applicable to the present case.

Rule 14(b), dealing with the answer to be filed by the Commissioner after service upon him of the petition, provides, "The answer shall be drawn so that it will advise the petitioner and the Court fully of the nature of the defense. It shall contain a specific admission or denial of each material allegation of fact contained in the petition and a statement of any facts upon which the Commissioner relies for defense or for affirmative relief or to sustain any issue raised in the petition in respect of which issue the burden of proof is, by statute, placed upon him."

Rule 17(c)(1), dealing with amended pleadings, provides, "The Court, upon its own motion, or upon motion of either party showing good cause, filed prior to the setting of the case for trial on the merits, may order a party to file a further and better statement of the nature of his claim, of his defense, or of any matter stated in any pleading." Rule 17(c)(3) authorizes the Court to strike the pleading to which the motion was directed or to make such other order as it deems just if the order to file an amended pleading is not obeyed.

The Commissioner's contention that under well recognized procedure at the present time the purpose of a pleading is to state the ultimate facts constituting the claim or defense relied upon in short and plain terms without pleading the evidence in support of such facts is, of course, sound as a general principle of pleading. Such is the rule in the U. S. District Courts. *Mutual Life Ins. Co. of N. Y.* v. *Krejci*, 123 F. (2) 594, 596, C. A. 7th; *Dunn* v. *J. P. Stevens & Co.*, 192 F. (2) 854, 855, C. A 2nd.

Under the Rules of Civil Procedure various discovery methods are available to litigants in the District Court to obtain whatever additional information is desired from the opposing party. *Bowles* v. *Karp*, 3 F. R. D. 327. But the Rules of Civil Procedure are not applicable in the Tax Court, and there is no rule of that court authorizing discovery procedure. *Starr* v. *Commissioner*, 226 F. (2) 721, 722, C. A. 7th, cert. denied, 350 U. S. 993; *Lasky* v. *Commissioner*, 235 F. (2) 97, 98, C. A. 9th, affirmed, 352 U. S. 1027. Under Rules 14(b) and 17(c)(1) of the Tax Court to what extent a more detailed statement should be made by a pleading is a matter within the discretion of the trial judge. *Commissioner* v. *Erie Forge Co.*, 167 F. (2) 71, 74, C. A. 3rd. Compare: *Polizzi* v. *Commissioner*, 247 F. (2) 875, C. A. 6th; *Evans* v. *Commissioner*, 222 F. (2) 922, C. A. 6th. The Commissioner relies to some extent upon a number of cases dealing with an analogous issue under Rule 7(f), Federal Rules of Criminal Procedure, and Rule 12(e), Federal Rules of Civil Procedure, in which motions in the nature of a request for a bill of particulars were denied. There is a difference in wording between those rules and the rules of the Tax Court, but disregarding that, we believe such cases merely serve to point out that in each case it was a question which addressed itself to the discretion of the trial judge under the particular circumstances of that case, in the exercise of which the reviewing court found no abuse of discretion. There are other cases equally helpful to the taxpayer where such motions were sustained, some of which are: *United States* v. *Smith*, 16 F. R. D. 180, W. D. N. Y.; *United States* v. *Empire State Paper Corp.*, 8 F. Supp. 220, S. D. N. Y.; *Walling* v. *West Virginia Pulp and Paper Co.*, 2 F. R. D. 416, E. D. S. C.; *United States* v. *Griffith Amusement Co.*, 1 F. R. D. 229, W. D. Okla.; *Remick Music Corp.* v. *Interstate Hotel Co. of Nebraska*, 2 F. R. D. 510, D. C. Neb.

The Commissioner also contends that the present ruling is a radical departure from the previous practice of the Tax Court. *Gutterman Strauss Co.* v. *Commissioner*, 1 B. T. A. 243. He points out that mindful of the increasing number of such motions in net worth cases the Tax Court has heretofore evolved and used a somewhat standardized order which requires the Commissioner in such cases to set out the net worth of the petitioner at the beginning and end of each of the taxable years, the general category and amounts of assets which make up said net worth, the amount of petitioner's living expenses for each of the taxable years, and any other factor requisite to the use of said net worth, without requiring the detailed information asked for in this case. Apparently, the use of such order in any particular case is optional, in that it has not been made a rule of court. Possibly, in the majority of cases the entry of such an order is appropriate. But the failure or refusal of a particular judge to use the order in a particular case because in his opinion it is not appropriate for that case can not be held by us to be reversible error in the absence of a finding by us of abuse of discretion on his part.

The Commissioner complains of the ruling for the reason that the taxpayer has been indicted in the District Court for wilful evasion of income taxes for the years 1950 and 1951 and that the Government's disclosure of its evidence in this case prior to the criminal trial might seriously impair prosecution by affording the taxpayer an opportunity to concoct defenses and by minimizing the possible effectiveness of cross examination if he should take the stand. On this issue we agree with the comment of the Trial Judge that the Tax Court must confine itself to its own problems. We do not believe that a rule of pleading in civil actions applicable in a case when no criminal action is pending, should be held not applicable in another case merely because a criminal action is pending. The trial of the civil case is independent of the criminal action.

As the foregoing discussion shows, the real question which we have in this case is whether the ruling of the Tax Court was, under the particular circumstances of the case, an abuse of discretion. An affirmance of the decision is not a ruling that we would reverse the decision if it had denied the motion, or that the Tax Court should hereafter follow such a ruling in all net worth tax cases.

In our opinion, the Judge of the Tax Court has stated reasons for the ruling which prevent us from classifying it as arbitrary or capricious. Essentially it was for the purpose of reducing the area of disagreement to a minimum, thus conserving the time, effort and expense of all concerned, including the Court. As pointed out in his Memorandum, with respect to the category of real estate, the Commissioner's total must obviously consist of several pieces having various costs. This is a factual matter controlled by records and documentary evidence. We see no prejudice to the Commissioner in disclosing what pieces of real estate are included in the total. Such disclosure would enable the taxpayer to concede the claim or make an issue thereof with respect to each piece, and thus not only expedite the case but afford the taxpayer the opportunity of preparing to meet only such issues as are actually involved. Other categories present similar questions.

Rule 31(b)(1), Rules of Practice before the Tax Court, states, "The Court expects the parties to stipulate evidence to the fullest extent to which complete or qualified agreement can be reached including all material facts that are not or fairly should not be in dispute." Rule 31(b)(2) directs the party expecting to introduce any evidence which might possibly be stipulated to confer with his adversary promptly after receipt of the hearing notice in an endeavor to stipulate all facts *not already* stipulated. The argument of the Commissioner against disclosing his evidence because of the pending criminal proceedings based on practical considerations, loses most of its effectiveness if Rule 31 is to be enforced. The wording of Rule 31(b)(2) indicates that the duty of stipulating facts which can be stipulated is not restricted to a time after the hearing notice. No doubt, many of the facts which the Commissioner is presently refusing to disclose would be quickly stipulated if the Commissioner attempted to make a stipulation. In view of the refusal of the Commissioner to give the taxpayer the information which he seeks, the ruling of the Tax Court seems to be in furtherance of the purpose of Rule 31.

The Decision of the Tax Court is affirmed.

SUPPLEMENT M.—INTEREST AND ADDITIONS TO THE TAX

SECTION 293.—ADDITIONS TO THE TAX IN CASE OF DEFICIENCY

Consistent failure to report income as evidence of fraudulent intent. See Ct. D. 1822, page 508.

SECTION 294.—ADDITIONS TO THE TAX IN CASE OF NONPAYMENT

REGULATIONS 118, SECTION 39.294–1: Additions to the tax.

Penalties for underestimation of tax as based upon reconstructed income. See Ct. D. 1822, page 508.

SUBCHAPTER D.—EXCESS PROFITS TAX

PART I.—RATE AND COMPUTATION OF TAX

SECTION 453.—NONTAXABLE INCOME FROM CERTAIN MINING AND TIMBER OPERATIONS AND FROM NATURAL GAS PROPERTIES

REGULATIONS 130, SECTION 40.453–3: Nontaxable income from exempt excess output. (Also Section 40.453–6.) T. D. 6295 [1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Regulations 130 amended to delete the provisions of paragraph (a) (5) of section 40.453–3 and paragraph (c) of section 40.453–6 of such regulations, relating to computation of nontaxable income from exempt excess output with respect to strategic minerals.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On February 26, 1958, notice of proposed rulemaking regarding the amendment of sections 40.453–3 and 40.453–6 of Regulations 130, relating to computation of nontaxable income from exempt excess output with respect to strategic minerals, was published in Federal Register (23 F. R. 1191). After consideration of the comments received during the 30-day period prescribed in the notice, the following amendment to such regulations is hereby adopted:

Regulations 130 [26 CFR (1939) Part 40] are hereby amended by deleting paragraph (a) (5) of section 40.453–3 and paragraph (c) of section 40.453–6 thereof.

[1] 23 F. R. 4167.

(This Treasury Decision is issued under the authority contained in sections 62 and 3791 of the Internal Revenue Code of 1939 (53 Stat. 32, 467; 26 U. S. C. 62, 3791).)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved June 6, 1958.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 11, 1958, 8:49 a. m., and published in the issue of the Federal Register for June 12, 1958, 23 F. R. 4167.)

REGULATIONS 130, SECTION 40.453–6: Nontaxable bonus income.

Regulations 130 amended to correct provisions relating to the computation of nontaxable income from exempt excess output and nontaxable bonus income with respect to strategic minerals. See T. D. 6295, page 554.

PART IV.—EXCESS PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN TAXABLE ACQUISITIONS OCCURRING PRIOR TO DECEMBER 1, 1950

SECTION 474.—EXCESS PROFITS CREDIT BASED ON INCOME—CERTAIN TAXABLE ACQUISITIONS

REGULATIONS 130, SECTION 40.474–4: Rules for the prevention of duplication. Rev. Rul. 58–42

> The assumption of the "deposit liabilities" of a selling bank, in a transaction described in section 474(a)(1)(A) of the Internal Revenue Code of 1939, does not constitute a use of the assets of the purchasing bank which contributed to its own base period income experience. The purchasing bank is entitled, under section 474 of the Code, to compute its average base period net income, upon which its excess profits credit is based, by taking into account the base period experience of the selling bank to the extent attributable to the properties acquired, for which the consideration was the assumption of the "deposit liabilities."
>
> Revenue Ruling 56–163, C. B. 1956–1, 658, revoked.

In view of the decision in *National Bank of Commerce of Seattle* v. *Commissioner*, 27, T. C. No. 92, acquiescence, page 5, reconsideration has been given to Revenue Ruling 56–163, C. B. 1956–1, 658.

Revenue Ruling 56–163, *supra*, holds that the "deposit liabilities" of a selling bank, assumed by a purchasing bank in a transaction of the type described in section 474(a)(1)(A) of the Internal Revenue Code of 1939, do not constitute a bona fide long-term increase in capital structure within the meaning of section 40.474–4(a)(2)(ii) of Regulations 130. To the extent that duplication of base period experience occurs, an adjustment is required, under the provisions of section 40.474–4(a)(1) of Regulations 130, in determining the average base period net income of the purchasing bank upon which its excess profits credit is based.

An identical issue was considered in *National Bank of Commerce of Seattle, supra.* The court there held that no duplication of experience resulted and that the acquiring bank was entitled to compute its average base period net income by taking into account the excess profits net income (or deficit therein) of the selling bank to the extent attributable to the properties acquired, for which the consideration was the assumption of the deposit liabilities. The court expressly disagreed with the holding in Revenue Ruling 56–163 and stated:

> If the petitioner had borrowed money by the issuance of bonds or debentures and had used the funds to purchase the assets of the selling corporations, apparently there would be no question as to its right to use the income experience of the selling corporations in computing its excess profits credit, except to the extent that some duplication might occur in some other manner, as, for example, by reason of an increase in the excess profits credit on account of a capital addition under section 435. This is contemplated by section 40.474–4 of the regulations where it is provided that no adjustment is necessary where properties are acquired through a bona fide long-term increase in the capital structure of the purchasing corporation, except to the extent that duplication may occur. We see no reason why the same result should not follow where the increase in indebtedness results from an assumption of liability to depositors. In either case the purchasing corporation has incurred an indebtedness in connection with the acquisition of assets, and without parting with any of its own assets which have contributed to its own base period income experience.

In view of the above, it is now the position of the Internal Revenue Service that the assumption of the "deposit liabilities" of the selling bank is not tantamount to the use of the purchaser's assets, in acquiring the properties of the selling corporation. Accordingly, since the purchasing bank did not part with any of its own assets which contributed to its own base period income experience, it is entitled, under section 474 of the Code, to compute its average base period net income, upon which its excess profits credit is based, by taking into account the base period experience of the selling bank to the extent attributable to the properties acquired, for which the consideration was the assumption of the "deposit liabilities."

Revenue Ruling 56–163, *supra*, is hereby revoked.

CHAPTER 2.—ADDITIONAL INCOME TAXES

SUBCHAPTER A.—PERSONAL HOLDING COMPANIES

SECTION 502(f).—PERSONAL HOLDING COMPANY INCOME: USE OF CORPORATION PROPERTY BY SHAREHOLDERS

REGULATIONS 118, SECTION 29.502–1: Personal holding company income.

Section 223 of the Revenue Act of 1950, limiting the application of section 502(f) of the 1939 Code relating to the use of corporation property by a shareholder, is amended. See P. L. 85–319, page 628.

CHAPTER 3.—ESTATE TAX

SUBCHAPTER A.—BASIC ESTATE TAX

PART II.—ESTATES OF CITIZENS OR RESIDENTS OF THE UNITED STATES

SUBPART I.—COMPUTATION OF TAX

SECTION 811(c).—GROSS ESTATE: TRANSFERS IN CONTEMPLATION OF, OR TAKING EFFECT AT, DEATH

REGULATIONS 105, SECTION 81.18: Transfers with possession or enjoyment retained. Ct. D. 1824

ESTATE TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. GROSS ESTATE—TRANSFERS WITH RIGHT TO INCOME RETAINED—PROCEEDS OF LIFE INSURANCE.

The proceeds of the life insurance portions of single-premium life insurance and annuity policy combinations are not includible in the gross estate of the insured under Section 811(c)(1)(B) of the 1939 Code as a transfer with income retained where such proceeds are payable to named beneficiaries and have been irrevocably assigned by the insured. The Court held that the payment of the annuities was not conditioned upon the continued existence of the life insurance portion of the contract and that the Commissioner could not, by aggregating the two types of policies into one investment, conclude that receipt of the annuities by the insured constituted retention of income from the life insurance portions.

2. CASE DISTINGUISHED.

Helvering v. *Le Gierse*, 312 U. S. 531, distinguished.

Judgment of the United States Court of Appeals for the Third Circuit, 241 F. 2d 690, reversed.

SUPREME COURT OF THE UNITED STATES

Fidelity-Philadelphia Trust Company and Robert B. Haines, III, executors of the will of Mary H. Haines, deceased, petitioners v. *Francis R. Smith, Collector of Internal Revenue*

On writ of certiorari to the United States Court of Appeals for the Third Circuit

[April 28, 1958]

OPINION

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

The question before the Court is whether the proceeds of certain insurance policies on the life of the decedent, payable to named beneficiaries and irrevocably assigned by the insured, should be included in the estate of the decedent for the purposes of the federal estate tax. The facts are not in dispute. In 1934 decedent, then aged 76, purchased a series of annuity-life insurance policy combinations. Three single-premium life insurance policies, at face value of $200,000, $100,000, and $50,000, respectively, were obtained without the requirement of a medical examination. As a condition to selling decedent each life insurance policy, the companies involved required decedent also to purchase a separate, single-premium, nonrefundable life annuity policy. The premiums for each life insurance policy and for each annuity policy were fixed at regular rates. The size of each annuity, however, was calculated so that in the event the annuitant-insured died prematurely the annuity premium, less the amount allocated to annuity payments already made, would combine with the companion life insurance premium, plus interest, to equal the amount of insurance proceeds to be paid.[1] Each annuity policy could have been purchased without the insur-

[1] Of course, an additional amount is added to the premiums to compensate the insurance companies for expenses.

ance policy for the same premium charged for it under the annuity-life insurance combination.

The decedent's children were primary beneficiaries of the insurance policies; the Fidelity-Philadelphia Trust Company, as trustee of a trust established by decedent, was named beneficiary of the interests of any of decedent's children who predeceased her. In the year of purchase, decedent assigned all rights and benefits under two of the life insurance policies to her children and under the other to the Fidelity-Philadelphia Trust Company as trustee. These rights and benefits included the rights to receive dividends, to change the beneficiaries, to surrender the policies, and to assign them. Dividends were received, but as far as the record discloses, none of the other rights was exercised. A gift tax on these transfers was paid by the decedent in 1935. In 1938 decedent amended the above-mentioned trust so that it became irrevocable. As the Government concedes, the decedent retained no beneficial or reversionary interest in the trust.

The insured died in 1946. The proceeds of the three insurance policies were not included in her estate in the estate tax return. The Commissioner of Internal Revenue determined that these proceeds should have been included and assessed a deficiency accordingly. The adjusted tax was paid by the executors, and when claim for refund was denied, this action for refund followed. The District Court entered judgment for the taxpayers, but the Court of Appeals for the Third Circuit reversed. 241 F. 2d 690. We granted certiorari.[2] 354 U. S. 921.

It is conceded by the parties that the question of whether the proceeds should be included in the estate is not determinable by the federal estate tax provision dealing with life insurance proceeds. Cf. *Helvering* v. *Le Gierse*, 312 U. S. 531. To support the decision below, the Government argues that the proceeds are includible in the estate under Section 811(c)(1)(B) of the Internal Revenue Code of 1939, which includes, in the estate of the decedent, property, to the extent of the decedent's interest therein, which the decedent had transferred without adequate and full consideration, under which transfer the decedent

> "has retained for his life * * * (i) the possession or enjoyment of, or the right to income from, the property * * *"

The Government contends that the annuity payments, which were retained until death, were income from property transferred by the decedent to her children through the use of the life insurance policies.

On the other hand, petitioners, executors of the estate, assert that the annuity payments were income from the annuity policies, which were separate property from the insurance policies, and that since decedent had assigned away the life insurance policies before death, she retained no interest in them at death.

The Government relies on *Helvering* v. *Le Gierse*, *supra*, where this Court also had before it the issue of the taxability of proceeds from a life insurance policy in an annuity-life insurance combination. After holding that the taxability of these proceeds was not to be determined for estate tax purposes according to the statutory provisions dealing with life insurance,[3] the Court held that the proceeds were includible in the estate under Section 302(c) of the Revenue Act of 1926 because they devolved on the beneficiaries in a transfer which took "effect in possession or enjoyment at or after . . . death." 312 U. S., at 542. However, in reaching this conclusion the decision did not consider the problem in the case at bar, for in *Le Gierse* the insured had retained the rights and benefits of the

---

[2] In agreement with the decision below are *Burr* v. *Commissioner*, 156 F. 2d 871 (C. A. 2d Cir.), and *Conway* v. *Glenn*, 193 F. 2d 965 (C. A. 6th Cir.). To the contrary is *Bohnen* v. *Harrison*, 199 F. 2d 492 (C. A. 7th Cir.), affirmed by an equally divided Court. 345 U. S. 946.

[3] Section 302(g) of the Revenue Act of 1926 exempted from the estate proceeds up to $40,000 "receivable . . . as insurance" by persons other than the executor. The proceeds in *Helvering* v. *Le Gierse* were not considered to have arisen from "insurance" as Congress meant the word to be used because the ordinary "insurance risk" was not present. The insurance company had not undertaken to shift the risk of premature death from the insured and to distribute the risk among its other policyholders. On the contrary, by requiring a concurrent purchase of a nonrefundable annuity contract, the company had neutralized the risk at the expense of the "insured." The remaining risk, whether the annuitant would live beyond the actuarial prediction and after the insurance policy had been surrendered, was considered not an insurance risk but a risk of ordinary investment. Cf. Meisenholder, Taxation of Annuity Contracts under Estate and Inheritance Taxes, 39 Mich. L. Rev. 856, 883.

The principle that the proceeds are not considered "receivable . . . as insurance" applies whether at death the rights and benefits of the policies are the hands of the insured or of another person. *Goldstone* v. *United States*, 325 U. S. 687, 690.

insurance policy until death. The facts in the instant case on this point are fundamentally different. Prior to death, the decedent had divested herself of all interests in the insurance policies, including the possibility that the funds would return to her or her estate if the beneficiaries predeceased her.[4] The assignees became the "owners" of the policies before her death; they had received the right to the immediate and unlimited use of the policies to the full extent of their worth. The immediate value of the policies was always substantial. In the year of assignment their total cash surrender value was over $289,000; in the year of death it was over $326,000. Under the assignment, the decedent had not become a life tenant who postpones the possession and enjoyment of the property by the remaindermen until her death.[5] Cf. *Helvering* v. *Bullard*, 303 U. S. 297; *Commissioner* v. *Estate of Church*, 335 U. S. 632. On the contrary, the assignees held the bundle of rights, the incidents of ownership, over property from which the decedent had totally divorced herself. Cf. *Chase National Bank* v. *United States*, 278 U. S. 327; *Goldstone* v. *United States*, 325 U. S. 687.

Illustrative of the distinction between *Helvering* v. *Le Gierse* and the case at bar is the fact that the Government has not endeavored here to sustain the tax under the statutory provision applied in that case. Instead of the provision taxing transfers "intending to take effect in possession or enjoyment at or after" the transferor's death,[6] the provision applied in *Le Gierse*, the Government relies on the provision taxing transfers in which the transferor has retained until death "the right to income from" the transferred property.[7] However, the Government's position that the annuities were income from property which the insured transferred to her children under the life insurance policies is not well taken.

To establish its contention, the Government must aggregate the premiums of the annuity policies with those of the life insurance policies and establish that the annuity payments were derived as income from the entire investment. This proposition cannot be established. Admittedly, when the policies were purchased, each life insurance-annuity combination was the product of a single, integrated transaction. However, the parties neither intended that, nor acted as if, any of the transactions would have a quality of indivisibility. Regardless of the considerations prompting the insurance companies to hedge their life insurance contracts with annuities, each time an annuity-life insurance combination was written, two items of property, an annuity policy and an insurance policy, were transferred to the purchaser. The annuity policy could have been acquired separately, and the life insurance policy could have been, and was, conveyed separately. The annuities arose from personal obligations of the insurance companies which were in no way conditioned on the continued existence of the life insurance contracts. These periodic payments would have continued unimpaired and without diminution in size throughout the life of the insured even if the life insurance policies had been extinguished.[8] Quite clearly the annuity payments arose solely from the annuity policies. The use and enjoyment of the annuity policies were entirely independent of the life insurance policies. Because of this independence, the Commissioner may not, by aggregating the two types of policies into one investment, conclude that by receiving

[4] Cf. *Goldstone* v. *United States*, *supra*.

[5] Nor are the assignees like second annuitants in survivorship annuities or joint annuitants in joint and survivor annuities. The donor's and donee's annuities have a common fund as the source so that if the source of the donor's annuity is extinguished, the donee's annuity is destroyed. The entire economic enjoyment of the second annuitant must, realistically speaking, await the death of the first annuitant, and a substantial portion of the surviving joint annuitant's enjoyment is similarly postponed. Cf., *e. g.*, *Commissioner* v. *Wilder's Estate*, 118 F. 2d 281; *Commissioner* v. *Clise*, 122 F. 2d 998; *Mearkle's Estate* v. *Commissioner*, 129 F. 2d 386.

[6] Section 811(c)(1)(C) of the Internal Revenue Code of 1939, as amended by Section 7(a) of the Act of October 25, 1949, c. 720, 63 Stat. 891.

[7] Section 811(c)(1)(B) of the Internal Revenue Code of 1939, as amended by Section 7(a) of the Act of October 25, 1949, c. 720, 63 Stat. 891. This provision was also a part of Section 302(c) of the Revenue Act of 1926 at the time applicable in *Helvering* v. *Le Gierse*.

[8] Where a decedent, not in contemplation of death, has transferred property to another in return for a promise to make periodic payments to the transferor for his lifetime, it has been held that these payments are not income from the transferred property so as to include the property in the estate of the decedent. *E. g.*, *Estate of Sarah A. Bergan*, 1 T. C. 543, acq., 1943 Cum. Bull. 2; *Security Trust & Savings Bank, Trustee*, 11 B. T. A. 833; *Seymour Johnson*, 10 B. T. A. 411; *Hirsh* v. *United States*, 35 F. 2d 982 (Ct. Cl. 1929); cf. *Welch* v. *Hall*, 134 F. 2d 366. In these cases the promise is a personal obligation of the transferee, the obligation is usually not chargeable to the transferred property, and the size of the payments is not determined by the size of the actual income from the transferred property at the time the payments are made.

the annuities, the decedent had retained income from the life insurance contracts.[9]

Accordingly, the judgment of the Court of Appeals is Reversed.

MR. JUSTICE BURTON with whom MR. JUSTICE BLACK and MR. JUSTICE CLARK join, dissenting, in a separate opinion.

SECTION 812(e).—NET ESTATE: BEQUESTS, ETC., TO SURVIVING SPOUSE

REGULATIONS 105, SECTION 81.47a: Bequests, etc. to surviving spouse.

Decedents dying after April 2, 1948, who were adjudged incompetent before April 2, 1948, and not restored to competency prior to their death. See P. L. 85–318, page 627.

CHAPTER 4.—GIFT TAX

SECTION 1005.—GIFTS MADE IN PROPERTY

REGULATIONS 108, SECTION 86.19(f): Valuation of property.

Valuation of amount, for gift tax purposes, transferred to a reversionary trust for a period of ten years and six months. See Rev. Rul. 58–242, page 251.

SUBTITLE B.—MISCELLANEOUS TAXES

CHAPTER 9.—EMPLOYMENT TAXES

SUBCHAPTER B.—EMPLOYMENT BY CARRIERS

PART I.—TAX ON EMPLOYEES

SECTION 1500.—RATE OF TAX

REGULATIONS 114, SECTION 411.301: Measure of employees' tax.

Instructions for computation of tax to be reported on Form CT–1 with respect to compensation for services rendered before 1947. See Rev. Proc. 58–3, page 685.

---

[9] For the treatment by lower courts of the life insurance-annuity combination in a similar situation in the field of federal income taxation, cf. *Commissioner* v. *Meyer*, 139 F. 2d 256; *Edna E. Meredith*, 1 T. C. M. 847, affirmed, *Helvering* v. *Meredith*, 140 F. 2d 973; *John Koehrer*, 4 T. C. M. 219.

CHAPTER 9A.—WAR TAXES AND WAR TAX RATES (TERMINATED)

SECTION 1651.—RETAILERS' EXCISE TAX ON CERTAIN LUGGAGE, ETC.

Whether the term "sold at retail" is equivalent to "sale for purposes other than resale." See Rev. Rul. 58–125, below.

CHAPTER 10.—ADMISSIONS AND DUES

SUBCHAPTER A.—ADMISSIONS

SECTION 1701.—EXEMPTIONS FROM TAX

REGULATIONS 43, SECTION 101.15: Exemptions from tax.

Applicability of the tax to admissions the proceeds of which inure exclusively to the benefit of a separate retirement, pension, or disability fund maintained by a policemen's or firemen's benevolent association. See Rev. Rul. 58–203, page 431.

CHAPTER 19.—RETAILERS' EXCISE TAXES

SECTION 2400.—TAX ON JEWELRY, ETC.

(Also Sections 1651, 2401, 2402.) Rev. Rul. 58–125
(Also Part I, Sections 4001, 4011, 4021, 4031.)

The Internal Revenue Service will recognize the decisions in the cases of *Nathan Gellman, et al.* v. *United States*, 235 Fed. (2d) 87, and *Torti* v. *United States*, 249 Fed. (2d) 623, as precedents in the disposition of other cases involving the meaning of the term "sold at retail" for purposes of the retailers excise tax.
Rev. Rul. 56–538, C. B. 1956–2, 1005, revoked.

In view of the decision of the United States Court of Appeals for the Seventh Circuit in the case of *Torti* v. *United States*, 249 Fed. (2d) 623, the Internal Revenue Service has given further consideration to Revenue Ruling 56–538, C. B. 1956–2, 1005.

In the case of *Nathan Gellman, et al.* v. *United States*, 235 Fed. (2d) 87, the United States Court of Appeals for the Eighth Circuit, reversed a decision of the United States District Court (Minnesota), 129 Fed. Supp. 291, which had sustained the position of the Government that in applying the retailers excise taxes imposed by sections 1651 and 2400 of the Internal Revenue Code of 1939, the term "sold at retail" is equivalent to "sale for purposes other than resale."

Revenue Ruling 56–538 announced that the decision in the *Gellman* case would not be considered by the Service as a precedent in the

disposition of other cases involving a similar factual situation. However, subsequent to the publication of that ruling, the United States Court of Appeals for the Seventh Circuit in the *Torti* case also rejected the Government's definition of the term "sold at retail," and the court followed the *Gellman* decision.

In view of these decisions, Revenue Ruling 56–538 has been reconsidered with the result that the Service will now recognize the *Gellman* and *Torti* cases as precedents in the disposition of other cases involving similar factual situations. This will apply whether the situation arises under section 1651, 2400, 2401, or 2402 of the 1939 Code or under the similar provisions of section 4001, 4011, 4021, or 4031 of the Internal Revenue Code of 1954.

Revenue Ruling 56–538, *supra*, is hereby revoked.

SECTION 2401.—TAX ON FURS

Whether the term "sold at retail" is equivalent to "sale for purposes other than resale." See Rev. Rul. 58–125, page 561.

SECTION 2402.—TAX ON TOILET PREPARATIONS

Whether the term "sold at retail" is equivalent to "sale for purposes other than resale." See Rev. Rul. 58–125, page 561.

CHAPTER 28.—PROVISIONS COMMON TO MISCELLANEOUS TAXES

SUBCHAPTER A.—GENERAL PROVISIONS

PART II.—ASSESSMENT, COLLECTION, AND REFUND

SECTION 3312.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION

Rev. Rul. 58–158

The four-year period of limitation upon assessment, provided by section 3312(a) of the Internal Revenue Code of 1939, does not apply with respect to "collected" excise taxes where no return has been filed and there has been no attempt by either the taxpayer or the collecting agency to see that the tax is received by the Government.

Advice has been requested whether the period of limitation upon assessment provided by section 3312(a) of the Internal Revenue Code of 1939 prohibits an assessment of the tax on the transportation of property under the circumstances described below.

A shipper contracted with various persons to transport property for him. Neither the shipper nor the other persons realized that the amounts paid for such transportation were subject to the tax on the transportation of property imposed by section 3475(a) of the Code.

Consequently, no taxes were collected from the shipper, and no returns were filed by the persons transporting the property.

Section 3475(c) of the Code requires that the person making a taxable transportation payment shall pay the tax to the person receiving such payment who, in turn, shall file a return and pay the taxes so collected to the Government. Inasfar as it is applicable to the excise taxes, section 3312(a) of the Code provides the general rule that such taxes shall be assessed within four years after such taxes became due. However, section 3312(b) of the Code provides that in case of a failure to file a return within the time required by law, the tax may be assessed at any time.

The tax imposed upon the amount paid for the transportation of property is one of the so-called "collected" excise taxes, which are those excise taxes imposed upon the person making the payment subject to the tax. Other taxes included in this category are the taxes on admissions, club dues, communications, transportation of persons, and safe deposit boxes.

Under the provisions of the statute, the person making the payment subject to tax has a duty to pay the tax, while the person receiving the taxable payment for the facilities or services has a duty to collect such tax, to file a return, and to remit to the Government the tax thus collected. There is, therefore, a bipartisan obligation to see that the Government receives the tax. Either party can dispose of his obligation to the Government by performing the acts required of him and, having performed the required acts, will not be held liable for the other's failures.

For example, in this case, had the shipper paid the tax to the carrier at the time the charges for transportation were paid, the Government would be able to assess the tax against the carrier at any time, since no return was filed. On the other hand, had the carrier filed returns and reported that it was unable to collect the tax from the shipper the Government would have been able to assess the tax directly against the shipper within the statutory period of limitations provided by section 3312(a) of the Code.

It is held that, with respect to "collected" excise taxes, where no return has been filed and there has been no attempt by either party to see that the tax is received by the Government, the period of limitation upon assessment provided by section 3312(a) of the Code is not applicable. Accordingly, in this case, the tax may be assessed directly against the shipper at any time.

SUBTITLE D.—GENERAL ADMINISTRATIVE PROVISIONS

CHAPTER 38.—MISCELLANEOUS PROVISIONS

SECTION 3793.—PENALTIES AND FORFEITURES

Preliminary hearing to determine the admissibility of evidence. See Ct. D. 1817, page 540.

SECTION 3801(a).—MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES: DEFINITIONS

REGULATIONS 118, SECTION 39.3801(a)–1: Purpose and scope of section 3801.

Inventory adjustments. See Rev. Rul. 58–327, page 316.

SECTION 3801(b).—MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES: CIRCUMSTANCES OF ADJUSTMENT

REGULATIONS 118, SECTION 39.3801(b)–1: Double inclusion of item of gross income.

Inventory adjustments. See Rev. Rul. 58–327, page 316.

SUBPART B.—RULINGS AND DECISIONS UNDER THE FEDERAL FIREARMS ACT

Rulings and decisions published in Part II, Subpart B, of the Internal Revenue Bulletin are based on the application of provisions of the Federal Firearms Act.

SECTION 2.—TRANSPORTING, SHIPPING, OR RECEIVING FIREARMS OR AMMUNITION IN INTERSTATE OR FOREIGN COMMERCE; ACTS PROHIBITED

26 CFR 315.40: General. Rev. Rul. 58-109

The Internal Revenue Service has been requested to clarify the status under the Federal Firearms Act, 15 U. S. C., Chapter 18, of a dealer engaged in the business of selling firearms and ammunition in intrastate commerce only. *Held*, any person engaged in the business of selling firearms or pistol or revolver ammunition which are received in interstate commerce, either directly or indirectly, operates in violation of section 2(a) of the Federal Firearms Act, 15 U. S. C. 902(a), unless he has obtained a license as required by section 3 of such Act, 15 U. S. C. 903, regardless of whether such firearms or ammunition are subsequently sold only in intrastate commerce.

475254°—58——37

SUBPART C.—RULINGS AND DECISIONS UNDER OTHER PUBLIC LAWS

Rulings and decisions published in Part II, Subpart C, of the Internal Revenue Bulletin are based on the application of provisions of other public laws on internal revenue matters, except those relating to the various alcohol taxes, which appear in Part III.

REVENUE ACT OF 1950

Section 223 of the Revenue Act of 1950, limiting the application of section 502(f) of the 1939 Code relating to the use of corporation property by a shareholder, is amended. See P. L. 85–319, page 628.

PART III

ALCOHOL TAX RULINGS AND DECISIONS

SUBPART A.—RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1954

Rulings and decisions published in Part III, Subpart A, of the Internal Revenue Bulletin are based on the application of provisions of the Internal Revenue Code of 1954 and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1939, the Federal Alcohol Administration Act, or other public laws.

SUBTITLE E.—ALCOHOL, TOBACCO AND CERTAIN OTHER EXCISE TAXES

CHAPTER 51.—DISTILLED SPIRITS, WINES, AND BEER

SUBCHAPTER A.—GALLONAGE AND OCCUPATIONAL TAXES

PART I.—GALLONAGE TAXES, SUBPART A.—DISTILLED SPIRITS

SECTION 5008.—STRIP STAMPS FOR DISTILLED SPIRITS: CONTAINERS OF OTHER THAN BOTTLED IN BOND

(Also Section 5642.) Ct. D. 1816

WIRETAPPING BY STATE OFFICERS IN ACCORDANCE WITH STATE LAW PROHIBITED—DECISION OF COURT

1. WIRETAPPING BY STATE OFFICERS PROHIBITED.

Evidence obtained from a search by local police authorities, the search having been based on information secured through a telephone wiretap by local police authorities in conformity with State law and without participation by Federal authorities, is not admissible in Federal court. Such interception and divulgence are in violation of section 605 of the Federal Communications Act.

2. JUDGMENT REVERSED AND REMANDED.

Judgment of the United States Court of Appeals for the Second Circuit, 244 F. 2d 389, reversed and the case remanded to the Court of Appeals.

SUPREME COURT OF THE UNITED STATES

Salvatore Benanti v. *United States of America*

On a writ of certiorari to the United States Court of Appeals for the Second Circuit

[December 9, 1957]

OPINION

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

The question presented by petitioner is whether evidence obtained as the result of wiretapping by state law enforcement officers, without participation by federal authorities, is admissible in a federal court. Petitioner was convicted of the illegal possession and transportation of distilled spirits without tax stamps affixed thereto in violation of 28 U. S. C. sections 5008(b)(1), 5642.* The New York police, suspecting that petitioner and others were dealing in narcotics in violation of state law, obtained a warrant in accordance with state law [1] authorizing them to tap the wires of a bar which petitioner was known to frequent. On May 10, 1956, the police overheard a conversation between petitioner and another in which it was said that "eleven pieces" were to be transported that night at a certain time and to a certain place in New York City. Acting according to this information, the police followed and stopped a car driven by petitioner's brother. No narcotics were found, but hidden in the car were eleven five-gallon cans of alcohol without the tax stamps required by federal law. The brother and the alcohol were turned over to federal authorities and this prosecution followed.

At the trial the first government witness, a state police officer, testified to the events leading up to the discovery of the cans of alcohol in an automobile which had been driven by the petitioner and then taken by his brother to the appointed spot. No mention was made of the wiretap on direct examination. However, on cross-examination this witness admitted that the information causing the police to follow the car and intercept it came from a wiretap.[2] On re-direct examination the prosecutor sought to prove that the wiretap had been authorized by state law. The Government introduced a second police official, who testified substantially as the first, admitting on direct examination that a wiretap had existed and on cross-examination that the discovery of the alcohol was occasioned by knowledge of the contents of the wiretapped conversation. The words of that conversation were not disclosed to the jury although they were disclosed to the trial judge and the defense counsel.[3] The record is silent as to whether the prosecutor was told the words of the conversation. However, in our view it is unimportant whether he had this information or not.

---

*The title reference is apparently intended for Title 26.

[1] N. Y. Const., Art. I, § 12; N. Y. Code of Criminal Procedure, § 813–a (1942).

[2] R. 7: "Cross examination by Mr. Todaro [defense counsel]:
"Q. Officer, you were in the vicinity of this Reno Bar quite frequently?
"A. Yes, sir.
"Q. Did the Police Department have a tap on the Reno, Bar, if you know?
"A. Yes, they have several taps on the Reno Bar.
"Q. Did you obtain any information as part of this investigation from the wiretap conversation?
"A. Did I obtain any information in regard—
"Q. Yes, in reference to the Benantis.
"A. Benanti?
"Q. Yes.
"A. Yes.

. . . . .

"Q. You also obtained information as a result of this wiretap that this car was going to be driven to a certain location?
"A. Yes.

. . . . .

"Q. But you had obtained some information through the wiretap which gave you a lead to this trap?
"A. Part of the information."

[3] R. 52: "(The following took place in the absence of the jury:)
"THE COURT: Mr. Todaro, the assistant district attorney is here with the order of the [state] court [authorizing the wiretap]. I just tell you, Mr. Todaro, I have looked at it and it does provide for the tap of these premises, so that your concession [that the tap was authorized under state law], generally made, was actually well based.
"Also, for whatever factual interest it may have on this motion, Mr. Murphy overheard the conversation that night, if you want to get the full facts on that.
"The reference on the wire was to 'eleven pieces' which they thought meant narcotics, and that was why they intercepted the car."

Petitioner's motion to suppress the evidence was denied and he was convicted. The Court of Appeals for the Second Circuit affirmed, 244 F. 2d 389, holding that while the action of the state officials violated Section 605 of the Federal Communications Act, the evidence obtained from the violation was still admissible. We granted certiorari. 355 U. S. 801. Petitioner, relying on this Court's supervisory powers over the federal court system, claims that the admission of the evidence was barred by the Federal Constitution and Section 605. We do not reach the constitutional questions as this case can be determined under the statute.

Section 605 states in pertinent part:[4]

> " * * * no person not being authorized by the sender shall intercept any communication and divulge or publish the existence, contents, substance, purport, effect, or meaning of such intercepted communication to any person * * *."

I.

In *Nardone* v. *United States*, 302 U. S. 379, and 308 U. S. 338, this Court held that evidence obtained from wiretapping by federal agents was inadmissible in federal court. In *Schwartz* v. *Texas*, 344 U. S. 199, the same type of evidence was held admissible in a state court where it had been obtained by state agents. The case before us, containing elements from these three cases, forces a choice between the different results reached.

The *Nardone* decisions laid down the underlying premises upon which is based all subsequent consideration of Section 605. The crux of those decisions is that the plain words of the statute created a prohibition against any persons violating the integrity of a system of telephonic communication and that evidence obtained in violation of this prohibition may not be used to secure a federal conviction. *Nardone* v. *United States*, 302 U. S. 379, 382. Moreover, as the second *Nardone* decision asserts, distinctions designed to defeat the plain meaning of the statute will not be countenanced. 308 U. S. 338, 340. We hold that the correct application of the above principle dictates that evidence obtained by means forbidden by Section 605, whether by state or federal agents, is inadmissible in federal court.

In this case the statute was violated if not earlier at least upon the disclosure to the jury of the *existence* of the intercepted communication,[5] for Section 605 forbids the divulgence of "the *existence*, contents, substance, purport, effect, or meaning" of the intercepted message. The effect of that violation in contributing to the conviction here is manifest. The jury were free to speculate that the existence of the communication, the source of the Government's evidence, was further proof of petitioner's criminal activities.[6] The prosecutor continued to use evidence now linked to a disclosed wiretap although he had been made aware of its existence and of its obvious significance to his case.[7]

Respondents argue that the evidence obtained from the disclosed wiretap should have been admissible by referring to *Schwartz* v. *Texas*, *supra*, and by drawing a parallel to the Fourth Amendment. It is urged that as long as the wiretapping occurred without the participation or even knowledge of federal law enforcement officers, the evidence should be admitted in federal court; the Federal Government, being without fault, should not be handicapped. However, *Schwartz* v. *Texas* does not indicate approval of such a proposition. Both a

---

[4] 48 Stat. 1103, 47 U. S. C. § 605.

[5] Because both an interception *and* a divulgence are present in this case we need not decide whether both elements are necessary for a violation of § 605. Also because here the disclosure was of the existence of the communication, it is not necessary for us to reach the issue whether § 605 is violated by an interception of the communication and a divulgence of its fruits without divulging the existence, contents, etc., of the communication.

[6] The obvious prejudice to the petitioner from the disclosure of the wiretap is shown by efforts of the prosecution to mitigate it by showing that the wiretap had not been instigated on account of the charge for which petitioner was being tried. However, disclosure of the *existence* of the communication was the prejudicial error that was not overcome.

[7] The heart of the Government's case was (1) the testimony of the two policemen, who were present at the scene of the wiretap and at least one of whom arrested petitioner's brother and discovered the alcohol, and (2) the evidence of a government chemist as to his analysis of the seized alcohol. As the Court of Appeals below said: "But it is equally clear that but for the wiretap there would have been no basis for any prosecution whatever, as the apprehension of Angelo [petitioner's brother] and seizure of the 'eleven pieces' led to the discovery of appellant's participation in the violations of federal law for which he has been convicted; and the sequence of cause and effect is clear." 244 F. 2d, at 390.

state court and state law enforcement officers were there involved. The rationale of that case is that despite the plain prohibition of Section 605, due regard to federal-state relations precluded the conclusion that Congress intended to thwart a state rule of evidence in the absence of a clear indication to that effect. In the instant case we are not dealing with a state rule of evidence. Although state agents committed the wiretap, we are presented with a federal conviction brought about in part by a violation of federal law,[8] in this case in federal court.[9]

Furthermore, confronted as we are by this clear statute, and resting our decision on its provisions, it is neither necessary nor appropriate to discuss by analogy distinctions suggested to be applicable to the Fourth Amendment.[10] Section 605 contains an express, absolute prohibition against the divulgence of wiretapping. *Nardone* v. *United States*, 302 U. S. 379, 382. This case is but another example of the use of wiretapping that was so clearly condemned under the other circumstances in the second *Nardone* decision:[11]

> "To forbid the direct use of [these] methods . . . but to put no curb on their full indirect use would only invite the very methods deemed 'inconsistent with ethical standards and destructive of personal liberty.' What was said in a different context in *Silverthorne Lumber Co.* v. *United States*, 251 U. S. 385, 392, is pertinent here: 'The essence of a provision forbidding the acquisition of evidence in a certain way is that not merely evidence so acquired shall not be used before the court, but that it shall not be used at all.'"

The above principle has for its purpose enhancement of the proper administration of criminal justice. To impute to the statute anything less would give it "a self-defeating, if not disingenuous purpose."[12] *Nardone* v. *United States*, 308 U. S. 338, 340–341.

II.

As an alternative argument to support the judgment below, respondent urges that the interception and divulgence in this case were no violation of Section 605 because the wiretap was placed by state agents acting in accordance with the law of New York. The Constitution and statutes of the State of New York[13] provide that an *ex parte* order authorizing a wiretrap may be issued by judges of a certain rank upon the oath or affirmation of certain officials that there is reasonable ground to believe evidence of a crime may be obtained and which identifies the telephone line and the persons who are to be affected thereby. It is undisputed that an order pursuant to that law was issued in this case and that it was executed according to state law.

Respondent does not urge that, constitutionally speaking, Congress is without power to forbid such wiretapping even in the face of conflicting state law. Cf. *Weiss* v. *United States*, 308 U. S. 321, 327. Rather the argument is that Congress has not exercised this power and that Section 605, being general in

---

[8] A complementary distinction was made in *Rea* v. *United States*, 350 U. S. 214. There this Court reversed the denial of an injunction against a federal agent who had seized evidence in violation of the Federal Rules of Criminal Procedure and, being unable to introduce the evidence in federal court, was about to do so in a state prosecution. In answer to the argument that such an injunction would interfere with state judicial procedure, the decision states: "The command of the federal Rules is in no way affected by anything that happens in a state court. They are designed as standards for federal agents. The fact that their violation may be condoned by state practice has no relevancy to our problem." *Id.*, at 217.

[9] The first divulgence appearing on the record occurred in court, but we do not mean to imply that an out-of-court violation of the statute would not also lead to the invalidation of a subsequent conviction.

[10] It has remained an open question in this Court whether evidence obtained solely by state agents in an illegal search may be admissible in federal court despite the Fourth Amendment. See *Lustig* v. *United States*, 338 U. S. 74, 78–79. The instant decision is not concerned with the scope of the Fourth Amendment.

[11] 308 U. S., at 340.

[12] *Goldstein* v. *United States*, 316 U. S. 114, is not to the contrary. The holding of that decision is that one not a party to an intercepted conversation may not bar the testimony of one who has been induced to testify by exposure of the fact that his own conversations have been wiretapped. *Id.*, at 122. The broad language in the decision that the policy of the Fourth Amendment applies to § 605 is placed in the context of a discussion of the right of one not a party to the conversation to complain. *Id.*, at 120, 121. This right was rejected on the ground that since the statute allows the "sender" of a message to consent to its divulgence, it meant to protect only him.

[13] N. Y. Const., Art. I, § 12; N. Y. Code of Criminal Procedure, § 813–a (1942).

its terms, should not be deemed to operate to prevent a State from authorizing wiretapping in the exercise of its legitimate police functions. However, we read the Federal Communication Act, and Section 605 in particular, to the contrary.

The Federal Communications Act is a comprehensive scheme for the regulation of interstate communications.[14] In order to safeguard those interests protected under Section 605, that portion of the statute pertinent to this case applies both to intrastate and to interstate communications. *Weiss* v. *United States*, *supra*. The natural result of respondent's argument is that both interstate and intrastate communication would be removed from the statute's protection because, as this Court noted in *Weiss*,[15] the intercepter cannot discern between the two and will listen to both. Congress did not intend to place the protections so plainly guaranteed in Section 605 in such a vulnerable position. Respondent points to portions of the Act which place some limited authority in the States over the field of interstate communication. The character of these matters, dealing with aspects of the regulation of utility service to the public, are technical in nature[16] in contrast to the broader policy considerations motivating Section 605.[17] Moreover, the very existence of these grants of authority to the States underscores the conclusion that had Congress intended to allow the States to make exceptions to Section 605, it would have said so. In light of the above considerations, and keeping in mind this comprehensive scheme of interstate regulation and the public policy underlying Section 605 as part of that scheme, we find that Congress, setting out a prohibition in plain terms, did not mean to allow state legislation which would contradict that section and that policy.[18] Cf. *Pennsylvania* v. *Nelson*, 350 U. S. 497; *Hill* v. *Florida*, 325 U. S. 538; *Hines* v. *Davidowitz*, 312 U. S. 52.[19]

The judgment is reversed and the cause is remanded to the District Court for further proceedings not inconsistent with this opinion.

Reversed.

---

[14] The Federal Communications Act was the response to a Presidential message calling to the attention of Congress the disjointed exercise of federal authority over the forms of communication. The primary purpose of the Act was to create a commission "to regulate all forms of communication and to consider needed additional legislation." H. R. Rep. No. 1850, 73d Cong., 2d Sess. 3. Note also the remarks of Senator Dill, chairman of the Committee on Interstate Commerce, who introduced the bill in the Senate, that the Act would correct the theretofore cursory regulation of telephone and telegraph companies. 78 Cong. Rec. 8822.

[15] 308 U. S., at 328.

[16] 47 U. S. C. § 220(h) allows the Federal Communications Commission to place carriers under state authority in regard to accounting systems and methods of depreciation accounting. See H. R. Rep. No. 1850, 73d Cong., 2d Sess. 7. 47 U. S. C. § 221(b), as originally enacted, enabled state commissions "to regulate exchange services in metropolitan areas overlapping State lines." S. Rep. No. 781, 73d Cong., 2d Sess. 5; H. R. Rep. No. 1850, 73d Cong., 2d Sess. 7. State authority over intrastate communication is reserved by 47 U. S. C. § 152(b), which removes the jurisdiction of the Federal Communications Commission from "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier." See S. Rep. No. 781, 73d Cong., 2d Sess. 3.

[17] Cf. *Nardone* v. *United States*, 302 U. S. 379; *Nardone* v. *United States*, 308 U. S. 338; *Weiss* v. *United States*, 308 U. S. 321.

[18] In passing, it should be pointed out that several Attorneys General of the United States have urged Congress to grant exceptions to § 605 to federal agents under limited circumstances. See, *e. g.*, Hearings before Subcommittee No. 5 of the House Committee on the Judiciary on H. R. 762, 867, 4513, 4728, 5096, 84th Cong., 1st Sess. 28; Rogers, The Case for Wire Tapping, 63 Yale L. J. 792 (1954). But Congress has declined to do so. In view of this, it would seem unreasonable to believe that Congress is willing to allow this same sort of exception to state agents with no further legislation on its part.

[19] *Schwartz* v. *United States*, *supra*, is not to the contrary. While it refused to overturn a state rule of evidence, the Court was satisfied that the action of the state officials nonetheless violated § 605. 344 U. S., at 202.

26 CFR 251.89a: Destruction of red strip stamps abroad. T. D. 6287 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 251.—IMPORTATION OF DISTILLED SPIRITS, WINES AND BEER

Destruction of unused red strip stamps abroad

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On July 25, 1957, a notice of proposed rulemaking with respect to regulations designated as Parts 250 and 251 of Title 26 of the Code of Federal Regulations was published in the Federal Register (22 F. R. 5899). The purposes of the proposal were (1) to simplify the procedures for filing Form 1627A at the port of diversion where spirits are diverted to a port other than the specified port, and (2) to provide for the destruction of red strip stamps abroad. After consideration of all such relevant matter as was presented by interested persons relating to the rules proposed, the amendment, set forth below, is hereby adopted.

PARAGRAPH 1. 26 CFR Part 251 is amended by inserting a new section, reading as follows, immediately after § 251.89:

§ 251.89a DESTRUCTION OF RED STRIP STAMPS ABROAD.—When for any reason a foreign bottler or exporter has on hand a quantity of red strip stamps which are not to be affixed to containers for export to the United States, and it is impractical to return such stamps to the importer from whom they were received, the collector of customs who approved the requisition, Form 428, may, on application (in triplicate) by the importer, authorize the destruction of the stamps abroad. The application shall show the denomination, quantity, and serial numbers of the stamps, the name and address of the foreign bottler or exporter who has possession of the stamps, and the reasons why destruction abroad is requested. If the collector of customs approves the application for destruction he will return the original and one copy of the application to the importer who will forward both to the foreign bottler or exporter abroad. On receipt of the approved application, the stamps may be destroyed provided such destruction is under the supervision of a Foreign Service officer of the United States of America, or of a Treasury Department officer stationed abroad, or of an excise official of the foreign government concerned, and such officer certifies to the destruction of the stamps on the approved application. After destruction, the original of the application bearing the required certificate of destruction will be returned, through the foreign bottler or exporter and the importer, to the collector of customs. The collector of customs will credit the Form 428 accordingly, stamp on the copy of the application "strip stamps credited", and send the copy to the importer who filed the application. Such importer may then take credit for the stamps on Form 96. (68A Stat. 602; 26 U. S. C. 5008)

This Treasury Decision shall be effective on the first day of the first month which begins not less than 30 days after the date of publication in the Federal Register.

[1] 23 F. R. 1856.

(This Treasury Decision is issued under authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U. S. C. 7805).)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.
RALPH KELLY,
Commissioner of Customs.

Approved March 17, 1958.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on March 19, 1958, at 8:51 a. m., and published in the issue of the Federal Register for March 20, 1958, 23 F. R. 1856.)

SECTION 5011.—ABATEMENT, REMISSION, REFUND AND ALLOWANCE FOR LOSS OR DESTRUCTION OF DISTILLED SPIRITS

(Also Part III–B, Section 2901.) Ct. D. 1815

CLAIMS FOR REFUND OF TAXES ON DISTILLED SPIRITS DESTROYED AFTER WITHDRAWAL FROM BOND NOT ALLOWABLE—DECISION OF COURT

1. CLAIM FOR REFUND OF DISTILLED SPIRITS TAXES DENIED.

Tax paid on distilled spirits destroyed in a train wreck after withdrawal from bond may not be refunded to the manufacturer. The tax on distilled spirits is one imposed on production which accrues when the substance comes into being and is payable at the time of withdrawal from bond. Although Congress has specifically provided for relief from tax on distilled spirits lost under certain circumstances while in bond, Congress has expressly forbidden the remission or refund of taxes on spirits lost or destroyed after withdrawal from bond.

2. THE OPINION WAS CERTIFIED TO CONGRESS PURSUANT TO HOUSE LUTION 402 OF THE 84TH CONGRESS, 2D SESSION.

UNITED STATES COURT OF CLAIMS

Erie Railroad Company and Atlantic Mutual Insurance Company v. *United States*

Referred to the Court of Claims by the House of Representatives under sections 1492 and 2509, Title 28, United States Code

[December 4, 1957]

OPINION

WHITAKER, Judge, delivered the opinion of the court:

This case has been referred to us by the House of Representatives under 28 U. S. C. 1492 and 2509, pursuant to the House Resolutions set out in findings 3 and 4, for such findings of fact and conclusions thereon as shall be sufficient to inform the Congress of the nature and character of the demand as a claim legal or equitable against the United States, and the amount, if any, legally or equitably due from the United States to the plaintiffs.

Section 1492 authorizes us to render judgment on a claim so referred if we have jurisdiction of the claim under other acts of Congress. We would, of course, have jurisdiction of a claim such as plaintiffs' present claim, except for the fact that the statute of limitations within which claims against the United States must be presented in this court has long since run. It is not within our power, therefore, to render judgment on the claim, but, of course, the running of the statute is not a bar to the allowance of the claim by Congress. However,

we know of no special circumstances in this case which would justify Congress in doing so. The facts respecing plaintiffs' delay in presenting their claim follow.

On June 16, 1945, the National Distillers Products Corporation withdrew from bond 8,080.90 wine gallons of alcohol, equivalent to 15,353.60 proof gallons, and shipped them from Peoria, Illinois, consigned to New England Distillers, Inc., at Clinton, Massachusetts. In transit the liquors were destroyed in a railroad wreck.

The National Distillers Products Corporation filed a claim with the Erie Railroad Company in the total amount of $147,730.62, covering the value of the alcohol lost in the sum of $9,135.39, the internal revenue tax that had been paid thereon of $138,182.40, and the prepaid freight of $412.83. Subsequently, on December 20, 1945, the National Distillers Products Corporation filed with the District Director of Internal Revenue a claim for refund of the taxes paid on the liquors lost. This claim was denied by the Commissioner of Internal Revenue on January 16, 1946, on the ground that there was no provision of law authorizing the refund of internal revenue taxes which had been properly paid on distilled spirits, and that the taxes in question had been properly paid. Following this, the Erie Railroad Company on March 6, 1946, paid the National Distillers Products Corporation the full amount of its claim of $147,730.62.

Notwithstanding rejection of the claim for refund of the taxes paid on January 16, 1946, no further effort was made by anyone to recover them until the introduction in the House of Representatives of H. R. 5918 on April 27, 1955. Presumably, this was because the parties did not believe that their claim had sufficient validity to justify any further effort to secure its allowance.

On April 3, 1950, this court decided the case of *Stephano Bros.* v. *United States*, 116 C. Cls. 503, in which we held that a shipper of tobacco was entitled to recover the value of stamps affixed to a shipment of cigarettes which had been destroyed in a railroad wreck. This was followed by our decision in *Philip Morris* v. *United States*, 120 C. Cls. 703, decided November 6, 1951, in which we reaffirmed our previous holding. These decisions apparently encouraged plaintiffs to make a further effort to recover the tax paid on this alcohol. At any rate, in their briefs they rely largely on these cases in support of their claim.

But, even if it could be said that our decision in *Stephano Bros.* v. *United States*, *supra*, recognized a right to recover excise taxes on tobacco not previously recognized, and if this decision could be applied to plaintiffs' claim, as they seek to do, nevertheless, it appears that they waited much longer than the statutory period before filing their petition in this court. While the statute of limitations applicable to most claims against the United States is six years, the statute applicable to the recovery of internal revenue taxes is two years. (Section 3772 of the Internal Revenue Code of 1939; 26 U. S. C. 1952 ed. sec. 3772.) The time for filing suit for the recovery of these taxes, therefore, expired some eight years before the suit was filed in this court, and four years after our decision in *Stephano Bros.* v. *United States*, *supra*.

Whether so long a delay in presenting any claim which plaintiffs may have should be waived by Congress, even if plaintiffs have a valid claim, is of course a matter for Congress to determine.

But, as we will more fully point out in a discussion of the claim on the merits, we do not think plaintiffs' claim can possibly be brought within our decisions in the *Stephano Bros.*, and *Philip Morris* cases, *supra*.

Second. We are further of opinion that the National Distillers Products Corporation is not entitled to recover the taxes paid on this liquor, notwithstanding its destruction. Of course if the National Distillers Products Corporation is not entitled to recover them, the plaintiffs are not entitled to recover, because the only claim they could have is derived from the claim of National Distillers Products Corporation.

Section 2800 of the Internal Revenue Code of 1939 levies a tax on all distilled spirits "produced in or imported into the United States" at a certain rate, "to be paid by the distiller or importer when withdrawn from bond." Subsection (c) of section 2800 provides, "the tax shall attach to the distilled spirits * * * as soon as this substance is in existence as such." Hence, the tax is one on the production of distilled spirits, and not a consumer's tax as plaintiffs insist. This is clearly recognized by the decisions of the Supreme Court in *Thompson* v. *United States*, 142 U. S. 471; *United States* v. *One Ford Coupe*, 272 U. S. 321; and *United States* v. *Rizzo*, 297 U. S. 530, as well as by other cases.

Therefore, at the moment the production of distilled spirits is complete, liability for the tax accrues. However, if spirits are distilled in bond, and kept in a

bonded warehouse for a time, the tax is not payable until they are withdrawn from bond, but at that time the tax must be paid.

Therefore, when the National Distillers Products Corporation withdrew this alcohol from bond, everything had occurred to fix liability for the tax. The amount of that liability had been determined, and the time for payment of the tax had arrived. The tax was paid and the transaction was closed. Anything that happened to the liquor thereafter had no effect on the amount of taxes owing to the Government on account of the production of these liquors.

Although the tax is on the production of the distilled spirits and accrues when production is complete, still, the law makes certain allowances for loss of the liquor after production and while it remains in bond. An allowance is made for leakage or evaporation, or if the liquor is otherwise lost while on the premises of a registered distiller and before deposit in an internal revenue bonded warehouse, or if lost while being transferred between buildings constituting a bonded warehouse, or while being transferred by a common carrier from a distillery to a bonded warehouse, or between bonded warehouses, or if the spirits are withdrawn for use in the fortification of sweet wines, and are lost while stored in bonded winery premises, or if they are lost by theft, or if they are voluntarily destroyed by the distillers because unfit for beverage purposes. In all such cases the Commissioner of Internal Revenue is authorized to abate the tax on the liquor so lost, that is to say, the liability for the tax is extinguished. And, if taxes have been inadvertently paid on spirits so lost, subsection (c) of section 2901, as amended by the Act of April 8, 1942, permits the refund of them. But this, by its terms, refers only to taxes which may have been paid *subsequent to the loss or destruction* of the liquor in the manner set out above. It has no application to a loss of liquor after payment of the tax.

When the spirits have once been withdrawn from the warehouse, and the tax has been paid, no provision is made in the law for loss or destruction of them thereafter. The only provision for refund of taxes paid on spirits lost and destroyed is for spirits lost or destroyed while under bond.

No court had ever held to the contrary until the District Court for the Western District of Kentucky decided *Stitzel-Weller Distillery* v. *United States*, 82 F. Supp. 50, affirmed, 180 F. 2d 357.[1] In this case the court said that recovery might be had for a loss of spirts occurring after the payment of the tax if at the time the liquor was still in the possession and under the supervision of the Government in a bonded warehouse. This was a departure from the opinion that the loss or destruction must have occurred before the tax was paid, and when this decision was called to the attention of Congress, it very promptly added to section 2901(c), providing for refunds, the following:

> Nothing in section 2901, as hereby amended, or as heretofore amended, shall be construed to authorize refund of the tax where the loss occurred after the tax was paid.

This was section 3 of the Act of February 21, 1950, c. 36, 64 Stat. 6.

The Internal Revenue Code of 1954 is quite as explicit. It reads at section 5011(a)(3):

> * * * * * * *
>
> No tax shall be remitted or refunded under this subsection where the loss occurred after the tax was determined (as provided in section 5006 (a)) and the spirits withdrawn from bond.

In short, liability for the tax accrues when production of the distilled spirits is complete, and it is payable when the spirits are withdrawn from bond, less such amount of the tax as may have accrued on spirts lost in certain ways before withdrawal from bond. But after withdrawal from bond and payment of the tax, Congress has expressly forbidden the remission or refund of taxes on spirits thereafter lost or destroyed.

But plaintiff says that section 3113(a) of the Internal Revenue Code of 1939 permits the refund of taxes lost by a casualty or other unavoidable cause occurring during distillation, or redistillation, denaturation, withdrawal, piping, shipment, warehousing, storage, packing, transfer, or recovery, of any such alcohol, and since these spirits were being shipped, it may recover the tax on the spirits lost in this railroad wreck. We are, however, of opinion that all

---

[1] This case does not help plaintiff because it was based on the fact that, while the tax had been paid, the spirits had not been released from bond, and, hence, were still under the control of the Government.

of the processes mentioned in the section refer to processes before the spirits are withdrawn from bond. No court has ever held to the contrary.

Most of the processes mentioned of necessity take place before withdrawal from the bonded warehouse, e. g., distillation, redistillation, denaturation, piping, warehousing, storage. Hence, it would seem to follow that the "shipment" in mind was a shipment from distillery to bonded warehouse, from one building in a bonded warehouse to another, or from one bonded warehouse to another, or any shipment while the spirits were still under bond.

This must be the shipment that was in mind, because the bond is given to secure payment of the tax that has already accrued on the spirits, and when the tax is paid the bond is discharged; the liquors, leaving the custody of the Government, become the property of the owner to do with them what he please, and, of course, at his own risk.

Again, this must be the proper construction of the section, because otherwise it would be in express conflict with section 2901(c), as amended, as we have pointed out above. Congress, of course, did not mean to prohibit the refund by one section, and allow it in a succeeding section of the same statute. In enacting the Internal Revenue Code of 1939 it did not mean to allow a refund of taxes only on spirits lost before the tax was paid, and in a succeeding section allow a refund on account of spirits lost or destroyed both before and after payment of the tax.

This is made quite clear by the 1954 Internal Revenue Code. Section 2901(c) of the 1939 Code appears in the 1954 Code as section 5011(a)(3). This section expressly prohibits the refund of a tax where the loss occurs after the tax is determined and the spirits withdrawn from bond. Section 3113(a) is carried into the 1954 Code as subsection (c) of the same section 5011. Congress could not have intended both to prohibit and to allow the refund by what was said in the same section.

We have no doubt that this is the proper construction of section 3113 (a) of the 1939 Code. But, whether it is or not, this section is of no help to plaintiffs because it is limited to domestic alcohol produced at an industrial alcohol plant.

Chapter 26 of the Internal Revenue Code relates to the tax on liquor. Subchapter A relates to the tax on distilled spirits, subchapter B relates to wines, and subchapter C relates to industrial alcohol. Section 2901, relating to losses of distilled spirits, is contained in subchapter A, containing all the provisions specially applicable to distilled spirits; section 3113 is contained in subchapter C, relating to industrial alcohol.

In the 1954 Code the provisions of both section 2901 and section 3113 are found in section 5011. Section 3113 of the 1939 Code is subsection (c) of section 5011 of the 1954 Code, and this subsection states that it relates to alcohol produced at an industrial alcohol plant.

The distilled spirits produced at the distillery of the National Distillers Products Corporation were not produced at an industrial alcohol plant. The National Distillers Products Corporation produced distilled spirits for beverage purposes.

Third. It is clear that plaintiffs' claim is not covered by our decisions in the *Stephano Bros.*, and *Philip Morris* cases. Recovery of the taxes paid on the tobacco shipped in the *Stephano* case and lost in a railroad wreck was allowed under a provision applicable alone to tobacco, and not to liquor, which permits the redemption of stamps on "tobacco, snuff, cigars, or cigarettes which, after removal from factory or customhouse for consumption or sale, the manufacturer or importer withdraws from the market." We held that the cigarettes lost in this wreck had been withdrawn from the market within the meaning of this statute, 26 U. S. C. 2198; but, as stated, this statute has no application whatever to distilled spirits.

The provisions of the Internal Revenue Code applicable to tobacco have no application to liquor, and the provisions applicable to liquor have no application to tobacco. They have no relation one to another, no analogy, no affinity, no consanguinity; they are not on speaking terms.

The Government raises other defenses to plaintiffs' claim, but we do not discuss them because we are so clearly of the opinion that plaintiffs are not entitled to recover on the merits, irrespective of the statute of limitations. We know of no special considerations which would justify making an allowance to plaintiffs not enjoyed by others in a similar situation.

We are of opinion that the National Distillers Products Corporation has neither a legal nor an equitable claim against the United States, and *a fortiori*, the Erie Railroad Company and the Atlantic Mutual Insurance Company have neither a legal nor an equitable claim against the United States.

This opinion, together with the findings of fact, will be certified to the Congress pursuant to House Resolution 402 of the 84th Congress, 2d Session.

It is so ordered.

WASHINGTON, *Circuit Judge*, sitting by designation; MADDEN, *Judge*; LITTLETON, *Judge*; and JONES, *Chief Judge*, concur.

FINDINGS OF FACT

1. The petition in this case was filed on April 2, 1956 by the Erie Railroad Company and the Atlantic Mutual Insurance Company. Erie seeks to recover $30,000 (plus interest) and Atlantic Mutual seeks to recover $108,182.40 (plus interest) from the United States. These sums equal the amount of the internal revenue tax paid to the United States by another company on a quantity of grain alcohol that was lost in a train wreck.

2. The Erie Railroad Company and the Atlantic Mutual Insurance Company are corporations organized and existing under the laws of the State of New York. They are now, and for long periods of time they have been, engaged in the respective businesses indicated by their corporate names.

3. The proceedings in this court were instituted after the House of Representatives had agreed to H. Res. 402, 84th Congress, on March 6, 1956. That resolution referred H. R. 5918, 84th Congress, to the Court of Claims pursuant to 28 U. S. C. 1492 and 2509, and instructed the court to:

* * * report to the House, at the earliest practicable date, giving such findings of fact and conclusions thereon as shall be sufficient to inform the Congress of the nature and character of the demand, as a claim legal or equitable, against the United States, and the amount, if any, legally or equitably due from the United States to the claimant.

4. H. R. 5918, 84th Congress, provided in pertinent part as follows:

That the Secretary of the Treasury is authorized and directed to pay, out of any money in the Treasury not otherwise appropriated, to the Erie Railroad Company and Atlantic Mutual Insurance Company et al., the sum of $138,182.40 with interest. The payment of such sum shall be in full settlement of all claims against the United States for refund of Federal distilled spirits tax paid on fifteen thousand three hundred fifty-three and sixty one-hundredths proof gallons of grain alcohol owned by National Distillers Products Corporation, and lost from tank car GATX51703 as a result of the derailment of such tank car on June 21, 1945, at Burns, New York. * * *

5. On June 16, 1945, the National Distillers Products Corporation loaded a railroad tank car, numbered GATX51703, at its plant in Peoria, Illinois, with 8,080.90 wine gallons of 190-proof grain alcohol that was eligible to be used for beverage purposes. The 8,080.90 wine gallons of alcohol were the equivalent of 15,353.60 proof gallons. After being loaded, the tank car was delivered to the Nickel Plate Road for transportation by rail via the Nickel Plate Road, the Erie Railroad, and the New Haven Railroad to New England Distillers, Inc., at Clinton, Massachusetts.

6. The carload of alcohol referred to in finding 5 was owned by the National Distillers Products Corporation. The shipment of the alcohol from Peoria did not involve any change in the ownership of the alcohol, as the consignee was to process the alcohol further for a fee and then deliver it to a subsidiary of the National Distillers Products Corporation.

7. (a) The alcohol mentioned in the previous findings had a value of 59½ cents per proof gallon, f. o. b. Peoria, Illinois, or a total value of $9,135.39 for the 15,353.60 proof gallons involved in the shipment.

(b) Prior to the shipment of the alcohol from Peoria, the National Distillers Products Corporation paid to the United States an internal revenue tax on the alcohol at the rate of $9 per proof gallon, or a total amount of $138,182.40 on the 15,353.60 proof gallons involved in the shipment. The payment of the internal revenue tax by the consignor was in accordance with established procedures.

(c) Freight charges in the amount of $412.83 were prepaid by the National Distillers Products Corporation.

8. (a) The carload of alcohol mentioned in the previous findings was covered by a uniform straight bill of lading. It provided in section 1 (among other things) that:

The carrier * * * in possession of any of the property herein described shall be liable as at common law for any loss thereof * * * except * * * any loss * * * caused by the act of God, the public enemy, the authority of law, or the act or default of the shipper or owner, or for natural shrinkage. * * *

(b) It was provided in section 2 of the bill of lading that any claim based on the loss of the property must be filed in writing "within nine months after a reasonable time for delivery has elapsed."

9. (a) While tank car GATX 51703, containing the 8,080.90 wine gallons (15,353.60 proof gallons) of alcohol belonging to the National Distillers Products Corporation, was in transit and in the possession of the Erie Railroad Company, it was derailed as part of a train wreck at Burns, New York, on June 21, 1945. The entire contents of the car were lost as a result of the wreck.

(b) A total of 33 other cars in the same train were derailed along with tank car GATX 51703 in the wreck that is mentioned in paragraph (a) of this finding. The wreck was caused by a broken truck side in one of the cars.

(c) The National Distillers Products Corporation was not indemnified by insurance for the value of the alcohol that was lost in the wreck or for the amount of the internal revenue tax that had been paid on the alcohol.

10. (a) On June 27, 1945, which was six days after the derailment of tank car GATX 51703 and the loss of its contents, the National Distillers Products Corporation loaded another railroad tank car, numbered GATX 15369, with 8,032.50 wine gallons of 190-proof grain alcohol (or 15,261.70 proof gallons) at Cincinnati, Ohio, and consigned it to New England Distillers, Inc., at Clinton, Massachusetts.

(b) The National Distillers Products Corporation paid to the United States an internal revenue tax of $9 per proof gallon on the alcohol that was shipped in tank car GATX 15369, or a total amount of $137,355.30 on the 15,261.70 proof gallons contained in that tank car.

11. On July 31, 1945, the National Distillers Products Corporation filed with the Erie Railroad Company a claim in the total amount of $147,730.62 to cover the value of the alcohol that was lost when tank car GATX 51703 was derailed ($9,135.39), the amount of the internal revenue tax that had been paid on the alcohol ($138,182.40), and the amount of the prepaid freight charges ($412.83). The orginal bill of lading that covered the shipment of the alcohol in tank car GATX 51703 was submitted by National Distillers to Erie along with the former's claim.

12. (a) On December 20, 1945, the National Distillers Products Corporation filed with the District Director of Internal Revenue for the 8th District, Illinois, a claim for the refund of the internal revenue tax in the amount of $138,182.40 that had been paid on the 15,353.60 proof gallons of alcohol lost as a result of the derailment of tank car GATX 51703 on June 21, 1945.

(b) The claim of the National Distillers Products Corporation mentioned in paragraph (a) of this finding was rejected by the Deputy Commissioner of Internal Revenue on January 16, 1946. The reason given by the Deputy Commissioner for the rejection of the claim was that:

There is no provision of law authorizing the refund of internal revenue taxes which have been properly paid on distilled spirits. * * *

13. (a) The claim of the National Distillers Products Corporation against the Erie Railroad Company (see finding 11) was paid by Erie in the full amount of $147,730.62 on March 6, 1946.

(b) Other claims were also filed against and paid by the Erie Railroad Company because of the train wreck mentioned in finding 9. Erie paid out a total of $205,115.46 on all the claims arising out of this wreck, including the claim of the National Distillers Products Corporation.

14. At the time of the train wreck mentioned in finding 9, the Erie Railroad Company was protected by insurance policies in the aggregate amount of $250,000 that covered Erie's legal liability for all damages in excess of $30,000 arising out of that incident. The names of the insurance companies participating in the coverage and the share of the $250,000 coverage provided by each company are shown below:

Coverage for damages in excess of $30,000 and up to $130,000—	
Atlantic Mutual Insurance Co	$25,000
Lloyd's Underwriters	35,000
Fireman's Fund Insurance Co	10,000
Hanover Fire Insurance Co	10,000
Potomac Insurance Co	5,000
Norwich Union Fire Insurance Society, Ltd	7,500
Sun Insurance Office, Ltd	3,000
Providence Washington Insurance Co	4,500
Total	100,000
Coverage for damages in excess of $130,000 and up to $280,000—	
Atlantic Mutual Insurance Co	$37,500
Lloyd's Underwriters	52,500
Fireman's Fund Insurance Co	15,000
Hanover Fire Insurance Co	15,000
Potomac Insurance Co	7,500
Norwich Union Fire Insurance Society, Ltd	6,750
Sun Insurance Office, Ltd	15,750
Total	150,000

15. (a) The insurance policies of the Atlantic Mutual Insurance Company, Fireman's Fund Insurance Company, Hanover Fire Insurance Company, Potomac Insurance Company, Norwich Union Fire Insurance Society, Ltd., Sun Insurance Office, Ltd., and Providence Washington Insurance Company mentioned in finding 14 stated in identical language that each of them covered:

* * * the Legal Liability of the assured [Erie Railroad Company] whether as common carrier * * * or otherwise, under uniform bills of lading * * * for all physical loss, damage or expense to shipments of overy nature and description whatsoever from the time such property becomes at risk of the assured and continuously thereafter during transit or otherwise until the liability of the assured shall have ceased.

(b) It was stated in each of the policies issued by Lloyd's Underwriters that it covered:

Legal Liability of the Assured [Erie Railroad Company] as common carrier * * * or otherwise under uniform bills of lading or shipping receipts for all physical loss damage or expense as per Warranty Company.

16. The insurance policies mentioned in finding 14 provided as follows regarding the subject of subrogation:

The assurers shall be subrogated to all the rights which the assured [Erie Railroad Company] may have against any other person or entity, in respect of any payment made under this policy, to the extent of such payment, and the assured shall, upon the request of the assurers, execute all documents necessary to secure to the assurers such right.[2]

17. (a) After paying out a total of $205,115.46 to shippers, including $147,730.62 to the National Distillers Products Corporation, because of the damages suffered as a result of the train wreck mentioned in finding 9, the Erie Railroad Company submitted claims to the insurance companies for reimbursement under the insurance policies mentioned in finding 14.

(b) Four separate claims, in the respective amounts of $25,000, $17,318.65, $898.84, and $561.38, were submitted by the Erie Railroad Company to the Atlantic Mutual Insurance Company.

(c) In conection with the submission of the claims for $25,000 and $17,318.65 mentioned in paragraph (b) of this finding, the Erie Railroad Company executed documents which (among other things) stated in identical language that:

> In consideration of the payment to be made hereunder WE hereby subrogate to said insurers our right, title and interest in and to the property for which claim is being made hereunder * * *.

[2] There were variations in capitalization and punctuation among the several policies; and the subrogation provision in each policy of the Atlantic Mutual Insurance Company contained the words "claim or" between "any" and "payment." Each policy of Lloyd's Underwriters incorporated by reference the subrogation provision from the related policies of the other companies.

(d) In connection with the submission of the claims for $898.84 and $561.38 mentioned in paragraph (b) of this finding, the Erie Railroad Company executed documents which included the following provision:

In consideration of the payment to be made hereunder, we hereby assign and transfer to the said Insurers each and all claims and demands against any person, persons, corporation or property, arising from or connected with such loss or damage, (and the said Insurer is subrogated in the place of and to the claims and demands of the undersigned against said person, persons, corporation or property in the premises), to the extent of the amount above named * * *.

(e) The evidence does not show whether subrogation provisions similar to those quoted in paragraphs (c) and (d) of this finding were included in any of the documents that the Erie Railroad Company executed in connection with the submission of claims to insurance companies other than the Atlantic Mutual Insurance Company.

18. (a) Payments were made by the several insurance companies to the Erie Railroad Company in the respective amounts indicated below:

Atlantic Mutual Insurance Co	$43,778.87
Lloyd's Underwriters	61,290.41
Fireman's Fund Insurance Co	17,511.55
Hanover Fire Insurance Co	17,511.55
Potomac Insurance Co	8,755.76
Norwich Union Fire Insurance Society, Ltd	10,880.20
Sun Insurance Office, Ltd	10,887.12
Providence Washington Ins. Co	4,500.00
Total	175,115.46

(b) The aggregate reimbursement received by the Erie Railroad Company under its insurance policies lacked $30,000 of covering the total amount that it had paid to shippers, including the National Distillers Products Corporation, because of the damages arising from the train wreck mentioned in finding 9. This is the basis for the claim asserted by the Erie Railroad Company against the United States in the present proceedings.

(c) The share of the Atlantic Mutual Insurance Company in the total of $175,115.46 that was paid by all the interested insurance companies to the Erie Railroad Company amounted to $43,778.87, rather than the amount of $108,182.40 claimed by the Atlantic Mutual Insurance Company in these proceedings.

19. Under the date of October 31, 1956, which was after the filing of the petition in this court, the National Distillers Products Corporation executed a document designated as an "Assignment and Subrogation Agreement". This document provides as follows:

> For and in consideration of the sum of One Dollar ($1.00) the receipt of which is hereby acknowledged, and for further consideration heretofore paid by Erie Railroad Company, we hereby assign to the Erie Railroad Company all rights, title and interest in and to the claim filed with the Internal Revenue Service (Treasury Department) under date of December 20, 1945, covering the refund of One Hundred Thirty Eight Thousand One Hundred Eighty Two Dollars and Forty Cents ($138,182.40) representing tax paid on 15,353.6 proof gallons of distilled spirits (EBP) lost and/or destroyed from tank car GATX 51703 while in transit from our plant in Peoria, Illinois to the New England Distillers Inc. at Clinton, Massachusetts due to a railroad wreck at Burns, New York on June 21, 1945.
>
> This claim was paid in full by Erie Railroad Company on March 4, 1946 to the assignor herein, National Distillers Products Corporation.
>
> In addition to the full assignment given herein, we hereby grant to the Erie Railroad Company full and complete rights of subrogation thereby conveying all rights at law and in equity to maintain suit in the name of Erie Railroad Company or its assigns, agents or representatives, insurance carriers or to any persons nominated by said Erie Railroad Company.

SUBPART B.—RECTIFICATION

SECTION 5021.—IMPOSITION AND RATE OF TAX

26 CFR 235.452: Mixing with other spirits or materials prohibited. Rev. Rul. 58–253

A rectifier has requested permission to redesignate bottled vodka, produced exempt from rectification tax under section 235.450 of the Regulations relating to Rectification of Spirits and Wines, as neutral grain spirits for use as the spirit component in future taxable whisky blends. *Held*, the provisions of section 235.452 of the regulations and Revenue Ruling 55–594, C. B. 1955–2, 700, restricting the classification and use of vodka produced and bottled at a rectifying plant under exemption from the rectification tax, do not preclude the reclassification of the product as neutral spirits for use as such in taxable rectification.

SECTION 5025.—EXEMPTION FROM RECTIFICATION TAX

26 CFR 235.450: Methods of production.

Production of vodka by treating reduced neutral spirits with activated carbon. See Rev. Rul. 58–336, page 588.

26 CFR 235.541: Exemption from rectification tax. Rev. Rul. 58–84

> Imported pure fruit brandies distilled from the same kind of fruit, aged in wood for a period of not less than two years and without the addition of coloring or flavoring material or any other substance except pure water and otherwise meeting the requirements of the regulations, may be blended at a rectifying plant exempt from the rectification tax.

Advice has been requested whether imported brandies may be blended exempt from the rectification tax under section 5025(e) of the Internal Revenue Code of 1954 and section 235.541 of the Regulations relating to the Rectification of Spirits and Wines.

Section 5025(e) of the Code provides, in part, that the rectification tax shall not apply to blends made exclusively of two or more pure fruit brandies distilled from the same kind of fruit, aged in wood for a period not less than two years and without the addition of coloring or flavoring materials (other than caramel) or any other substance than pure water, and if not reduced below 80 proof. It further provides that such blended fruit brandies shall be exempt from the rectification tax *only* when compounded under the immediate supervision of a revenue officer, in such tanks and under such conditions as are prescribed. The procedure and requirements for such blending are contained in sections 235.466 through 235.475, inclusive, of the Regulations relating to the Rectification of Spirits and Wines.

It is held that such blends of pure fruit brandies may be composed either of domestic or imported brandies, or both. Revenue Ruling 54–595, C. B. 1954–2, 460, holds that brandies produced by different dis-

tillers may be so blended. The rectifier so blending imported brandies must furnish the Internal Revenue officer assigned to the rectifying plant a certificate, issued by a duly authorized official of the government of the foreign country in which the brandies were produced, certifying that such brandies were distilled from the same kind of fruit, aged in wood for a period of not less than two years, without the addition of coloring or flavoring material, (other than caramel) or any other substance than pure water, and not reduced below 80 proof. The term "pure fruit brandies" as used in section 5025(e) of the Code is construed to mean brandies distilled from the same kind of fruit, conforming to the limitations stated in section 5.21, Class 4, of the Regulations relating to the Labeling and Advertising of Distilled Spirits.

SUBPART D.—BEER

SECTION 5053.—EXEMPTIONS

26 CFR 245.195: General.

For application as to aircraft engaged in trade between the United States and Hawaii, see Rev. Rul. 58–124, page 606.

---

26 CFR 245.197: Reciprocating foreign countries.

The country of Mexico has been added to the list of reciprocating foreign countries. See Rev. Rul. 58–86, page 592.

Listing of foreign countries for which beer may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Rul. 58–138, page 593.

Listing of foreign countries for which beer may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Rul. 58–319, page 593.

SUBPART E.—GENERAL PROVISIONS

SECTION 5062.—REFUND AND DRAWBACK IN CASE OF EXPORTATION

26 CFR 252.4: Reciprocating foreign countries.

The country of Mexico has been added to the list of reciprocating foreign countries. See Rev. Rul. 58–86, page 592.

Listing of foreign countries for which liquors may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Rul. 58–138, page 593.

Listing of foreign countries for which liquors may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Rul. 58–319, page 593.

---

26 CFR 252.55: Bottle export stamps. Rev. Rul. 58–85
(Also 252.140; Section 5114; 194.270.)

The Regulations relating to Liquor Dealers, the Regulations relating to Drawback, and other pertinent regulations, as amended by Treasury Decision 6244, C. B. 1957–2, 931, and Treasury Decision 6245, C. B. 1957–2, 938, authorize wholesalers, qualified as such under the Federal Alcohol Administration Act, to establish export storage facilities on their premises and to receive, transfer, and remove taxpaid bottled distilled spirits and taxpaid bottled or packaged wine, bottled or packaged especially for exportation, including use as supplies on vessels and aircraft and transfers to a foreign-trade zone. Under such regulations, the wholesalers are also authorized to file claims for drawback on these products when exported. *Held*, distilled spirits bottled, and wines bottled or packaged, especially for export with benefit of drawback may be shipped by a rectifier or bottler to a public warehouse operated by a properly qualified wholesaler at a coastal port for storage prior to exportation. A wholesaler who purchases and so stores such distilled spirits or wines may file claim for drawback in his own name, upon exportation thereof. If title to the spirits or wine stored in the coastal port remains with the inland shipper (rectifier or bottler), the claim for drawback may be filed by such inland shipper. In either case, the claim must be filed with the Assistant Regional Commissioner, Alcohol and Tobacco Tax, of the region in which the coastal port is located.

Rev. Rul. 58–316

Section 252.55 of the Regulations relating to Drawback on Liquors Exported requires that red strip stamps be overprinted for use as export stamps and that such overprinting be accomplished by printing in black ink the word "EXPORT" in boldface 8-point century or gothic type in the center of the stamp between the words "bottle" and "stamp." *Held*, a rubber stamp with the word "EXPORT" in letters in the size type prescribed by the regulations and impregnated with permanent black ink may be used for imprinting the word "EXPORT" on the red strip stamps in lieu of overprinting.

---

26 CFR 252.140. Claim.

For the filing of claims for drawback upon removal of spirits from wholesaler coastal storage, see Rev. Rul. 58–85, above.

PART II.—OCCUPATIONAL TAX

SUBPART C.—MANUFACTURERS OF STILLS

SECTION 5101.—IMPOSITION AND RATE OF TAX

26 CFR 196.28: Materials or apparatus procured and converted into distilling apparatus. Rev. Rul. 58-30

The construction of a completely new and different still, by a distiller, from various parts of distilling apparatus not separately subject to tax, with the intent that the still is to be used for distilling, subjects the distiller to liability for the special (occupational and commodity) taxes imposed upon manufacturers of stills.

Advice has been requested whether the construction, by a distiller, of a still from a number of sections of a beer still and a number of sections of a rectifying column subjects the distiller to liability for the special (occupational and commodity) taxes as a manufacturer of stills.

In the instant case, the distiller combined several sections of a beer still with sections of a rectifying column to create a beer still intended for use in distilling. Although all of the parts used in constructing the still were taken from units originally purchased from the same company, they are parts of two entirely different units, *i. e.*, parts of a beer still and parts of a rectifying column. There is no evidence of payment of the commodity taxes in connection with any of the separate parts used in constructing the still.

Section 5101 of the Internal Revenue Code of 1954 provides a special occupational tax and a special commodity tax on the manufacture of "each still or worm for distilling." Section 5102 thereof and section 196.25 of the Regulations relating to Stills define a manufacturer of stills as "any person who manufactures any still or worm to be used in distilling."

Section 196.27 of the regulations provides that if separate parts of a *complete* still or worm or condenser, of any kind, are furnished by the same manufacturer to a distiller, or other person, who assembles the same into a still or worm or condenser for distilling, the manufacturer of the parts will incur liability for the special (occupational and commodity) taxes imposed upon manufacturers of stills. Section 196.28 thereof provides that if a distiller or other person procures materials or apparatus, which are not separately subject to the tax, and converts them into a still or worm or condenser for distilling, he (the distiller) will incur liability for the special taxes.

Section 220.790 of the Regulations relating to the Production of Distilled Spirits provides, among other things, that whenever distillers manufacture or reconstruct stills or worms, they must comply with the Regulations relating to Stills governing the payment of special and commodity taxes.

It is held that where a distiller constructs a completely new or different still from various parts of distilling apparatus not separately subject to tax, with the intent that the still is to be used for distilling, as in the instant case, the distiller incurs liability for the special (occupational and commodity) taxes imposed upon manufacturers

of stills. Since the completed still contains parts of entirely separate units, although such units were originally purchased from the same company, the provisions of section 196.27 are not applicable.

SUBPART D.—WHOLESALE DEALERS

SECTION 5114.—RECORDS

26 CFR 194.270: General.

For requirements with respect to spirits stored by wholesalers pending exportation, see Rev. Rul. 58–85, page 583.

SUBPART E.—RETAIL DEALERS

SECTION 5123.—EXEMPTIONS

26 CFR 194.193: Sales of entire stock by retail liquor dealer in liquidation. (Also 194.194.) — Rev. Rul. 58–217

Section 5123(c) of the Internal Revenue Code of 1954 provides that the special tax as a wholesale dealer in liquors or wholesale dealer in beer shall not apply to a retail dealer in liquors or a retail dealer in beer because of such retail dealer selling out his entire stock of liquors in one parcel, or in parcels embracing not less than his entire stock of distilled spirits, wines, or beer. *Held*, where a retail dealer discontinues business during a fiscal year for which he has paid special tax and in the next fiscal year, in liquidating his business, sells out his entire stock of liquors in one parcel, or in parcels embracing not less than the entire stock of distilled spirits, or wine, or of beer, it is not necessary that he pay special tax as either a retail or wholesale dealer. The selling of the stock in liquidation, within the stated limitations, does not constitute engaging in the business of selling alcoholic liquors and is regarded as being within the exemption granted by section 5123 (c) of the Code.

For a similar ruling with respect to the discontinuance of business as a wholesale dealer in liquors during one fiscal year and the liquidation of stock in the succeeding fiscal year, see Revenue Ruling 55–634, C. B. 1955–2, 697. The exemption from special tax specified in this Revenue Ruling and in Revenue Ruling 55–634, *supra*, applies only to liquidating the business in the fiscal year following that in which the business was discontinued.

---

26 CFR 194.194: Sales of entire stock by retail beer dealer in liquidation.

For the liquidation of stocks in the year following that in which business was discontinued, see Rev. Rul. 58–217, above.

SUBPART F.—NONBEVERAGE DOMESTIC DRAWBACK CLAIMANTS

SECTION 5131.—ELIGIBILITY AND RATE OF TAX

26 CFR 197.96: Products not requiring formulas. (Also 197.109.) Rev. Rul. 58–317

The distilled spirits used in Low-Alcoholic Elixir are eligible for drawback of tax under section 5131 of the Internal Revenue Code of 1954 when the elixir is manufactured. The distilled spirits used in High-Alcoholic Elixir are not eligible for drawback except when such elixir is used, as an intermediate, in the manufacture of a product under an approved formula.

Advice has been requested as to the eligibility for drawback of tax on distilled spirits used in the manufacture of High-Alcoholic Elixir and Low-Alcoholic Elixir which are produced under official formulas appearing on page 310 of the National Formulary, Tenth Edition, under the heading "Iso-Alcoholic Elixir."

Section 5131 of the Internal Revenue Code of 1954 makes provision for the limited drawback of tax paid on distilled spirits used in the manufacture or production of medicines, medicinal preparations, food products, flavors, or flavoring extracts which are unfit for beverage purposes.

Section 197.96 of the Regulations relating to Drawback on Distilled Spirits Used in Manufacturing Nonbeverage Products provides that quantitative formulas need not be submitted for products which are medicinal preparations, tinctures, or fluid extracts produced under formulas prescribed by, among others, the National Formulary if such products are identified, in the supporting statement to the drawback claim, by the name of the product followed by the letters "N.F."

Both types of elixir referred to are flavoring agents used primarily as flavored alcoholic vehicles in the manufacture of medicinal preparations. Tests have shown that the Low-Alcoholic Elixir is nonbeverage in character. Accordingly the distilled spirits used therein are eligible for drawback of tax. However, similar tests have shown that the High-Alcoholic Elixir is beverage in character. Therefore, the distilled spirits used therein are not eligible for drawback of tax upon manufacture of the product as such, but would be eligible for drawback only if the High-Alcoholic Elixir is used as an intermediate product in the manufacture of a nonbeverage finished product under an approved formula, as provided in section 197.95 of the regulations.

---

26 CFR 197.109: Information to be shown by the claim.

For eligibility for drawback of tax on distilled spirits used in the manufacture of High-Alcoholic Elixir and Low-Alcoholic Elixir, see Rev. Rul. 58–317, above.

SECTION 5132.—REGISTRATION AND REGULATION

26 CFR 197.95: Products requiring formulas. Rev. Rul. 58–123

The purpose of this Revenue Ruling is to restate Revenue Ruling 56–337, C. B. 1956–2, 1025, relative to the filing of formulas by a successor proprietor in the case of a change in proprietorship of a nonbeverage manufacturer, in order to clarify the intent of the Internal Revenue Service with respect to the disposition to be made of affidavits filed for the purpose of adopting formulas of the predecessor proprietor.

Where there is a change in the proprietorship of a nonbeverage manufacturer and the successor desires to use the formulas filed by the predecessor, he must (1) submit new formulas in his name on Form 1678, Formula and Process for Nonbeverage Product, to replace those submitted by the predecessor, or (2) adopt the formulas already on file by the submission of an affidavit to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, stating that the preparations covered by formulas submitted by the prior ownership, and on file with the Internal Revenue Service, will be manufactured in accordance with such approved formulas and processes. The affidavit should be prepared in quadruplicate and should identify the formulas by serial numbers and names of products. One copy of the affidavit will be retained by the nonbeverage product manufacturer. The Assistant Regional Commissioner will retain the original affidavit and one copy and will forward one copy to the Director, Alcohol and Tobacco Tax Division.

This Revenue Ruling supersedes Revenue Ruling 56–337, *supra.*

SUBPART G.—GENERAL PROVISIONS

SECTION 5144.—PROVISIONS RELATING TO LIABILITY FOR OCCUPATIONAL TAXES

Rev. Rul. 58–20

Section 5144(c) of the Internal Revenue Code of 1954, with certain exceptions not here pertinent, provides that payment of the special tax shall not exempt from an additional special tax the person carrying on a trade or business in any other place than that stated in the register of the principal collection officer in such district. "Place of business" is defined therein as "the entire office, plant, or area of the business in any one location under the same proprietorship, and passageways, streets, highways, rail crossings, waterways, or partitions dividing the premises shall not be deemed sufficient separation to require additional special tax, if the various divisions of the premises are otherwise contiguous." *Held*, where various hotels and stores are operated in specifically assigned and widely separated locations of a National park and, although under the same proprietorship, are not contiguous or operated essentially at one place of business, they cannot be considered as one place of

business as defined in section 5144(c) of the Code or as coming within the terms of the statute allowing the payment of but one special tax. Accordingly, special tax of the proper class is due at each location within the park where alcoholic liquors are sold.

SUBCHAPTER B.—DISTILLERIES

PART II.—OPERATION

SECTION 5193.—DRAWING, GAUGING, AND MARKING OF DISTILLED SPIRITS

26 CFR 220.548a: Whisky for experimental storage.

Proof at which distiller may withdraw whisky for experimental storage with identification of barrels on gauge report, subsequent transfer, and withdrawal forms. See T. D. 6290, page 590.

SECTION 5194.—TRANSFER OF SPIRITS AT REGISTERED DISTILLERIES

26 CFR 220.554: Vodka. Rev. Rul. 58–336
(Also Section 5025; 235.450.)

Vodka may be produced by a distiller from neutral spirits by the extractive distillation process under authority of section 220.554(c) of the Regulations relating to the Production of Distilled Spirits. Vodka may be produced by a distiller or a rectifier by the treatment of neutral spirits of 110 degrees of proof with one ounce of activated carbon for each 100 gallons of reduced spirits processed provided the neutral spirits, prior to reduction in proof, meet specified conditions.

Advice has been requested whether vodka may be produced by extractive distillation and also by the treatment of neutral spirits of 110 degrees of proof with activated carbon.

Extractive distillation is considered a suitable process for producing vodka under section 220.554(c) of the Regulations relating to the Production of Distilled Spirits, from neutral spirits after reduction of the distillate to not more than 110 degrees of proof and not less than 80 degrees of proof, provided the neutral spirits are subsequently redistilled to not less than 190 degrees of proof and then reduced to the prescribed vodka proof, prior to packaging and withdrawal.

Distillers desiring to employ extractive distillation in the production of vodka should submit to the Director, Alcohol and Tobacco Tax Division, a statement of their extractive distillation process together with a sample of the vodka produced by such process.

Distillers and rectifiers may use neutral spirits of not less than 190 degrees of proof and meeting the following specifications in the production of vodka under section 220.554(c) of the distilled spirits regulations and section 235.450(c) of the Regulations relating to the Rectification of Spirits and Wines, by treating the spirits, after reduc-

tion to vodka proof, with one ounce of activated carbon for each 100 gallons of reduced spirits processed:

Proof	190 degrees or more.
Color	Colorless.
Odor and taste	No foreign odor or taste.
Solids	Less than 2 grams per 100 liters.
Acids	Less than 2 grams per 100 liters.
Esters	Less than 2 grams per 100 liters.
Aldehydes	Less than 2 grams per 100 liters.
Fusel oil	Less than 2 grams per 100 liters.
Permanganate time (Alcohol and Tobacco Tax Division test procedure).	Not less than 20 minutes.
Optical purity	In a 1 cm. cell light absorbance shall be less than 0.1 at 250 millimicrons.

A sample of the neutral spirits to be used in the production of vodka should be submitted to the Director, Alcohol and Tobacco Tax Division, attention of the Laboratory Division, for testing for compliance with the above specifications.

PART III.—GENERAL PROVISIONS RELATING TO DISTILLERIES AND DISTILLED SPIRITS

SECTION 5212.—PREVENTION AND DETECTION OF FRAUD

26 CFR 182.405: Gauging of alcohol.

For the sampling of bulk spirits at the time of gauge for taxpayment, see Rev. Proc. 58–4, page 687.

---

26 CFR 216.196: Details of gauge, Form 577. Rev. Rul. 58–21

Section 216.196 of the Regulations relating to the Denaturation of Rum provides, in part, that denatured rum may be withdrawn into weighing tanks for transfer into tank cars or tank trucks for immediate shipment. Such provision is permissive rather than mandatory. In this respect, the gauging of denatured rum for removal by tank car or tank truck is analogous to the gauging of denatured alcohol which, under Revenue Ruling 54–525, C. B. 1954–2, 461, may be accurately gauged either by weight or by volume. *Held*, proprietors of distillery denaturing bonded warehouses providing suitable facilities for accurately gauging the denatured rum by volume, satisfactory to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, may effect such gauge by volume for removal of the denatured rum in tank cars or tank trucks and, in such case, weighing tanks for this purpose will not be required.

---

26 CFR 220.536: Gauging of spirits.

For the sampling of bulk spirits at the time of gauge for taxpayment, see Rev. Proc. 58–4, page 687.

26 CFR 225.632: Gauge and taxpayment.

For the sampling of bulk spirits at the time of gauge for taxpayment, see Rev. Proc. 58–4, page 687.

SECTION 5214.—REGULATION OF TRAFFIC IN CONTAINERS OF DISTILLED SPIRITS

26 CFR 175.34: Indicia for domestic liquor bottles. (Also 175.62, 175.87.) Rev. Rul. 58–318

Section 175.34 of the Regulations relating to Traffic in Containers of Distilled Spirits, with respect to domestic liquor bottles, and section 175.87 thereof, with respect to imported liquor bottles, require certain identifying indicia to be placed on each liquor bottle, as for example, the permit number of the manufacturer, symbol and number representing the name of the bottler, etc. Such sections also require that the words "Federal Law Forbids Sale or Reuse of This Bottle" be placed on each bottle. Section 175.62 of the regulations provides in part that no bottler shall use any liquor bottle except in connection with the sale of its contents. *Held*, empty bottles which bear the reuse clause but which do not contain indicia of the bottler do not fulfill the requirements for a liquor bottle under the regulations since the full indicia required would not be shown. Accordingly, such bottles may be used for display purposes without being drilled or without having the reuse clause obliterated, provided they are clearly marked as display bottles and the contents are properly identified. Such display bottles may not bear strip stamps. However, the use of a border or a design on a display stamp formed entirely of the printed words of the legend "Not genuine—for display purposes only" may be permitted. As an alternative, a plain strip of paper, of such color (one only) as the bottler may desire, may be used.

---

26 CFR 175.42: Net contents. T. D. 6290[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PARTS 175, 220, 230, 231, 235 AND 240.

Amendments relating to distilled spirits and wine

(Also Section 5193; 220.548a.)

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

In order to conform with the requirements of 27 CFR Parts 4 and

[1] 23 F. R. 2179.

5, with respect to the withdrawal proof of whisky and to the labeling of wine and distilled spirits, 26 CFR Parts 175, 220, 230, 231, 235, and 240 are amended as follows:

PARAGRAPH 1. 26 CFR Part 175, "Traffic in Containers of Distilled Spirits," is amended by striking from section 175.42 the phrase, "legibly marked, in the manner prescribed in section 175.34, in the bottles" and inserting in lieu thereof the phrase "marked on the side of the bottle in the manner prescribed in section 175.34."

PAR. 2. 26 CFR Part 220, "Production of Distilled Spirits," is amended by adding immediately after section 220.548 the following new section.

§ 220.548a WHISKEY FOR EXPERIMENTAL STORAGE.—The distiller may, prior to July 1, 1960, withdraw from the cistern room for experimental storage a maximum of 1,000 barrels of whisky at above 110 degrees of proof but at not more than 160 degrees of proof. Such whisky, notwithstanding the provisions of § 220.548, may, under the provisions of 27 CFR 5.21 (b), be given the designation to which it would have been entitled but for the fact that it was withdrawn at over 110 degrees of proof. The report of gauge and subsequent transfer and withdrawal forms covering such whisky shall have noted thereon that the whisky was withdrawn for experimental storage and the proof of the spirits. Such notation shall be in the following form:

"Withdrawn for experimental storage at——degrees of proof."

PAR. 3. 26 CFR Part 230, "Bottling of Taxpaid Spirits," is amended by deleting from the second sentence of § 230.206, which begins "Each bottle", the phrase "unless legibly blown in the bottle" and inserting in lieu thereof the phrase "unless displayed on the bottle as provided in 27 CFR 4.37 (d)".

PAR. 4. 26 CFR Part 231, "Taxpaid Wine Bottling Houses", is amended by deleting from paragraph (d) of § 231.82 the phrase "unless legibly blown in the bottle" and inserting in lieu thereof the phrase "unless displayed on the bottle as provided in 27 CFR 4.37 (d)".

PAR. 5. 26 CFR Part 235, "Rectification of Spirits and Wine", is amended by deleting from the second sentence of § 235.631, which begins "Each bottle", the phrase "unless legibly blown in the bottle" and inserting in lieu thereof the phrase "unless displayed on the bottle as provided in 27 CFR 4.37 (d)".

PAR. 6. 26 CFR Part 240, "Wine", is amended by deleting from paragraph (d) of section 240.579 the phrase "unless legibly blown in the bottle" and inserting in lieu thereof the phrase "unless displayed on the bottle as provided in 27 CFR 4.37 (d)".

The provisions of this Treasury Decision were considered at public hearings on proposals similarly to amend Title 27, Code of Federal Regulations, and no objections were made thereto. Therefore, because this Treasury Decision merely conforms the regulations to which it applies to those changes made after notice and public hearing, it is hereby found unnecessary to issue the Treasury Decision with notice and public procedure thereon under section 4(a), or subject to the effective date limitation of section 4(c), of the Administrative Procedure Act, approved June 11, 1946. Accordingly, this Treasury Decision shall be effective on the date of publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code (68A Stat. 917; 26 U. S. C. 7805).)

RUSSELL C. HARRINGTON,
Commissioner.

Approved March 28, 1958.

DAN THROOP SMITH,
Deputy to the Secretary of the Treasury.

(Filed by the Division of the Federal Register on April 2, 1958, at 8:52 a. m., and published in the issue of the Federal Register for April 3, 1958, 23 F. R. 2179.)

---

26 CFR 175.62: Use and resale of liquor bottles.

For restrictions on the use of bottles for display purposes see Rev. Rul. 58–318, page 590.

---

26 CFR 175.87: Indicia for empty liquor bottles.

For restrictions on the use of bottles for display purposes see Rev. Rul. 58–318, page 590.

SUBCHAPTER C.—INTERNAL REVENUE BONDED WAREHOUSES

PART II.—OPERATION

SECTION 5248.—WITHDRAWAL OF SPIRITS WITHOUT PAYMENT OF TAX

26 CFR 182.630b: Reciprocating foreign countries. (Also 225.861; Sections 5053, 5062, 5362; 245.197, 252.4, 240.691.) — Rev. Rul. 58–86

Alcohol, distilled spirits, wine, and beer may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft registered in the country of Mexico and actually engaged in foreign trade or trade between the United States and its possessions, where trade by foreign aircraft is permitted. Accordingly, Revenue Ruling 54–576, C. B. 1954–2, 472, as modified by Revenue Ruling 55–362, C. B. 1955–1, 577, Revenue Ruling 55–741, C. B. 1955–2, 702, and Revenue Ruling 56–81, C. B. 1956–1, 746, is further modified to include the country of Mexico.

As so modified, the Revenue Ruling reads as follows:

Under the provisions of section 309 of the Tariff Act of 1930, as amended, 46 Stat. 690, as amended, 19 U. S. C. 1309, Sections 5053 and 5056 of the Internal Revenue Code of 1954 and applicable regulations of the Internal Revenue Service, alcohol, distilled spirits, beer and wine may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft registered in the following foreign countries and actually engaged in foreign trade or trade between the United States and its possessions, where trade by foreign aircraft is permitted.

Australia	Brazil	Ecuador
Bahama Islands	Canada	France
Belgium	Costa Rica	Germany, Federal Republic of
Bermuda	Denmark	

Israel	Mexico	Sweden
Italy	The Netherlands	Switzerland
Japan	Norway	United Kingdom
Lebanon	Peru	

(Also 225.861; Sections 5053, 5062, 5362; 245.197, 252.4, 240.691.) Rev. Rul. 58–138

Under the provisions of section 309 of the Tariff Act of 1930, as amended, 46 Stat. 690, as amended, 19 U. S. C. 1309, sections 5053 and 5056 of the Internal Revenue Code of 1954, and applicable regulations of the Internal Revenue Service, alcohol, distilled spirits, beer, and wine may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft registered in the following foreign countries and actually engaged in foreign trade or trade between the United States and its possessions, where trade by foreign aircraft is permitted:

Australia	Dominican Republic	Lebanon
Bahama Islands	Ecuador	Mexico
Belgium	France	The Netherlands
Bermuda	Germany, Federal	Norway
Brazil	Republic of	Peru
Canada	Israel	Sweden
Costa Rica	Italy	Switzerland
Denmark	Japan	United Kingdom

This Revenue Ruling, which adds the Dominican Republic to lists as previously published, supersedes Revenue Rulings 54–576, C. B. 1954–2, 472; 55–362, C. B. 1955–1, 577; 55–741, C. B. 1955–2, 702; 56–81, C. B. 1956–1, 746; and 58–86, page 592.

(Also 225.861; Sections 5053, 5062, 5362; 245.197, 252.4, 240.691.) Rev. Rul. 58–319

Under the provisions of section 309 of the Tariff Act of 1930, as amended, 46 Stat. 690, as amended, 19 U. S. C. 1309, and sections 5053 and 5056 of the Internal Revenue Code of 1954, and applicable regulations of the Internal Revenue Service, alcohol, distilled spirits, beer, and wine may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft registered in the following foreign countries and actually engaged in foreign trade or trade between the United States and its possessions, where trade by foreign aircraft is permitted:

Australia	Ecuador	The Netherlands
Bahama Islands	France	Norway
Belgium	Germany, Federal	Peru
Bermuda	Republic of	Spain
Brazil	Israel	Sweden
Canada	Italy	Switzerland
Costa Rica	Japan	United Kingdom
Denmark	Lebanon	
Dominican Republic	Mexico	

This Revenue Ruling, which adds Spain to lists as previously published, supersedes Revenue Ruling 58–138, above.

26 CFR 225.860: General.

For application as to aircraft engaged in trade between the United States and Hawaii, see Rev. Rul. 58–124, page 606.

---

26 CFR 225.861: Reciprocating foreign countries.

The country of Mexico has been added to the list of reciprocating foreign countries. See Rev. Rul. 58–86, page 592.

Listing of foreign countries for which distilled spirits may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Rul. 58–138, page 593.

Listing of foreign countries for which distilled spirits may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Rul. 58–319, page 593.

SUBCHAPTER E.—INDUSTRIAL ALCOHOL PLANTS, BONDED WAREHOUSES, DENATURING PLANTS, AND DENATURATION

PART I.—INDUSTRIAL ALCOHOL PLANTS, BONDED WAREHOUSES, AND DENATURING PLANTS

SECTION 5304.—ALCOHOL PERMITS

26 CFR 182.661: Hospitals, sanitariums, or clinics.

For instructions covering the receipt, storage, and reporting of alcohol obtained from the General Services Administration by permittees using tax-free alcohol, see T. D. 6283, page 601.

SECTION 5310.—WITHDRAWAL OF ALCOHOL FREE OF TAX

26 CFR 182.61: Construction. Rev. Rul. 58–207

Users of tax-free alcohol must provide a storeroom or compartment for the storage of tax-free alcohol possessed by authority of permits issued in accordance with the Industrial Alcohol Regulations. The storerooms or compartments must be of sufficient capacity to hold the maximum quantity of alcohol which may be possessed at any one time and shall be securely constructed of substantial materials, and all doors, windows, and other openings shall be equipped so that they may be securely locked. See section 182.61 of the regulations. *Held*, the regulations do not require that hospital storerooms, compartments or vaults, set aside for the storage of tax-free alcohol, be used exclusively for such purpose. These storerooms, compartments or vaults, may also be used for the storage of drugs, flammable liquids and other hospital supplies requiring security. However, the tax-

free alcohol must be properly segregated from the other supplies and such storage of other supplies should not interfere with the proper accounting and safety of the tax-free alcohol as contemplated by the regulations, to be determined in any case by the Assistant Regional Commissioner.

PART II.—DENATURATION

SECTION 5331.—WITHDRAWAL FROM BOND FREE OF TAX

26 CFR 182.860: General. Rev. Rul. 58–31

Section 182.860(h) of the Industrial Alcohol Regulations provides, in part, that persons authorized to purchase products for resale, such as bay rum, lilac vegetal, hair lotions, skin lotions, perfumes, etc., made with specially denatured alcohol, under conditions prescribed therein, shall keep Record 134, Record of Specially Denatured Alcohol Articles, in the same manner as manufacturers, as provided in section 182.875. Such latter section provides that a true and correct sales record shall be kept on Record 134 of all articles manufactured, or received from others for reprocessing, bottling, repackaging, and/or resale, and of the disposition of all such articles. *Held*, Record 134 must be kept by all persons required to do so by sections 182.860 and 182.875 of the regulations. The fact that the products may be produced or purchased under one trade name and sold under another does not obviate the necessity of the record keeping. For example, a manufacturer of products made with specially denatured alcohol who makes such products under the name shown on his permit and charges off the articles to the sales department operated under a different name must keep a record of such articles upon the sale thereof by the sales department.

---

26 CFR 212.16(c): Standard proprietary solvents formulations using S. D. A. No. 1.

For the filing of new formulas to use rubber hydrocarbon solvent in proprietary solvents formulations and to make bay rum, alcoholado, or alcoholado type toilet waters, see Rev. Proc. 58–5, page 688.

---

26 CFR 212.44(a): Formula. T. D. 6284 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 212.—FORMULAS FOR DENATURED ALCOHOL

Amendments relating to the use of ethyl acetate

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On December 19, 1957, a notice of proposed rule making with respect to the amendment of the regulations in 26 CFR Part 212 was

[1] 23 F. R. 1198.

published in the Federal Register (22 F. R. 10222). The proposed amendments would provide for the use of ethyl acetate having an ester content of 100 percent by weight or equivalent.

In accordance with the notice, interested parties were afforded an opportunity to submit written data, views, or arguments pertaining thereto. No written comments were received within the period of 30 days prescribed. Accordingly, the amendments so published are hereby adopted.

In order to provide for the use of ethyl acetate having an ester content of 100% by weight or equivalent, 26 CFR Part 212 is amended as follows:

PARAGRAPH 1. Section 212.44 (a) is amended by striking the words "Thirty-five gallons of ethyl acetate" and substituting in lieu thereof the words "29.75 gallons of ethyl acetate having an ester content of 100% by weight or the equivalent thereof not to exceed 35 gallons of ethyl acetate with an ester content of not less than 85% by weight."

PAR. 2. Section 212.45 (a) is amended by striking the number "4.26" and substituting in lieu thereof the number "4.25".

This Treasury Decision shall be effective on the first day of the first month which begins not less than 30 days after the date of publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U. S. C. 7805).)

RUSSELL C. HARRINGTON,
Commissioner.

Approved February 21, 1958.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on Feb. 25, 1958, at 8:49 a. m., and published in the issue of the Federal Register for Feb. 26, 1958, 23 F. R. 1198.)

---

26 CFR 212.57: Formula No. 40. (Also 212.65.) Rev. Rul. 58–290

Section 212.57 of the Regulations relating to Formulas for Denatured Alcohol prescribes the use of brucine (alkaloid) or brucine sulfate in specially denatured alcohol Formula No. 40. However, as a result of a critical shortage of brucine and in accordance with the provisions of section 212.65 of the regulations, quassin, denaturing grade, in the amount of 1.5 avoirdupois ounces to each 100 gallons of ethyl alcohol, is authorized as a substitute denaturant for brucine (alkaloid) or brucine sulfate in the production of specially denatured alcohol Formula No. 40. Basic data concerning quassin are as follows:

Basic Data

Quassin—The bitter principle of quassia wood (occurring as a mixture of two isomeric forms).

Specifications—Quassin, Denaturing Grade. This shall be a good commercial grade of purified amorphous quassin, standardized as to bitterness by the following method:

When 0.4 gram is added to 20 ml of ethyl alcohol it shall dissolve completely. When 0.2 ml of this solution, measured from a burette is made up to 1 liter with water, the mixture shall have a distinctly bitter taste.

Identification Test—Dissolve about 0.5 gram quassin, denaturing grade, in 10 ml of 95 percent ethyl alcohol and filter. To 5 ml of the filtrate add 5 ml of concentrated hydrochloric acid and 1 mg phloroglucinol and mix well. A red color develops.

Optical Assay—When 1 gram of quassin, denaturing grade, is dissolved in 10,000 ml of water, the absorbance of the solution in a 1 cm. cell at a wavelength of 258 millicrons shall be not less than 0.550 (for convenience of solution initially dissolve the quassin in a small amount of 95 percent alcohol).

---

26 CFR 212.65: General.

For use of quassin, denaturing grade, in lieu of brucine in specially denatured alcohol Formula No. 40, see Rev. Rul. 58–290, page 596.

---

26 CFR 212.78: Ethyl acetate. Rev. Rul. 58–22

The formula requirements for standard proprietary and special industrial solvents are met when sufficient amounts of ethyl acetate having an ester content greater than 85 percent are used to produce a proprietary or special industrial solvent having the same composition as called for by the standard proprietary or special industrial solvent formula. Approved formulas on Form 1479–A, Formula for Preparation Made With Specially Denatured Alcohol, covering proprietary and special industrial solvent formulas are not required to be amended to show the use of ethyl acetate of higher ester content.

SUBCHAPTER F.—BONDED AND TAXPAID WINE PREMISES

PART II.—OPERATIONS

SECTION 5362.—REMOVALS OF WINE FROM BONDED PREMISES

26 CFR 240.690: Withdrawal free of tax.

For application as to aircraft engaged in trade between the United States and Hawaii, see Rev. Rul. 58–124, page 606.

---

26 CFR 240.691: Reciprocating foreign countries.

The country of Mexico has been added to the list of reciprocating foreign countries. See Rev. Rul. 58–86, page 592.

Listing of foreign countries for which wines may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Rul. 58–138, page 593.

Listing of foreign countries for which wines may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Rul. 58-319, page 593.

SECTION 5368.—GAUGING, MARKING, AND STAMPING

26 CFR 240.173: Other equipment, instruments and measures. Rev. Rul. 58-87

Section 240.173 of the Wine Regulations provides, in part, that the proprietor of a bonded wine cellar must provide appropriate and accurate instruments and measures for the testing and measuring of wine, including in all cases equipment for determining the alcohol content and volume of wine removed. *Held*, although section 240.981 and following sections of the regulations specifically relate to the use and care of the ebulliometer for determining the alcohol content of wine, it is not intended that the use of other suitable and accurate methods be precluded. Accordingly, under the authority of section 240.173 other scientifically sound and widely accepted methods may be used, including alcohol determination by means of the pycnometer, refractometer, hydrometer, and oxidation procedures, provided an accurate determination of the alcohol content of the wine may be obtained by such methods.

PART III.—CELLAR TREATMENT AND CLASSIFICATION OF WINE

SECTION 5382.—CELLAR TREATMENT OF NATURAL WINE

26 CFR 240.529: Materials authorized for treatment of wine. Rev. Rul. 58-39

The use of SAF Cation Exchange Resin and SAF Anion Exchange Resin in a continuous column process, for the stabilization of wines is considered as being consistent with good commercial practice and may be approved for use by winemakers by Assistant Regional Commissioners, Alcohol and Tobacco Tax, pursuant to the provisions of section 240.530 of the Wine Regulations. The cation exchange resin must be essentially in the sodium state so that certain of the metallic elements in the wine will be replaced with sodium ions. After regeneration and before reuse the resin must again be essentially in the sodium state. The overall change in the pH of the wine before and after treatment with cation exchange resin shall not be greater than 0.2 pH units. The fixed acids of wines treated with anion exchange resin may not be reduced below 0.5 gram per 100 milliliters and the resin shall be in the (OH) state when used initially or after regeneration.

Revenue Ruling 55-603, C. B. 1955-2, 709, containing a list of materials which have been approved for the treatment of wine, is hereby modified accordingly. Other Revenue Rulings approving additional materials are as follows:

Revenue Ruling 56-9, C. B. 1956-1, 750;
Revenue Ruling 56-64, C. B. 1956-1, 751;

Revenue Ruling 56–341, C. B. 1956–2, 1042;
Revenue Ruling 56–415, C. B. 1956–2, 1042;
Revenue Ruling 56–551, C. B. 1956–2, 1043;
Revenue Ruling 56–626, C. B. 1956–2, 1043;
Revenue Ruling 57–175, C. B. 1957–1, 608;
Revenue Ruling 57–306, C. B. 1957–2, 967;
Revenue Ruling 57–417, C. B. 1957–2, 968; and
Revenue Ruling 57–430, C. B. 1957–2, 968.

Rev. Rul. 58–108

The use of ion exchange resin "Amberlite-IR-120" for the stabilization of wines in a continuous column process is considered as being consistent with good commercial practice and may be approved by Assistant Regional Commissioners, Alcohol and Tobacco Tax, for use by winemakers, pursuant to the provisions of section 240.530 of the Wine Regulations. The overall change in the pH of the wine before and after treatment shall not be greater than 0.2 pH units. This recognition of "Amberlite-IR-120" for the treatment of wine is in addition to that relating to "Amberlite-IR-120 H" covered by Revenue Ruling 57–417, C. B. 1957–2, 968.

Revenue Ruling 55–603, C. B. 1955–2, 709, containing a list of materials which have been approved for the treatment of wine, is hereby modified to include the above material. Other Revenue Rulings approving additional materials are as follows:

Revenue Ruling 56–9, C. B. 1956–1, 750;
Revenue Ruling 56–64, C. B. 1956–1, 751;
Revenue Ruling 56–341, C. B. 1956–2, 1042;
Revenue Ruling 56–415, C. B. 1956–2, 1042;
Revenue Ruling 56–551, C. B. 1956–2, 1043;
Revenue Ruling 56–626, C. B. 1956–2, 1043;
Revenue Ruling 57–175, C. B. 1957–1, 608;
Revenue Ruling 57–306, C. B. 1957–2, 967;
Revenue Ruling 57–417, C. B. 1957–2, 968;
Revenue Ruling 57–430, C. B. 1957–2, 968; and
Revenue Ruling 58–39, page 598.

SUBCHAPTER I.—MISCELLANEOUS GENERAL PROVISIONS

SECTION 5555.—RECORDS, STATEMENTS, AND RETURNS

Rev. Rul. 58–75

Government reports required by the various regulations relating to alcohol, distilled spirits, wines, and beer to be submitted to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, covering operations at the various alcohol plants, distilleries, warehouses, wine cellars, breweries, and other establishments under Chapter 51 of the Internal Revenue Code of 1954, may be prepared by the use of reproduction methods, subject to the limitations prescribed herein. The

reproduction methods must be approved by the Assistant Regional Commissioner and the copy must be as legible as an original report. The copy of the report submitted to the Assistant Regional Commissioner must bear an original signature and not a reproduction. The Internal Revenue Service reserves the right to reject any reproductions with poor legibility and to withdraw the privilege in the event such reproduction processes are later found to be unsatisfactory.

SECTION 5556.—REGULATIONS

26 CFR 230.255: Preservation of marks and brands. (Also 231.85, 235.794.) — Rev. Rul. 58–88

Two half cases of distilled spirits filled at a rectifying plant or a taxpaid bottling house may be packed together in a corrugated outer sleeve. A strip of transparent tape may be placed across the Government panel of the two half cases in order to hold them securely in place. However, all of the Government markings on the two half cases must be visible and legible and such markings may not be obscured in any manner or removed when the cases are separated except upon emptying the cases. Half cases of wines may be similarly combined at a rectifying plant, a taxpaid bottling house, or a taxpaid wine bottling house. For provisions with respect to the packaging of two sizes of bottles of the same kind of spirits in a single case, see Revenue Ruling 56–369, C. B. 1956–2, 1028.

---

26 CFR 231.85: Marks.

For the packaging together of two half cases of spirits or wines in a corregated sleeve, see Rev. Rul. 58–88, above.

---

26 CFR 235.794: Destruction of marks and brands.

For the packaging together of two half cases of spirits or wines in a corregated sleeve, see Rev. Rul. 58–88, above.

SUBCHAPTER J.—PENALTIES, SEIZURES, AND FORFEITURES RELATING TO LIQUORS

PART I.—PENALTY, SEIZURE, AND FORFEITURE PROVISIONS APPLICABLE TO DISTILLING, RECTIFYING, AND DISTILLED AND RECTIFIED PRODUCTS

SECTION 5642.—PENALTIES FOR TRANSPORTING, POSSESSING, ETC. SPIRITS IN UNSTAMPED CONTAINERS

Admissibility of wiretap evidence obtained by state authorities. See Ct. D. 1816, page 567.

PART IV.——PENALTY, SEIZURE, AND FORFEITURE PROVISIONS COMMON TO LIQUORS

SECTION 5688.—DISPOSITION AND RELEASE OF SEIZED PROPERTY

26 CFR 182.671a: Receipt, storage, and records. T. D. 6283 [1]
(Also Section 5304; 182.661.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 182.—INDUSTRIAL ALCOHOL

Amendment relative to alcohol received from the General Services Administration by users of tax-free alcohol.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employes of the Internal Revenue Service and Others Concerned:

On November 15, 1957, a notice of proposed rule making with respect to the amendment of the regulations in 26 CFR Part 182 was published in the Federal Register (22 F. R. 9109). The proposed amendments would provide instructions relative to the receipt, storage, and reporting of alcohol obtained from the General Services Administration.

In accordance with the notice, interested parties were afforded an opportunity to submit written data, views, or arguments pertaining thereto. No written comments were received within the period of 30 days prescribed. Accordingly, the amendment so published is hereby adopted.

In order to provide instructions relative to the receipt, storage, and reporting of alcohol obtained from the General Services Administration by holders of permits to use tax-free alcohol, 26 CFR Part 182 is amended by inserting a new undesignated center-heading and a new section, reading as follows, immediately after § 182.671:

ALCOHOL RECEIVED FROM GENERAL SERVICES ADMINISTRATION

§ 182.671a RECEIPT, STORAGE, AND RECORDS.—Any eleemosynary institution holding a basic permit, Form 1447, to use alcohol free of tax and receiving alcohol from the General Services Administration under the provisions of section 5688(a)(2)(B) of the Internal Revenue Code shall include any quantity of alcohol so received in computing the quantity of alcohol that may be procured under its withdrawal permit, Form 1450, during the calendar month. Such alcohol must be stored in the locked storeroom or compartment required to be provided in accordance with § 182.61, and its receipt and use must be shown on the monthly report, Form 1451, covering alcohol received from an industrial alcohol plant or bonded warehouse under permit.

This Treasury Decision shall be effective on the first day of the first month which begins not less than 30 days after the date of publication in the Federal Register.

[1] 23 F. R. 703.

(This Treasury Decision is issued under the authority contained in secton 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U. S. C. 7805).)

RUSSELL C. HARRINGTON,
Commissioner.

Approved January 29, 1958.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on Feb. 3, 1958 at 8:48 a. m., and published in the issue of the Federal Register for Feb. 4, 1958, 23 F. R. 703.)

CHAPTER 65.—ABATEMENTS, CREDITS, AND REFUNDS

SUBCHAPTER B.—RULES OF SPECIAL APPLICATION

SECTION 6423.—CONDITIONS TO ALLOWANCE IN THE CASE OF ALCOHOL AND TOBACCO TAXES

Credits or refunds of alcohol taxes only to persons who have borne the ultimate burden of the tax. See P. L. 85–323, page 630.

CHAPTER 75.—CRIMES, OTHER OFFENSES, AND FORFEITURES

SUBCHAPTER B.—OTHER OFFENSES

SECTION 7271.—PENALTIES FOR OFFENSES RELATING TO STAMPS

For destruction of marks and brands on cartons containing bottled spirits or wines, when emptied, see Rev. Proc. 58–6, page 689.

CHAPTER 76.—JUDICIAL PROCEEDINGS

SUBCHAPTER B.—PROCEEDINGS BY TAXPAYERS

SECTION 7422.—CIVIL ACTIONS FOR REFUND

Refunds of alcohol taxes only to persons who have borne the ultimate burden of the tax. See P. L. 85–323, page 630.

CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

26 CFR 225.417d–1: Determining date of original entry. (Also Section 225.417f–1.) Rev. Rul. 58–208

The proprietor of an internal revenue bonded warehouse may make application on Form 2323, Consolidation of Packaged Spirits, and prepare Form 1520, Report of Spirits Gauged, for previously consolidated spirits combined in a tank, in the same manner as for the original consolidation of spirits in packages. In such case, the contents of the tank will acquire the entry date of the oldest package. A comparable procedure may not be applied to bulk neutral spirits mingled in tanks.

The expression "first-in, first-out" as used in the Regulations relating to the Warehousing of Distilled Spirits is construed as meaning that the first spirits deposited in bond shall be deemed to be the first spirits withdrawn in the case of withdrawals from a storage tank containing spirits of more than one entry date.

Advice has been requested concerning the determination of the original entry date for distilled spirits mingled or consolidated in storage tanks in an internal revenue bonded warehouse and the application of the first-in, first-out principle to spirits withdrawn from such storage tanks.

Section 225.417a–1 of the Regulations relating to the Warehousing of Distilled Spirits provides that packages of spirits meeting definite requirements specified therein may be dumped and consolidated in a warehouse storage tank. Section 225.417c of the regulations provides that the warehouse proprietor will make application for such consolidation of spirits, to the storekeeper-gauger, on Form 2323, Consolidation of Packaged Distilled Spirits.

Section 225.417f–1 of the regulations permits the transferring of such consolidated spirits from one tank to another, *i. e.*, further consolidation of the distilled spirts, if the spirts to be added to a tank are homogeneous with the consolidated spirits already in the tank. It further provides that each lot of consolidated spirits deposited in a storage tank shall retain its date of original entry and that withdrawals from a storage tank containing more than one lot of consolidated spirits shall be accounted for by lot on a first-in, first-out basis.

The determination of the original entry date here involved relates to storage tanks containing more than one lot of consolidated spirits. The application of the procedure whereby each lot of spirits so combined will retain its own entry date has, at times, complicated the keeping of warehouse records and the preparation of Form 1520 covering the transfer of consolidated spirits between tanks.

It is held that, since spirits previously consolidated from packages are eligible to be combined in a storage tank only if they could originally have been consolidated as a single lot, the proprietor may be permitted to make application on Form 2323 and prepare Form 1520 for consolidated spirits combined in a tank in the same manner as

provided for in the case of the original consolidation of spirits in packages. If this procedure is elected, the entire contents of the tank will acquire the entry date of the oldest package. This holding does not apply to bulk neutral spirits mingled in tanks since, unlike spirits being consolidated from packages, they may be mixed without regard to the date of original entry.

The first-in first-out principle expressed in sections 225.412, 225.417f–1, and 225.424 of the regulations is construed to mean that the first spirits deposited in bond shall be deemed to be the first spirits withdrawn in the case of withdrawals from a storage tank containing spirits of more than one entry date.

---

26 CFR 225.417f–1: Consolidated spirits held in storage tanks.

Procedure with respect to warehouse storage tanks containing more than one lot of consolidated spirits. See Rev. Rul. 58–208, page 603.

---

26 CFR 225.1017: Preservation of marks and brands.

For destruction of marks and brands on cartons containing bottled spirits or wines, when emptied, see Rev. Proc. 58–6, page 689.

---

26 CFR 225.1044: Concealing or obscuring stamps. (Also 252.55.) Rev. Rul. 58–23

The Regulations relating to the Importation of Distilled Spirits, Wines, and Beer provide that red strip stamps may be shipped to a foreign country for attachment therein to bottles of distilled spirits for exportation to the United States. No similar provision is made in the applicable regulations with respect to the attachment in this country of the stamps of a foreign country to distilled spirits bottled in the United States for exportation to that foreign country. Permission has been requested for the attachment in the United States of Canadian strip stamps to distilled spirits bottled for exportation to Canada. *Held*, Canadian strip stamps may be attached to bottles of distilled spirits, bottled for export at an internal revenue bonded warehouse, a rectifying plant, or a taxpaid bottling house, for exportation to Canada, provided the attachment thereof in no way obscures the required export strip stamp. In order to avoid possible obscuration of the export strip stamp in such case, it is suggested that the Canadian strip stamp be affixed to the bottle first and that the required export strip stamp then be superimposed thereon at right angles, in the maner prescribed in the pertinent regulations.

---

26 CFR 230.243: Tests of bottled spirits.

For the method of determining the proof of imported bulk spirits by a domestic bottler for bottling and labeling purposes, see Rev. Rul. 58–258, page 605.

26 CFR 230.244: Determining proof of sweetened spirits, wines, etc.

For the method of determining the proof of imported bulk spirits by a domestic bottler for bottling and labeling purposes, see Rev. Rul. 58–258, below.

---

26 CFR 230.255: Preservation of marks and brands.

For destruction of marks and brands on cartons containing bottled spirits or wines, when emptied, see Rev. Proc. 58–6, page 689.

---

26 CFR 235.569: Determining proof of unsweetened spirits. (Also Sections 230.243, 230.244, 235.570.) Rev. Rul. 58–258

Where proprietors of taxpaid bottling houses and rectifying plants desire to bottle imported bulk spirits taxpaid on a true proof basis prior to receipt of the Customs report of analysis of such spirits, they may determine the solids content of each lot of the spitits for the purpose of ascertaining the proof for bottling and labeling purposes within the limitations of Revenue Ruling 57–479, C. B. 1957–2, 977 subject to certain specified conditions.

Revenue Ruling 57–479, C. B. 1957–2, 977, modified.

Advice has been requested whether a bottler may bottle imported spirits immediately and before receipt of the Customs report of the alcohol content of the spirits.

Revenue Ruling 57–479, C. B. 1957–2, 977, held that the proof of imported bulk distilled spirits, the solid content of which does not exceed 0.200 gram per 100 milliliters, will be determined by the hydrometer method, for bottling and labeling purposes, by the domestic bottler. Where the solids content of such spirits exceeds 0.200 gram per 100 milliliters, and the tax has been paid on a true proof basis, the true proof of the spirits may be used for bottling and labeling purposes. If the true proof is to be used, a copy of the Customs Chemist's report covering the analysis of the imported bulk spirits must be obtained by the importer from the appropriate Collector of Customs and made available, through the bottler, to the storekeeper-gauger for verification purposes prior to release of the spirits for bottling.

In order to avoid delays in bottling pending receipt of the Customs report, proprietors of bottling plants may determine the solids content of each lot of imported bulk spirits for the purpose of ascertaining the proof of the spirits for bottling and labeling purposes within the limitations of Revenue Ruling 57–479, *supra*, subject to the conditions hereinafter outlined.

Where the bottler desires to bottle the imported spirits immediately and before receipt of the Customs report of the alcohol content of the spirits, he may proceed with such bottling provided the apparent proof and obscuration due to solids content are obtained. Should the distilled spirits have a solids content of more than 0.200 gram per 100 milliliters, representing an obscuration of more than .8° proof, the

true proof may be used for labeling purposes. In such instances, obscuration, that is, solids content, shall be determined both before and after reduction of the spirits. The method described in section 230.243 of the Regulations Relating to the Bottling of Taxpaid Spirits and section 235.570 of the Regulations Relating to Rectification of Spirits and Wines in respect of determining the solids content of blended spirits, will be employed for this purpose insofar as applicable. When the solids content is greater than 0.600 gram per 100 milliliters, the true proof will be determined by the distillation method. Where the solids content is 0.200 gram per 100 milliliters or less, representing an obscuration of .8° or less, the apparent proof shall be the proof shown on the label.

The Customs Chemist's report furnished under Revenue Ruling 57–479, *supra*, will be used for verification of the proof determination made by the bottler. In addition samples will be taken by the storekeeper-gauger from time to time prior to reduction of the spirits and furnished to the regional laboratory for comparative purposes in respect to the obscuration and proof determined by the bottler as to particular lots of imported spirits bottled prior to receipt of the Customs report. The determination of the solids content under the conditions outlined need not be conducted under supervision of storekeeper-gaugers.

Revenue Ruling 57–479, *supra*, is modified to the extent of the procedures permitted hereby.

---

26 CFR 235.570: Determining proof of sweetened spirits, wines, etc.

For the method of determining the proof of imported bulk spirits by a domestic bottler for bottling and labeling purposes, see Rev. Rul. 58–258, page 605.

---

26 CFR 235.794: Destruction of marks and brands.

For destruction of marks and brands on cartons containing bottled spirits or wines, when emptied, see Rev. Proc. 58–6, page 689.

---

26 CFR 252.3: Supplies upon certain vessels and aircraft. Rev. Rul. 58–124

(Also Sections 5053, 5248, 5362; 245.195, 225.860, 240.690.)

Section 309 of the Tariff Act of 1930, as amended, 46 Stat. 690, 19 U. S. C. 1309, authorizes, in part, the withdrawal of liquors, free of tax, for supplies on aircraft registered in the United States and actually engaged in foreign trade or trade, "between the United States and any of its possessions." It also authorizes the withdrawal of liquors, free of internal revenue tax, on a reciprocal basis, as supplies on aircraft registered in any foreign country and actually engaged in foreign trade or trade "between the United States and any of its possessions" where such trade by foreign aircraft is permitted. Drawback is authorized therein with respect to liquors laden as supplies

on aircraft so registered and actually engaged in such trade. Treasury Decision 45047, approved July 18, 1931, and Treasury Decision 45146, approved September 23, 1931, recognized the application of this provision to Puerto Rico and Alaska. *Held*, the provision is also applicable to the Territory of Hawaii. Accordingly, pursuant to the applicable regulations, liquors may be withdrawn, free of tax or with benefit of drawback, for use as supplies on the aircraft specified when such aircraft are actually engaged in trade between the United States and Hawaii.

---

26 CFR 252.55: Bottle export stamps.

For the attachment of Canadian strip stamps to bottles of distilled spirits in the United States prior to exportation to Canada, see Rev. Rul. 58–23, page 604.

SUBPART B.—RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939

Rulings and decisions published in Part III, Subpart B, of the Internal Revenue Bulletin are based on the application of provisions of the Internal Revenue Code of 1939 and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1954, the Federal Alcohol Administration Act, or other public laws.

SUBTITLE B.—MISCELLANEOUS TAXES

CHAPTER 26.—LIQUOR

SUBCHAPTER A.—DISTILLED SPIRITS

PART IV.—MISCELLANEOUS PROVISIONS RELATING TO DISTILLED SPIRITS

SECTION 2901.—LOSS ALLOWANCES

Refund of tax payments on distilled spirits lost in a train wreck after withdrawal from bond. See Ct. D. 1815, page 573.

SUBPART C.—RULINGS AND DECISIONS UNDER THE FEDERAL ALCOHOL ADMINISTRATION ACT

Rulings and decisions published in Part III, Subpart C, of the Internal Revenue Bulletin are based on the application of provisions of the Federal Alcohol Administration Act.

SECTION 5.—UNFAIR COMPETITION AND UNLAWFUL PRACTICES

Rev. Rul. 58–121

A wholesale liquor dealer may, without violation of section 5 of the Federal Alcohol Administration Act, offer to retail dealers combination "deals" composed of two or more kinds or brands of distilled spirits and/or wines at a special price at less than the combined list price of such items if sold separately, provided the retailer is given the option of purchasing the brands or kinds separately at the regular list price thereof and is without compulsion to purchase merchandise which he does not want. Such a transaction is held to be merely a question of price which is not within the purview of the trade practice provisions of the Act. For an example of the type of sales which constitutes a violation, see *Joseph F. Black* v. *Magnolia Liquor Company, Inc.*, 355 U. S. 24, Ct. D. 1813, below.

SECTION 5(a).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: EXCLUSIVE OUTLET

(Also Section 5(b).) Ct. D. 1813

TIE-IN SALES PROHIBITED—DECISION OF COURT

1. TIE-IN SALES PRACTICE VIOLATES THE ACT.

Practice of requiring retailers to purchase alcoholic beverages they do not want as a condition to selling them brands which they desire violates subsections (a) and (b) of Section 5 of the Act, which prohibit wholesalers and other suppliers from requiring retailers to purchase alcoholic beverages to the exclusion in whole or in part of alcoholic beverages sold by others in interstate or foreign commerce or from inducing retailers to so purchase such products by requiring the retailer to take and dispose of a quota of any such products, even though the practice did not create an exclusive outlet or a "tied-house". The Act is remedial legislation and should be liberally construed. Where the administrative construction of the Act is reasonably consistent it is of no significance that the agency sought a clarifying amendment.

2. JUDGMENT REVERSED AND REMANDED.

Judgment of the United States Court of Appeals for the Fifth Circuit, 231 F. (2d) 941, reversed and case remanded to Court of Appeals.

SUPREME COURT OF THE UNITED STATES

Joseph F. Black v. *Magnolia Liquor Company, Inc.*

On writ of certiorari to the United States Court of Appeals for the Fifth Circuit

[November 12, 1957]

OPINION

MR. JUSTICE DOUGLAS delivered the opinion of the Court.

Petitioner seeks to suspend repsondent's wholesale liquor permit issued under the Federal Alcohol Administration Act (49 Stat. 977, 27 U. S. C. section 201) for

having made "quota" sales of alcoholic beverages in violation of section 5 (a) and (b) of the Act. The agency ordered suspension of the permit for 15 days for that violation. The Court of Appeals set the order aside, 231 F. 2d 941. The case is here on a petition for a writ of certiorari, which we granted (352 U. S. 877) because of a conflict between the decision below and *Distilled Brands* v. *Dunigan*, 222 F. 2d 867 from the Second Circuit.

Section 5 makes it unlawful for a wholesaler to induce a retailer to purchase distilled spirits "to the exclusion in whole or in part of distilled spirits" offered by other persons "by requiring the retailer to take and dispose of a certain quota of any of such products," where *inter alia*, the effect is "substantially to restrain or prevent transactions in interstate or foreign commerce in any such products."

The facts are that during the period in question Johnny Walker Scotch and Seagram's V. O. Whiskey were in short supply, while Seagram's Ancient Bottle Gin and Seagram's 7-Crown Whiskey were plentiful, Ancient Bottle being a poor seller. Respondent in order to increase its sales of Ancient Bottle Gin and 7-Crown Whiskey compelled retailers to buy them, which they did not desire, in order to obtain the other two whiskeys which they did desire. The agency found that respondent's sales were "quota" sales within the meaning of the Act, that they affected adversely the sales of competing brands, and "excluded, in whole or in part, distilled spirits . . . offered for sale by other persons in interstate commerce"—all to the end of substantially restraining and preventing commerce. The Court of Appeals concluded that the transactions complained of, although tie-in sales, did not violate section 5 of the Act.

Tying agreements by which the sale of one commodity is conditioned on the purchase of another have been repeatedly condemned under the anti-trust laws, since they serve no purpose beyond the suppression of competition. *Standard Oil Co.* v. *United States*, 337 U. S. 293, 305–306; *United States* v. *Paramount Pictures*, 334 U. S. 131, 156–159; *International Salt Co.* v. *United States*, 332 U. S. 392; *Mercoid Corp.* v. *Honeywell Co.*, 320 U. S. 680. One aim of Congress by the present legislation was to prohibit practices that were "analogous to those prohibited by the antitrust laws," (see H. R. Rep. No. 1542, 74th Cong., 1st Sess. p. 12). The tie-in sales involved here seem to us to run afoul of that policy, since the retailer is coerced into buying distilled spirits he would otherwise not have purchased at that time, and other sellers of the products are to that extent excluded from the market that would exist when the demand arose. A wholesaler who compels a retailer to buy an unwanted inventory as a condition to acquisition of needed articles exacts a "quota" from the retailer and excludes sales by competing wholesalers in the statutory sense.

The court below relied on two countervailing considerations. It noted that section 5 (a) is headed "Exclusive outlet" and section 5 (b) "Tied house." These titles were enough, it thought, to raise doubts concerning the meaning of the statutory clauses, since the retailer in question was not a "tied house" or "exclusive outlet," but only the victim of these particular tied-in sales. The court was constrained to read the Act narrowly, as it conceived it to be penal in nature when it forfeited a permit to do business. But we deal here with remedial legislation whose language should be given hospitable scope. See *Securities and Exchange Commission* v. *Joiner*, 320 U. S. 344, 353, 355. The will of Congress would be thwarted if we gave the language in question the strictest construction possible. The fair meaning of the Act is our guide; and it seems to clear for extended argument that the tied-in sale, though it falls short of creating an exclusive outlet and a permanently "tied house," violates the Act.

The other consideration relied upon by the Court of Appeals was a letter written by the agency to Congress in 1947 asking for an amendment to section 5 because it had doubt "whether violations of the statute could be established through the 'tie-in' sales." The administrative practice, we are advised, has quite consistently reflected the view that such sales are banned by the Act. See Annual Report, Commissioner of Internal Revenue 1946, pp. 45–46; *id.*, 1947, p. 49. The fact that the agency sought a clarifying amendment is, therefore, of no significance. See *Wong Yang Sung* v. *McGrath*, 339 U. S. 33, 47; *United States* v. *Turley*, 352 U. S. 407, 415, n. 14. The judgment is reversed and the case is remanded to the Court of Appeals for proceedings in conformity with this opinion.

Reversed.

(Also Section 5(b).) Ct. D. 1818

BASIC PERMIT SUSPENDED—DECISION OF COURT

1. "WILLFUL" VIOLATIONS UNDER FEDERAL ALCOHOL ADMINISTRATION ACT—UNWILLING TESTIMONY—RESTRAINT OF INTERSTATE COMMERCE.

The intentional and continued execution of tie-in sales, when appellant was well aware of the administrative view that such sales were prohibited, constitutes willfulness under the Federal Alcohol Administration Act. The Hearing Examiner was justified in declining to credit unwilling testimony of retailers appearing under subpoena for the Government. Proof of some tie-in sales transactions, though only a small percentage of appellant's total business, together with evidence that, except for such sales, retailers would have purchased in interstate commerce from appellant's competitors, was sufficient to establish the violations charged.

2. JUDGMENT OF THE COURT HERETOFORE ENTERED (231 F. (2d) 941) VACATED AND SET ASIDE, AND JUDGMENT ENTERED AFFIRMING THE ORDER OF THE ASSISTANT REGIONAL COMMISSIONER SUSPENDING APPELLANT'S BASIC PERMIT FOR 15 DAYS.

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Magnolia Liquor Company, Inc., Appellant, v. *Joseph F. Black, Assistant Regional Commissioner, Alcohol & Tobacco Tax Division, (Dallas Region), Internal Revenue Service, Appellee*

Appeal from Administrative Ruling Pursuant to Alcohol Administration Act

(February 26, 1958)

OPINION

Before BORAH and JONES, Circuit Judges, and DAWKINS, District Judge.

PER CURIAM: In our judgment in this cause, formerly styled *Magnolia Liquor Company, Inc.* v. *Claud B. Cooper, Assistant Regional Commissioner*, reported at 231 F. 2d 941, we set aside an administrative order of the appellee which suspended for fifteen days the wholesaler's Basic Permit which had been issued to the appellant, Magnolia Liquor Company, Inc. under the Federal Alcohol Administration Act, 27 U.S.C.A. section 201 et seq. The order was based upon the administrative determination that tie-in sales to retailers were prohibited by the Act and upon an administrative finding that tie-in or quota sales had been made by the appellant to such an extent as substantially to restrain or prevent transactions by others in interstate or foreign commerce in distilled spirits or wine. It was our opinion that the Act was penal in nature and should be strictly construed. Applying such canon of construction we concluded that the Act did not prohibit tie-in sales.

The Supreme Court was of the opinion that the legislation was remedial in character and that tie-in sales violate the Act. *Black* v. *Magnolia Liquor Co.*, 355 U. S. 24, 78 S. Ct. —, 2 L. Ed. 2d 5. [Ct. D. 1813, IRB 1958- 4, 18.] Our judgment was reversed and the case was remanded. It is now before us for further proceedings. Other questions were presented on the appeal which, under the view we then took of the case we found it unnecessary to decide. These questions are again before us. Of these questions only three seem to require comment.

It was contended that the tie-in sales if prohibited were not "willful" violations. The appellant was well aware of the administrative view that tie-in sales were within the ban of the statute but nevertheless made and continued to make such sales. The sales were intentionally made. The element of willfulness was established. *Arrow Distilleries* v. *Alexander*, 7th Cir. 1940, 109 F. 2d 397; *Rex Wine Corporation* v. *Dunigan*, 2d Cir. 1955, 224 F. 2d 93.

The proposition that the evidence did not show a practice of tie-in sales "to such an extent as substantially to restrain or prevent transactions in interstate or foreign commerce" is urged. The Government's proof showed a number of tie-in sale transactions but the number was a very small percentage of the

total volume of the appellant's business. In some instances retailers who made purchases from appellant testified that their purchases from other distributors were curtailed. The examiner who heard these witnesses, who testified for the Government under subpoena, concluded that they were unwilling witnesses and declined to credit these statements. We cannot say that this conclusion is contrary to human experience. There is no basis for rejecting the determination of the examiner as to the credibility of witnesses whose demeanor was under his observation. Other testimony showed instances where, if the tie-in sales by the appellant had not been required, purchases of the products of appellant's competitors would have been made, and the evidence justified the determination that such purchases would have been transactions in interstate commerce. The evidence was sufficient to establish the violations. *International Salt Co.* v. *United States*, 332 U. S. 392, 68 S. Ct. 12, 92 L. Ed. 20; *Standard Oil Co.* v. *United States*, 337 U. S. 293, 69 S. Ct. 1051, 93 L. Ed. 1371.

The sanction, the appellant contends, is too severe. This is a matter for administrative discretion. No abuse is shown. See *Rex Wine Corporation* v. *Dunigan, supra.*

Our judgment heretofore entered will be vacated and set aside and judgment will be entered affirming the order of the Assistant Regional Commissioner suspending appellant's Basic Permit for fifteen days.

SECTION 5(b).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: "TIED HOUSE"

Tie-in sales, retailers required to buy or fill quotas of undesired brands to buy desired brands. See Ct. D. 1813, page 609.

Tie-in sales willfully violating the Act and restraining interstate commerce. See Ct. D. 1818, page 611.

---

27 CFR 8.1: Statutory provision. Rev. Rul. 58–136

Section 5(b)(6) of the Federal Alcohol Administration Act applies to the extension of credit to a state liquor control commission which sells alcoholic beverages at retail.

Advice has been requested whether the Federal Alcohol Administration Act applies with respect to the extension of credit beyond the 30-day limitation by an industry member to a state liquor control commission which sells alcoholic beverages at retail.

The liquor control commission operates, throughout the state, stores which offer alcoholic beverages for sale to consumers. The commission has requested a wholesale distributor to extend to it 90 days credit on alcoholic beverages purchased from the distributor.

Subsection 5(b)(6) of the Federal Alcohol Administration Act makes it unlawful for a producer, importer or wholesaler of alcoholic beverages, directly or indirectly, to induce a retailer to purchase any such products from such producer, importer, or wholesaler to the complete or partial exclusion of alcoholic beverages sold or offered for sale by other producers, importers or wholesalers in interstate commerce, by extending to the retailer credit for a period in excess of the credit period usual and customary in the industry for the particular class of transactions, as ascertained and prescribed by regulations.

Section 8.1 of the Regulation relating to Credit Period to be Extended to Retailers of Alcoholic Beverages states that the credit period usual and customary to the industry is ascertained to be 30 days from date of delivery in the case of all sales of alcoholic beverages.

In this case, the state liquor control commission operates stores throughout the state, which offer alcoholic beverages for sale to consumers and is therefore considered to be a retailer within the meaning of the Act. Accordingly, if the distributor should extend 90-day credit terms to the state liquor control commission and thereby induce the commission to purchase from him to the exclusion of alcoholic beverages sold or offered by other present or prospective vendors to the commission, violations of the cited provision of the Act would ensue.

SECTION 5(e).—LABELING

Rev. Rul. 58–122

Under the provisions of section 5(e)(3) of the Federal Alcohol Administration Act and sections 32(c)(4) and 38(a) of the Regulations relating to the Labeling and Advertising of Distilled Spirits, distilled spirits (other than cordials, liqueurs, and specialties) produced by blending or rectification, if neutral spirits have been used in the production thereof, must be labeled to show the percentage of neutral spirits used and the name of the commodity from which such neutral spirits have been distilled, or, in the case of neutral spirits or of gin produced by a process of continuous distillation, to show the name of the commodity from which distilled. *Held*, since flavored vodkas are "cordials or liqueurs" or "specialties," depending upon the amount of added sugar or dextrose, or both, flavored vodkas fall within the exception in the Act and regulations and labels for such products are, therefore, not required to bear the statement in question.

---

27 CFR 5.21: The standards of identity. T. D. 6288 [1]
(Also 5.34, 5.46.)

TITLE 27—INTOXICATING LIQUORS.—CHAPTER I, PART 5.—LABELING AND ADVERTISING OF DISTILLED SPIRITS

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

Notice of public hearing to be held in Washington, D. C., on November 28, 1956, and in San Francisco, California, on December 5, 1956, with respect to certain proposals to amend Regulations No. 5, Relating to Labeling and Advertising of Distilled Spirits, was published in the Federal Register on October 31, 1956 (21 F R. 8321). Upon the conclusion of the said hearing and after consideration of all relevant material submitted by interested persons in connection therewith regarding the proposals, the following amendments to Regulations No. 5 (27 CFR Part 5) are hereby adopted:

PARAGRAPH 1. In order to permit the labeling as a "whisky", or the appropriate type thereof, of limited quantities of a distillate conform-

[1] 23 F. R. 2180.

ing to the standard for such type, except for the fact that it was withdrawn from the cistern room of the distillery at more than 110° proof, section 21, class 2 (27 CFR 5 21(b)) is amended by changing the period at the end of the first sentencet to a colon and inserting the following proviso:

PROVIDED, That a maximum of 1000 barrels of whisky per registered distillery withdrawn prior to July 1, 1960, from the cistern room of such distillery at above 110° proof for experimental storage but at not more than 160° proof may be designated as whisky or any type thereof to which it would have been entitled under these standards of identity but the fact that it was withdrawn at over 110° proof.

This amendment is of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 2. In order to remove from the standards of identity the standard for "blended Scotch type whisky" (Scotch type whisky—a blend), and to remove from the regulations any recognition of this product as a type of whisky:

(A) Section 21, class 2 (27 CFR 5.21(b)) is amended by deleting subparagraph (n) (27 CFR 5.21(b)(14)) thereof,

(B) Section 21, class 8(d) (27 CFR 5.21(h)(4)) is amended by deleting the parenthetical phrase "(except for the use of the word 'scotch' in the type designation 'blended Scotch type whisky')",

(C) Section 34(f) (27 CFR 5.34(f)) is amended by changing the parenthetical phrase in the last sentence to read "(other than American type whisky)",

(D) Section 39 (27 CFR 5.39) is amended by deleting the proviso at the end of the undesignated paragraph following subparagraph (a)(7) and by deleting subparagraph (c) and relettering subparagraphs (d) and (e) as (c) and (d),

(E) Section 73(a)(3) (27 CFR 5.73(a)(3)) is amended by deleting the words " and Scotch and Irish type whisky".

These amendments shall become effective three years after date of publication in the Federal Register.

PAR. 3. In order to base the minimum sugar content of cordials and liqueurs on the amount of sugar or dextrose or both contained in the finished product rather than on the amount of added sugar or dextrose or both, section 21, class 6(a) (27 CFR 521(f)(1)) is amended by deleting the words "to which sugar or dextrose or both have been added in an amount not less than 2½ percent by weight of the finished product.", and inserting in lieu thereof the words "containing sugar or dextrose or both in an amount not less than 2½ percent by weight of the finished product."

This amendment relieves a restriction presently contained in the regulations and shall become effective on the date of publication in the Federal Register.

PAR. 4. In order to permit the addition of a natural flavoring material made from an integral part of the cherry (crushed cherry pits) to a cherry product without requiring the product to be designated as an imitation, section 21, class 7(c) (27 CFR 5.21(g)(3)) is amended by changing the semicolon at the end thereof to a colon and inserting the following proviso:

PROVIDED, That the word "imitation" shall not be required to appear as a part of the designation of a cherry product by reason of the addition of a natural flavoring material derived from crushed cherry pits;

This amendment is of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 5. Section 30(b)(1) (27 CFR 5.30(b)(1)) is amended by changing the proviso at the end of this subsection to read:

PROVIDED, That the assistant regional commissioner, ALCOHOL and Tobacco Tax, or the storekeeper-gauger, if any, assigned to the premises may, upon written application, permit additional labeling or relabeling of bottled distilled spirits with labels, covered by certificates of approval issued by the Director, which comply with the requirements of this part and with State law.

This amendment is of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 6. In order to permit the net contents of bottles to be stated in fluid ounces in the case of containers of less than a pint; in pints and fluid ounces in the case of containers of more than a pint but less than a quart; and in quarts, pints, and fluid ounces in the case of containers of more than a quart, but less than a gallon, except in the case of distilled spirits for which a standard of fill is prescribed in section 73(a) (27 CFR 5.73(a)):

(A) Section 37(a) (27 CFR 5.37(a)) is amended to read as follows:

The net contents of distilled spirits for which a standard of fill is prescribed in section 73(a) (27 CFR 5.73(a)) shall be stated in the same manner and form in which such standard of fill is set forth in said section.

(B) Section 37 (27 CFR 5.37) is further amended by relettering subparagraphs (b) and (c) as (c) and (d) and inserting a new subparagraph (b) reading as follows:

The net contents of distilled spirits for which no standard of fill is prescribed in section 73(a) (27 CFR 5.73(a)) shall be stated as follows:

(1) If one pint, one quart, or one gallon, the net contents shall be so stated.

(2) If less than a pint, the net contents shall be stated in fractions of a pint, or in fluid ounces.

(3) If more than a pint, but less than a quart, the net contents shall be stated in fractions of a quart, or in pints and fluid ounces.

(4) If more than a quart, but less than a gallon, the net contents shall be stated in fractions of a gallon, or in quarts, pints, and fluid ounces.

These amendments are of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 7. In order to permit the statement of net contents to be omitted from the label if permanently marked on the sides, front, or back of the bottle, the first sentence of section 37(c) (27 CFR 5.37(c)) is amended to read as follows:

The net contents need not be stated on any label if the net contents are displayed by having the same blown, etched, sand-blasted, marked by underglaze coloring, or otherwise permanently marked by any method approved by the Director, on the sides, front, or back of the bottle, in letters and figures in such manner as to be plainly legible under ordinary circumstances, and such statement is not obscured in any maner in whole or in part.

This amendment is of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 8. In order to simplify the manner of stating the age and percentage of the straight whisky contained in blended whisky, the second, third and fourth sentences of the second paragraph of section 39(a)(3) (27 CFR 5.39(a)(3)) are amended to read as follows:

If only one straight whisky and one other whisky is in the blend, the statement of age shall read: "The straight whisky in the product is —— (years and/or months) old; —— percent straight whisky, —— percent whisky —— (years and/or months) old" or "—— percent straight whisky —— (years and/or months) old, —— percent whisky —— (years and/or months) old." The age blanks shall be filled in with the respective ages of the straight whisky and the other whisky. If more than one straight whisky and more than one other whisky is in the blend, the statement of age shall read: "The straight whiskies in this product are —— (years and/or months) or more old; —— percent straight whisky, —— percent whisky —— (years and/or months) or more old" or "—— percent straight whiskies —— (years and/or months) or more old; —— percent whisky —— (years and/or months) or more old."

This amendment is of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 9. In order to permit statements on labels as to the use of selected or choice materials, without requiring the submission of proof and a finding as to each such representation by the Director, Alcohol and Tobacco Tax Division, section 40(g) (27 CFR 5.40(g)) is amended by deleting the proviso at the end thereof.

This amendment is of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 10. In order to authorize the Director, Alcohol and Tobacco Tax Division, to require under certain circumstances a certificate of origin and identity for any imported distilled spirits similar to those now required in the case of Scotch whisky, Irish whisky, Canadian whisky and Cognac:

(A) The first sentence of section 41(b)(2) (27 CFR 5.41(b)(2)) is amended to read as follows:

If imported distilled spirits are covered by a certificate of origin or of age issued by a duly authorized official of the appropriate foreign government, the label, except where prohibited by the foreign government, may refer to such certificate or the fact of such certification, but shall not be accompanied by any additional statement relating thereto.

(B) Section 46 (27 CFR 5.46) is amended by inserting the following new subparagraph at the end thereof:

(e) Distilled spirits (other than Scotch, Irish and Canadian whiskies, and Cognac) in bottles shall not be released from customs custody for consumption unless the invoice is accompanied by a certificate of origin issued by a duly authorized official of the appropriate foreign government, if the issuance of such certificates with respect to such distilled spirits has been authorized by the foreign government concerned, certifying as to the identity of the distilled spirits and that the distilled spirits have been manufactured in compliance with the laws of the respective foreign government regulating the manufacture of such distilled spirits for home consumption.

(C) Section 51 (27 CFR 5.51) is amended by inserting the following new subparagraph at the end thereof:

(e) Distilled spirits (other than Scotch, Irish and Canadian whiskies, and Cognac) imported in bulk may not be bottled in the United States unless the bottler possesses a certificate of origin issued by a duly authorized official of the appropriate foreign government, if the issuance of such certificates with respect to such distilled spirits has been authorized by the foreign government con-

cerned, certifying as to the identity of the distilled spirits and that the distilled spirits have been manufactured in compliance with the laws of the respective foreign government regulating the manufacture of such distilled spirits for home consumption.

These amendments shall become effective 90 days after publication in the Federal Register.

PAR. 11. In order to eliminate the requirement that an "Affidavit for Release of Distilled Spirits, Wine, or Malt Beverages under the Federal Alcohol Administration Act" on Form 1652 be deposited with the appropriate customs officer at the port of entry before bottled distilled spirits may be released from customs custody:

(A) Section 45(b) (27 CFR 5.45(b)) is amended to read:

(b) CERTIFICATE OF LABEL APPROVAL.—No bottled distilled spirits shall be released from customs custody unless there shall have been deposited with the appropriate customs officer at the port of entry the original or a photostatic copy of a "Certificate of Label Approval under the Federal Alcohol Administration Act" (Form 1649). Such certificate shall be issued by the Director upon application made on the form designated "Application for Certificate of Label Approval under the Federal Alcohol Administration Act" (Form 1647), properly filled out and certified to by the importer or transferee in bond.

(B) Section 45(c) (27 CFR 5.45(c)) is amended to read:

RELEASE.—If the original or photostatic copy of the "Certificate of Label Approval under the Federal Alcohol Administration Act" (Form 1649) bears the signature of the Director, then the brand or lot of bottled distilled spirits bearing labels identical with those shown thereon may be released from customs custody.

These amendments relieve a restriction presently contained in the regulations and shall become effective on the date of publication in the Federal Register.

(This Treasury Decision is issued pursuant to and under the authority contained in 49 Stat. 981, as amended; 27 U. S. C. 205.)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved March 28, 1958.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on April 2, 1958 at 8:52 a. m., and published in the issue of the Federal Register for April 3, 1958, 23 F. R. 2180.)

---

27 CFR 5.34: Class and type.

"Blended Scotch Type Whisky," has been eliminated as a type of domestic whisky. See T. D. 6288, page 613.

---

27 CFR 5.46: Certificates of age and origin.

Requirement for submission of certificates of origin and identity for distilled spirits imported from foreign countries. See T. D. 6288, page 613.

27 CFR 7.31: Label approval and release. T. D. 6289

TITLE 27—INTOXICATING LIQUORS.—CHAPTER I, PART 7.—LABELING AND ADVERTISING OF MALT BEVERAGES

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

Notice of public hearing to be held in Washington, D. C., on June 1, 1955, with respect to certain proposals to amend Regulations No. 7, Relating to Labeling and Advertising of Malt Beverages, was published in the Federal Register on May 7, 1955 (20 F. R. 3113). Upon the conclusion of the said hearing and after consideration of all relevant material submitted by interested persons in connection therewith regarding the proposals, the following amendments to Regulations No. 7 (27 CFR Part 7) are hereby adopted:

In order to eliminate the requirement that an "Affidavit for Release of Distilled Spirits, Wine, or Malt Beverages under the Federal Alcohol Administration Act" on Form 1652 be deposited with the appropriate customs officer at the port of entry before imported malt beverages may be released from customs custody,

PARAGRAPH 1. Section 31(b) (27 CFR 7.31(b)) is amended to read:

(b) CERTIFICATE OF LABEL APPROVAL.—No imported malt beverages shall be released from customs custody unless there shall have been deposited with the appropriate customs officer at the port of entry the original or a photostatic copy of a "Certificate of Label Approval under the Federal Alcohol Administration Act" (Form 1649). Such certificate shall be issued by the Director upon application made on the form designated "Application for Certificate of Label Approval under the Federal Alcohol Administration Act" (Form 1647), properly filled out and certified to by the importer or transferee in bond.

PAR. 2. Section 31(c) (27 CFR 7.31(c)) is amended to read:

RELEASE.—If the original or photostatic copy of the Certificate of Label Approval under the Federal Alcohol Administration Act" (Form 1649) bears the signature of the Director, then the brand or lot of imported malt beverages bearing labels identical with those shown thereon may be released from customs custody.

This Treasury Decision relieves a restriction presently contained in the regulations and shall become effective on the date of publication in the Federal Register.

(This Treasury Decision is issued pursuant to and under the authority contained in 49 Stat. 981, as amended; 27 U. S. C. 205.)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved March 28, 1958.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on April 2, 1958, at 8:52 a. m., and published in the issue of the Federal Register for April 3, 1958, 23 F. R. 2181.)

PART IV

LEGISLATION AND TREATIES

TABLE OF CONTENTS

Subpart A.—Tax Conventions Page

United States—Australia Income Tax Convention (Rev. Rul. 58–248) 621
United States—Canada Income Tax Convention (Rev. Rul. 58–247) 623
United States—France Income Tax Convention (Rev. Rul. 58–63) 624

Subpart B.—Legislation

Public Law 85–300 (H. R. 1937) 626
Public Law 85–318 (H. R. 5938) 627
Public Law 85–319 (H. R. 7762) 628
Public Law 85–320 (H. R. 9035) 628
Public Law 85–321 (H. R. 8865) 629
Public Law 85–323 (H. R. 8216) 630
Public Law 85–345 (H. R. 10021) 632
Public Law 85–367 (H. R. 8268) 633
Public Law 85–380 (H. R. 8794) 633
Public Law 85–395 (H. R. 8524) 634

Subpart C.—Committee Reports

House Report No. 1159 (H. R. 8794—P. L. 85–380) 636
Senate Report No. 1180 (H. R. 5938—P. L. 85–318) 637
Senate Report No. 1181 (H. R. 7762—P. L. 85–319) 638
Senate Report No. 1182 (H. R. 8865—P. L. 85–321) 640
Senate Report No. 1183 (H. R. 9035—P. L. 85–320) 644
Senate Report No. 1184 (H. R. 8216—P. L. 85–323) 647
Senate Report No. 1283 (H. R. 8794—P. L. 85–380) 650
House Report No. 1296 (H. R. 10021—P. L. 85–345) 652
Senate Report No. 1368 (H. R. 10021—P. L. 85–345) 653
Senate Report No. 1402 (H. R. 8268—P. L. 85–367) 656

PART IV

LEGISLATION AND TREATIES

SUBPART A—TAX CONVENTIONS

UNITED STATES-AUSTRALIA INCOME TAX CONVENTION

T. D. 6108, C. B. 1954–2, 614; Section 501.6: Pensions and annuities.
(Also Part I, Sections 402, 871, 1441; 26 CFR 1.402(a)–1, 1.871–7, 1.1441–1.)

Rev. Rul. 58–248

The exemption from tax in the United States, provided with respect to certain pension and annuity payments by Article XII(1) of the Tax Convention between the United States and Australia, does not apply to an amount constituting, with respect to any employee, the "total distributions payable," paid on account of the employee's death or other separation from service, as defined in section 402(a)(3)(C) of the Internal Revenue Code of 1954, when paid in one taxable year of the distributee by an employees' trust which qualifies under section 401(a), and is exempt under section 501(a), of the 1954 Code, to an alien residing in Australia. Such a distribution, to the extent such amount exceeds the amounts contributed by the employee to or under the trust, reduced by any amounts previously distributed which were not includible in gross income, shall be subject in the United States to a tax not less than the 30 percent thereof imposed by section 871 of the Code and to the 30 percent withholding thereon required by section 1441(a) of the Code.

Advice has been requested whether an amount will be exempt from tax in the United States under Article XII(1) of the Tax Convention between the United States and Australia, Treasury Decision 6108, C. B. 1954–2, 614, at page 616, where such amount constitutes, with respect to an employee, the "total distributions payable," as defined in section 402(a)(3)(C) of the Internal Revenue Code of 1954, when paid in one taxable year of the distributee, on account of the employee's death or other separation from service, by an employees' trust qualified under section 401(a), and exempt under section 501(a), of the Code, to an alien residing in Australia.

Article XII(1) of United States-Australia Tax Convention provides that "A pension (including a Government pension) and an annuity, derived from sources within one of the contracting States by a resident of the other contracting State, shall be exempt from tax by the former State." Article XII(2) defines the term "annuity" as meaning "a stated sum payable periodically at stated times, during life or during a specified or ascertainable period of time, under

an obligation to make the payments in consideration of money paid." See Treasury Decision 6108, *supra*.

Under the provisions of section 402(a)(2) of the Code, if the "total distributions payable," as defined in paragraph (3)(C), with respect to any employee under an employees' trust which qualifies under section 401(a), and is exempt under section 501(a), of the Code are paid to the distributee within one taxable year of the distributee on account of the employee's death or other separation from the service, the amount of such distribution, to the extent exceeding the amounts contributed by the employee (determined by applying section 72(f) of the Code), which employee contributions shall be reduced by any amounts theretofore distributed to him which were not includible in gross income, shall, for Federal income tax purposes, be considered a gain from the sale or exchange of a capital asset held for more than six months.

In the case of a nonresident alien individual not engaged in trade or business within the United States, section 871(a)(1) of the Code provides that amounts described in section 402(a)(2) of the Code which are considered to be gains from the sale or exchange of capital assets held for more than six months, when received by the individual from sources within the United States, are subject to a tax of 30 percent of such amount. Such amounts are also taxable where the rate of tax is higher than 30 percent by reason of the provisions of section 871(b). Section 1441 of the Code requires the person making such a distribution to a nonresident alien individual to deduct and withhold from such item a tax equal to 30 percent thereof.

While section 894 of the Code provides that income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under subtitle A of the Code, it has no application here because the Tax Convention between the United States and Australia contains no provision for the exemption of capital gains.

Accordingly, it is held that an amount shall be subject to the tax of 30 percent of such amount imposed by section 871(a)(1) of the Code, or to such higher rate of tax as may be imposed if section 871(b) applies, where such amount constitutes, with respect to any employee, the "total distributions payable," as defined in section 402(a)(3)(C) of the Code, when distributed or paid by or under a trust which qualifies under section 401(a), and is exempt under section 501(a), of the Code, to a nonresident alien residing in Australia in one taxable year of the distributee, on account of the employee's death or other separation from service. The amount subject generally to tax under section 871 and to withholding under section 1441(a) of the Code is the amount of the distribution or payment, to the extent such amount exceeds the amount contributed by the employee under the trust or plan, reduced by any amounts previously distributed which were not includible in gross income. For a determination of the amount subject to tax under 871(a)(1), the alternative tax and the amount deductible where section 871(b) applies, and the amount subject to withholding under section 1441(a), see sections 1.871–7(b)(3)(iii), 1.871.7(c)(1) and 3(iii), and 1.1441–3(d), respectively, of the Income Tax Regulations.

UNITED STATES-CANADA INCOME TAX CONVENTION

T. D. 5206, C. B. 1943, 526; Section 7.29: Capital gains.
(Also Part I, Sections 402, 871; 26 CFR 1.402(a)-1, 1.871-7.)

Rev. Rul. 58-247

The pensions and life annuities exemption from Federal income tax granted to nonresident aliens residing in Canada by Article VI A of the Tax Convention and Protocol between the United States and Canada, does not apply to an amount constituting, with respect to any employee, the "total distributions payable," as defined in section 402(a)(3)(C) of the Internal Revenue Code of 1954, made in one taxable year of the distributee to a nonresident alien residing in Canada by or from an employees' trust which qualifies under the applicable provisions of section 401(a), and is exempt under section 501(a), of the Code on account of an employee's death or other separation from service. However, such a distribution is exempt from Federal income tax, as a gain from the sale or exchange of a capital asset, by Article VIII of the Tax Convention.

Rev. Rul. 56-446, C. B. 1956-2, 1065, modified.

The Internal Revenue Service has reconsidered its treatment in Revenue Ruling 56-446, C. B. 1956-2, 1065, of an amount constituting, with respect to an employee, the "total distributions payable" by an employees' trust qualified under section 401(a), and exempt under section 501(a), of the Internal Revenue Code of 1954 when paid in one taxable year of the distributee, to a nonresident alien individual residing in Canada, on account of the employee's death or other separation from the service.

Revenue Ruling 56-446, *supra*, holds that where the "total distributions payable" with respect to an employee by a resident trust qualified under section 401(a), and exempt under section 501(a), of the Code are paid in one lump-sum to a nonresident alien residing in Canada on account of the employee's death or other separation from the service, the distribution is exempt from Federal income tax under Article VI A or Article VIII of the United States-Canada Tax Convention as supplemented, C. B. 1955-1, 624, at page 626. For the purposes of the particular case it was not necessary to decide which of these provisions of the convention should apply.

Article VI A of the Tax Convention and Protocol between the United States and Canada relates only to pensions and life annuities derived from within one of the contracting States by a resident of the other contracting State and provides that they shall be exempt from taxation in the former State.

Article VIII of the United States-Canada Tax Convention relates only to gains derived in one of the contracting States from the sale or exchange of capital assets by a resident or a corporation or other entity of the other contracting State and provides that such gains shall be exempt from taxation in the former State, provided such resident or corporation or other entity has no permanent establishment in the former State.

Section 402(a)(2) of the Code provides that, in the case of a trust described in section 401(a) and exempt under section 501(a) of the Code, if the "total distributions payable," as defined in section 402(a)(3)(C) of the Code, with respect to any employee are paid to the distributee within one taxable year of the distributee on account

of the employee's death or other separation from the service, or on account of the employee's death after his separation from the service, the amount of the distribution, to the extent exceeding the amount contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than six months.

Accordingly, such a distribution, when made to an alien resident in Canada, is exempt from taxation in the United States under Article VIII of the United States-Canada Tax Convention, *supra*, and not under Article VIA.

Revenue Ruling 56–446, *supra*, is modified to accord with the foregoing.

UNITED STATES—FRANCE INCOME TAX CONVENTION

T. D. 5499, C. B. 1946–1, 134; Section 7.414: Scope of convention with respect to determination of "industrial and commercial profits" of a nonresident alien individual resident of France, or of a French corporation or Other entity carrying on a French enterprise in the United States.
(Also Part I, Section 871, 26 CFR 1.871–8.)

Rev. Rul. 58–63

A nonresident alien individual owning a racing stable in France and engaged in the operation of the stable for profit who enters a horse in a race in the United States, is exempt from Federal income tax on his winnings under the income tax convention between the United States and France where the owner maintains no permanent establishment in the United States.

Advice has been requested whether a nonresident alien individual, owning a racing stable in France and engaged in the operation of same for profit, who enters a horse in a race in the United States, is exempt from United States income tax on the winnings therefrom.

A citizen and resident of France owned and operated a horse racing stable, located in France, for profit. He was invited to enter an outstanding horse in a race to be held in the United States. He and the racing association agreed that the horse would not compete in any other races while in the United States. The racing association invited him to view the race and participate in the social events connected therewith. The invitation was accepted. The horse won the race and the owner was paid the winner's purse.

The operation of a racing stable for profit is a business enterprise. The entry of a horse in a race in this country constitutes being "engaged in trade or business within the United States," within the meaning of section 871(c) of the Internal Revenue Code of 1954. Accordingly, income derived therefore is subject to United States income tax unless exempted by some other provision of law.

Article 3 of the income tax convention between the United States and France, C. B. 1946–1, 134, provides, in part, that an enterprise of one of the contracting states is not subject to taxation by the other contracting state in respect of its industrial and commercial profits except in respect of such profits allocable to its permanent establish-

ment in the latter state. A "French enterprise" includes every form of undertaking carried on by an individual resident of France in France. "Industrial and commercial profits" include profits derived from the industrial activity of a French enterprise. The term "permanent establishment" includes branches, mines and oil wells, plantations, factories, workshops, stores, purchasing and selling and other offices, agencies, warehouses, and other fixed places of business.

Accordingly, it is held that a nonresident alien individual does not have a permanent establishment in the United States merely by entering a race horse in a single race in the United States and coming to the United States to view the race and to participate in the social events connected therewith. While the winner's purse received by the owner of a racing stable operated for profit constitutes industrial or commercial profits, this income is exempt from United States income tax under Article 3 of the income tax convention between the United States and France.

SUBPART B.—LEGISLATION

PUBLIC LAW 85-300
EIGHTY-FIFTH CONGRESS, SEPTEMBER 7, 1957
H. R. 1937 [1]

An Act to authorize the construction, maintenance, and operation by the Armory Board of the District of Columbia of a stadium in the District of Columbia, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "District of Columbia Stadium Act of 1957".

SEC. 2. In order to provide the people of the District of Columbia with a stadium suitable for holding athletic events and other activities and events of a nature requiring such a facility, the Armory Board (hereinafter referred to as the "Board"), created by section 2 of the Act entitled "An Act to establish a District of Columbia Armory Board, and for other purposes", approved June 4, 1948 (D. C. Code, sec. 2-1702), is hereby authorized to construct, maintain, and operate a stadium (including necessary motor-vehicle parking areas) with a seating capacity of not to exceed fifty thousand, on a site in the District of Columbia determined in accordance with provisions of section 3 of this Act. The cost of constructing such stadium shall not exceed $6,000,000, and such amount shall be deemed to include interest during the construction of the stadium and for 12 months thereafter and all engineering, legal, financial, architectural, and other expenses incident to the construction of the stadium.

* * * * * * *

SEC. 4. (a) The Board is hereby authorized to provide for the payment of the cost of such stadium, including the land upon which said stadium is located, by an issue or issues of negotiable bonds of the Board, bearing interest, payable semiannually, at the rate of not more than to be approved by the Secretary of the Treasury, the principal and interest of such bonds shall be payable solely from the funds provided in accordance with this Act, and such payments may be further secured by mortgage of the stadium. All such bonds may be registered as to principal alone or both principal and interest, shall be payable as to principal within not to exceed thirty years from the date thereof, shall be in such denominations, shall be executed in such manner, and shall be payable in such medium and at such place or places as the Board may determine, and the face amount thereof shall be so calculated as to produce, at the price of their sale, the cost of the stadium constructed pursuant to this Act, but such cost shall not exceed $6,000,000. The Board may reserve the right to redeem any or all of the bonds before maturity in such manner and at such price or prices not exceeding 105 per centum of the face value and accrued interest as may be fixed by the Board prior to the issuance of the bonds. The

[1] This publication of the law is restricted to excerpts involving internal revenue matters; House Report No. 370, Senate Report No. 692, and House Conference Reports Nos. 1183 and 1220 not published.

Board when it deems advisable may issue refunding bonds to refinance any outstanding bonds at maturity or before maturity when called for redemption, except that such refunding bonds shall mature within not to exceed thirty years from the date thereof, or not to exceed fifty years from the date of enactment of this Act, whichever shall first occur, and shall not exceed in principal amount the principal amount of outstanding bonds replaced by such refunding bonds. The Board may enter into an agreement with any bank or trust company in the United States as trustee having the power to make such agreement, setting forth the duties of the Board with respect to acquisition, construction, maintenance, operation, repair, and insurance of the stadium, the conservation and application of all funds, the security for the payment of the bonds, safeguarding of money on hand or on deposit, and the rights and remedies of such trustee and the holders of the bonds, restricting the individual right of action on the bondholders as is customary in trust agreements respecting bonds of corporations. Such trust agreement may contain such provisions for protecting and enforcing the rights and remedies of the trustee and the bondholders as may be reasonable and proper.

(b) The bonds may be sold at not less than par. If the proceeds of the bonds shall exceed the cost, the excess shall be placed in the fund created by section 6 for the payment of the principal and interest of such bonds. Prior to the preparation of definitive bonds the Board may, under like restrictions, issue temporary bonds, or may, under like restrictions, issue temporary bonds or interim certificates without coupons, of any denomination whatsoever, exchangeable for definitive bonds when such bonds that have been executed are available for delivery.

(c) All bonds, or other obligations, issued by the Board under authority of this Act, shall be exempt both as to principal and interest, from all taxation (except estate and inheritance taxes) now or hereafter imposed by the United States, or by the District of Columbia.

* * * * * * *

Approved September 7, 1957.

PUBLIC LAW 85-318
EIGHTY-FIFTH CONGRESS, FEBRUARY 11, 1958
H. R. 5938 [2]

An Act to amend section 812(e)(1)(D) of the Internal Revenue Code of 1939 with respect to certain decedents who were adjudged incompetent before April 2, 1948.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 812(e)(1)(D) of the Internal Revenue Code of 1939 (relating to bequests of an interest to a surviving spouse conditional on survival for a limited period) is amended by adding at the end thereof the following:

> For the purposes of subparagraph (B), an event or contingency shall not be considered an event or contingency upon the occurrence of which an interest passing to the surviving spouse will terminate or fail if—

[2] Senate Report No. 1180, page 637; since House Report No. 984 is substantially identical to the Senate Report, it is not being published in the Bulletin.

(iii) within six months after the date of the decedent's death, such event or contingency becomes impossible of occurrence; and

(iv) the decedent was adjudged incompetent before April 2, 1948, and was not restored to competency before his death

SEC. 2. The amendment made by this Act shall apply with respect to decedents dying after April 2, 1948.

SEC. 3. No interest shall be allowed or paid on any overpayment resulting from the amendment made by this Act.

Approved February 11, 1958.

PUBLIC LAW 85-319
EIGHTY-FIFTH CONGRESS, FEBRUARY 11, 1958
H. R. 7762 [3]

An Act to amend section 223 of the Revenue Act of 1950, so that it will apply to taxable years ending in 1954 to which the Internal Revenue Code of 1939 applies.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 223 of the Revenue Act of 1950 (relating to use of corporation property by a shareholder) is amended by striking out "and before January 1, 1954," and inserting in lieu thereof "to which the Internal Revenue Code of 1939 applies,".

SEC. 2. No interest shall be allowed or paid on any overpayment resulting from the amendment made by the first section of this Act.

Approved February 11, 1958.

PUBLIC LAW 85-320
EIGHTY-FIFTH CONGRESS, FEBRUARY 11, 1958
H. R. 9035 [4]

An Act to amend the Internal Revenue Code of 1954 with respect to the basis of stock acquired by the exercise of restricted stock options after the death of the employee.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 421(d)(6) of the Internal Revenue Code of 1954 (relating to restricted stock options exercised by estate) is amended by adding at the end thereof the following new subparagraph:

(C) BASIS OF SHARES ACQUIRED.—In the case of a share of stock acquired by the exercise of an option to which subparagraph (A) applies—

(i) the basis of such share shall include so much of the basis of the option as is attributable to such share; except that the basis of such share shall be reduced by the excess (if any) of the amount, which would have been includible in gross income under subsection (b) if the employee had exercised the option and held such share at the time of his death, over the amount which is includible in gross income under subsection (b); and

(ii) the last sentence of subsection (b) shall apply only to the extent that the amount includible in gross income under such sub-

[3] Senate Report No. 1181, page 638; since House Report No. 890 is substantially identical to the Senate Report, it is not being published in the Bulletin.

[4] Senate Report No. 1183, page 644; since House Report No. 1128 is substantially identical to the Senate Report, it is not being published in the Bulletin.

section exceeds so much of the basis of the option as is attributable to such share.

SEC. 2. Subsection (d) of section 1014 of the Internal Revenue Code of 1954 (relating to basis of restricted stock options) is hereby repealed.

SEC. 3. The amendments made by this Act shall apply with respect to taxable years ending after December 31, 1956, but only in the case of employees dying after such date.

Approved February 11, 1958.

PUBLIC LAW 85-321
EIGHTY-FIFTH CONGRESS, FEBRUARY 11, 1958
H. R. 8865 [5]

An Act relating to the administration of certain collected taxes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That chapter 77 of the Internal Revenue Code of 1954 (relating to miscellaneous administrative provisions) is amended by adding at the end thereof the following new section:

SEC. 7512. SEPARATE ACCOUNTING FOR CERTAIN COLLECTED TAXES, ETC.

(a) GENERAL RULE.—Whenever any person who is required to collect, account for, and pay over any tax imposed by subtitle C or by chapter 33—

(1) at the time and in the manner prescribed by law or regulations (A) fails to collect, truthfully account for, or pay over such tax, or (B) fails to make deposits, payments, or returns of such tax, and

(2) is notified, by notice delivered in hand to such person, of any such failure,

then all the requirements of subsection (b) shall be complied with. In the case of a corporation, partnership, or trust, notice delivered in hand to an officer, partner, or trustee, shall, for purposes of this section, be deemed to be notice delivered in hand to such corporation, partnership, or trust and to all officers, partners, trustees, and employees thereof.

(b) REQUIREMENTS.—Any person who is required to collect, account for, and pay over any tax imposed by subtitle C or by chapter 33, if notice has been delivered to such person in accordance with subsection (a), shall collect the taxes imposed by subtitle C or chapter 33 which become collectible after delivery of such notice, shall (not later than the end of the second banking day after any amount of such taxes is collected) deposit such amount in a separate account in a bank (as defined in section 581), and shall keep the amount of such taxes in such account until payment over to the United States. Any such account shall be designated as a special fund in trust for the United States, payable to the United States by such person as trustee.

(c) RELIEF FROM FURTHER COMPLIANCE WITH SUBSECTION (b).—Whenever the Secretary or his delegate is satisfied, with respect to any notification made under subsection (a), that all requirements of law and regulations with respect to the taxes imposed by subtitle C or chapter 33, as the case may be, will henceforth be complied with, he may cancel such notification. Such cancellation shall take effect at such time as is specified in the notice of such cancellation.

SEC. 2. Part I of subchapter A of chapter 75 of such Code (relating to general provisions concerning crimes, other offenses, and for-

[5] Senate Report No. 1182, page 640; since House Report No. 1006 is substantially identical to the Senate Report, it is not being published in the Bulletin.

feitures) is amended by adding at the end thereof the following new section:

SEC. 7215. OFFENSES WITH RESPECT TO COLLECTED TAXES.

(a) PENALTY.—Any person who fails to comply with any provision of section 7512 (b) shall, in addition to any other penalties provided by law, be guilty of a misdemeanor, and, upon conviction thereof, shall be fined not more than $5,000, or imprisoned not more than one year, or both, together with the costs of prosecution.

(b) EXCEPTIONS.—This section shall not apply—

(1) to any person, if such person shows that there was reasonable doubt as to (A) whether the law required collection of tax, or (B) who was required by law to collect tax, and

(2) to any person, if such person shows that the failure to comply with the provisions of section 7512(b) was due to circumstances beyond his control.

For purposes of paragraph (2), a lack of funds existing immediately after the payment of wages (whether or not created by the payment of such wages) shall not be considered to be circumstances beyond the control of a person.

SEC. 3. (a) The table of sections for chapter 77 of such Code is amended by adding at the end thereof the following:

Sec. 7512. Separate accounting for certain collected taxes, etc.

(b) The table of sections for part I of subchapter A of chapter 75 of such Code is amended by adding at the end thereof the following:

Sec. 7215. Offenses with respect to collected taxes.

SEC. 4. Notification may be made under section 7512(a) of the Internal Revenue Code of 1954 (as added by the first section of this Act)—

(1) in the case of taxes imposed by subtitle C of such Code, only with respect to pay periods beginning after the date of the enactment of this Act; and

(2) in the case of taxes imposed by chapter 33 of such Code, only with respect to taxes so imposed after the date of the enactment of this Act.

Approved February 11, 1958.

PUBLIC LAW 85-323
EIGHTY-FIFTH CONGRESS, FEBRUARY 11, 1958
H. R. 8216 [6]

An act to amend the Internal Revenue Code of 1954 to prevent unjust enrichment by precluding refunds of alcohol and tobacco taxes to persons who have not borne the ultimate burden of the tax.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subchapter B of chapter 65 of the Internal Revenue Code of 1954 (relating to rules of special application for abatements, credits, and refunds) is amended by adding at the end thereof the following new section:

---

[6] Senate Report No. 1184, page 647, this Bulletin; since House Report No. 883 is substantially identical to the Senate Report, it is not being published in the Bulletin.

"SEC. 6423. CONDITIONS TO ALLOWANCE IN THE CASE OF ALCOHOL AND TOBACCO TAXES.

(a) CONDITIONS.—No credit or refund shall be allowed or made, in pursuance of a court decision or otherwise, of any amount paid or collected as an alcohol or tobacco tax unless the claimant establishes (under regulations prescribed by the Secretary or his delegate)—

(1) that he bore the ultimate burden of the amount claimed; or

(2) that he has unconditionally repaid the amount claimed to the person who bore the ultimate burden of such amount; or

(3) that (A) the owner of the commodity furnished him the amount claimed for payment of the tax, (B) he has filed with the Secretary or his delegate the written consent of such owner to the allowance to the claimant of the credit or refund, and (C) such owner satisfies the requirements of paragraph (1) or (2).

(b) FILING OF CLAIMS.—No credit or refund of any amount to which subsection (a) applies shall be allowed or made unless a claim therefor has been filed by the person who paid the amount claimed, and, except as hereinafter provided in this subsection, unless such claim is filed after April 30, 1958, and within the time prescribed by law, and in accordance with regulations prescribed by the Secretary or his delegate. All evidence relied upon in support of such claim shall be clearly set forth and submitted with the claim. Any claimant who has on or before April 30, 1958, filed a claim for any amount to which subsection (a) applies may, if such claim was not barred from allowance on April 30, 1958, file a superseding claim after April 30, 1958, and on or before April 30, 1959, conforming to the requirements of this section and covering the amount (or any part thereof) claimed in such prior claim. No claim filed before May 1, 1958, for the credit or refund of any amount to which subsection (a) applies shall be held to constitute a claim for refund or credit within the meaning of, or for purposes of, section 7422 (a); except that any claimant who instituted a suit before June 15, 1957, for recovery of any amount to which subsection (a) applies shall not be barred by this subsection from the maintenance of such suit as to any amount claimed in such suit on such date if in such suit he establishes the conditions to allowance required under subsection (a) with respect to such amount.

(c) PERIOD NOT EXTENDED.—Any suit or proceeding, with respect to any amount to which subsection (a) applies, which is barred on April 30, 1958, shall remain barred. No claim for credit or refund of any such amount which is barred from allowance on April 30, 1958, shall be allowed after such date in any amount.

(d) APPLICATION OF SECTION.—This section shall apply only if the credit or refund is claimed on the grounds that an amount of alcohol or tobacco tax was assessed or collected erroneously, illegally, without authority, or in any manner wrongfully, or on the grounds that such amount was excessive. This section shall not apply to—

(1) any claim for drawback,

(2) any claim made in accordance with any law expressly providing for credit or refund where a commodity is withdrawn from the market, returned to bond, or lost or destroyed, and

(3) any amount claimed with respect to a commodity which has been lost, where a suit or proceeding was instituted before June 15, 1957.

(e) MEANING OF TERMS.—For purposes of this section—

(1) ALCOHOL OR TOBACCO TAX.—The term "alcohol or tobacco tax" means—

(A) any tax imposed by chapter 51 (other than part II of subchapter A, relating to occupational taxes) or by chapter 52 or by any corresponding provision of prior internal revenue laws, and

(B) in the case of any commodity of a kind subject to a tax described in subparagraph (A), any tax equal to any such tax, any additional tax, or any floor stock tax.

(2) TAX.—The term "tax" includes a tax and an exaction denominated a "tax", and any penalty, addition to tax, additional amount, or interest applicable to any such tax.

(3) ULTIMATE BURDEN.—The claimant shall be treated as having borne the ultimate burden of an amount of an alcohol or tobacco tax for purposes of subsection (a) (1), and the owner referred to in subsection (a) (3) shall be treated as having borne such burden for purposes of such subsection, only if—

(A) he has not, directly or indirectly, been relieved of such burden or shifted such burden to any other person,

(B) no understanding or agreement exists for any such relief or shifting, and

(C) if he has neither sold nor contracted to sell the commodities involved in such claim, he agrees that there will be no such relief or shifting, and furnishes such bond as the Secretary or his delegate may require to insure faithful compliance with his agreement.

SEC. 2. The table of sections for subchapter B of chapter 65 of such Code is amended by adding at the end thereof the following:

SEC. 6423. Conditions to allowance in the case of alcohol and tobacco taxes.

SEC. 3. The amendments made by this Act shall not apply to any credit or refund allowed or made before May 1, 1958.

Approved February 11, 1958.

PUBLIC LAW 85-345
EIGHTY-FIFTH CONGRESS, MARCH 17, 1958
H. R. 10021 [7]

An Act to provide that the 1955 formula for taxing income of life insurance companies shall also apply to taxable years beginning in 1957.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. EXTENSION OF 1955 FORMULA TO 1957.

Subsections (a) and (c) of section 802 of the Internal Revenue Code of 1954 (relating to tax on income of life-insurance companies) are each amended by striking out "beginning in 1955 or in 1956" and inserting in lieu thereof "beginning after December 31, 1954, and before January 1, 1958,".

SEC. 2. TECHNICAL AMENDMENTS.

(a) The heading of section 802 of the Internal Revenue Code of 1954 is amended to read as follows:

SEC. 802. TAX IMPOSED.

(b) The table of sections for subpart A of part I of subchapter L of the Internal Revenue Code of 1954 is amended by striking out

Sec. 802. Tax imposed for 1955 and 1956.

and inserting in lieu thereof

Sec. 802. Tax imposed.

(c) Section 811(a) of the Internal Revenue Code of 1954 (relating to tax under 1942 formula) is amended by striking out "December 31, 1956" and inserting in lieu thereof "December 31, 1957".

Approved March 17, 1958.

---

[7] House Report No. 1296, page 652; Senate Report No. 1368, page 653.

PUBLIC LAW 85-367
EIGHTY-FIFTH CONGRESS, APRIL 7, 1958
H. R. 8268 [8]

An Act to amend section 512 of the Internal Revenue Code of 1954

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 512 (b) of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following new paragraph:

(13) In the case of a trust—

(A) created by virtue of the provisions of the will of an individual who died after August 16, 1954, and before January 1, 1957,

(B) which, by virtue of the provisions of such will, is a limited partner in a partnership created under the laws of a State (i) providing for the creation of limited partnerships, and (ii) under which a limited partner has no right to take part in the control of the business without becoming liable as a general partner,

(C) which, at no time before or during a taxable year of the partnership ending within or with the taxable year of the trust, was (or was liable as) a general partner in such partnership, and

(D) which is required to distribute all of its income (within the meaning of section 643 (b)) currently exclusively for religious, charitable, scientific, literary, or educational purposes, and which is required to distribute all of the corpus exclusively for such purposes,

there shall be excluded its share (determined under subsection (c) without regard to this paragraph and paragraph (11)) of gross income of the partnership as such limited partner and of the partnership deductions directly connected with such income, but, if such share of gross income exceeds such share of deductions, only to the extent that the partnership makes distributions during its taxable year which are attributable to such gross income. For purposes of the preceding sentence (i) any distribution made after the close of a partnership taxable year and on or before the 15th day of the fourth calendar month after the close of such taxable year shall be treated as made on the last day of such taxable year, and (ii) distributions shall be treated as attributable first to gross income other than gross income described in the preceding sentence, and shall be properly adjusted (under regulations prescribed by the Secretary or his delegate) to the extent necessary to reflect capital contributions to the partnership made by the trust, income of the partnership exempt from tax under this title, and other items.

(b) The amendment made by subsection (a) shall apply to taxable years of trusts beginning after December 31, 1955.

Approved April 7, 1958.

PUBLIC LAW 85-380
EIGHTY-FIFTH CONGRESS, APRIL 16, 1958
[H. R. 8794] [9]

An Act to provide exemptions from the tax imposed on admissions for admissions to certain musical and dramatic performances and certain athletic events.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 4233 (a) (3) of the Internal Revenue Code of 1954 is amended (1) by

---

[8] Senate Report No. 1402, page 656; since House Report No. 1453 is substantially identical to the Senate Report, it is not being published in the Bulletin.

[9] House Report No. 1159, page 636; Senate Report No. 1283, page 650.

striking out the word "concerts" and inserting in lieu thereof "musical or dramatic performances" and (2) by striking out "CERTAIN CONCERTS.—" in the heading of such paragraph and inserting in lieu thereof "CERTAIN MUSICAL OR DRAMATIC PERFORMANCES.—".

SEC. 2. Section 4233(a)(1)(C) of such Code is amended by inserting before the period at the end of the last sentence thereof "or to the benefit of hospitals for crippled children, or both".

SEC. 3. Section 4233(a) of such Code is amended by adding at the end thereof the following new paragraph:

"(11) ATHLETIC GAMES FOR BENEFIT OF RETARDED CHILDREN.—Any admissions to an athletic game between teams composed of students from elementary or secondary schools, or colleges, if the proceeds from such game inure exclusively to the benefit of an organization described in section 501(c)(3) which is exempt from tax under section 501(a) and which is operated exclusively for the purpose of aiding and advancing retarded children."

SEC. 4. The amendments made by this Act shall apply only with respect to amounts paid for admissions on or after the first day of the first month which begins more than 10 days after the date of the enactment of this Act.

Approved April 16, 1958.

PUBLIC LAW 85-395
EIGHTY-FIFTH CONGRESS, MAY 9, 1958
H. R. 8524 [10]

An act to authorize the preparation of a roll of persons of Indian blood whose ancestors were members of the Otoe and Missouria Tribe of Indians and to provide for per capita distribution of funds arising from a judgment in favor of such Indians.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of the Interior is hereby authorized and directed to prepare a roll of the Indians of the blood of the Otoe and Missouria Tribe whose names appear on the allotment rolls of the tribe approved December 7, 1899, June 1, 1906, and January 17, 1907, and who are living on the date of this Act, and the descendants of such allottees who are living on the date of this Act regardless of whether such allottees are living or deceased. Applications for enrollment shall be filed within six months after the date of this Act. The determination of the Secretary regarding the eligibility of an applicant for enrollment shall be final and conclusive.

SEC. 2. The Secretary is authorized and directed to withdraw the funds on deposit in the Treasury of the United States to the credit of the Otoe and Missouria Tribe appropriated by the Act of May 19, 1956 (70 Stat. 161, 176), together with accrued interest, in satisfaction of the judgment obtained in the Indian Claims Commission against the United States in docket numbered 11, and to distribute such funds per capita to the persons whose names appear on the roll prepared pursuant to section 1 of this Act.

SEC. 3. (a) The Secretary shall make per capita payments directly to a living enrollee, except as provided in subsection (b) of this

[10] House Report No. 1542 and Senate Report No. 1504, not published.

section. The Secretary shall distribute the share of a person determined to be eligible for enrollment but who dies subsequent to the date of this Act and on whose behalf the application is filed and approved, and the share of a deceased enrollee, directly to his next of kin or legatee as determined by the laws of the place of domicile of the decedent, upon proof of death and inheritance satifactory to the Secretary, whose findings upon such proof shall be final and conclusive.

(b) Per capita payments due persons under twenty-one years of age or persons under legal disability shall be made in accordance with the laws of the place of domicile of such person.

(c) No part of any per capita payment shall be subject to any debt or debts, other than to the United States, created prior to the date of this Act by a person of Indian blood, and such per capita payments shall not be taxable.

SEC. 4. All costs incurred by the Secretary in the preparation of such roll and in the payment of such per capita shares shall be paid from the judgment fund or the interest accruing thereon.

SEC. 5. The Secretary is authorized to prescribe rules and regulations to carry out the provisions of this Act.

Approved May 9, 1958.

SUBPART C.—COMMITTEE REPORTS

[H. R. 8794] [1]
ADMISSIONS TO CERTAIN MUSICAL PERFORMANCES

[House of Representatives Report No. 1159, Eighty-fifth Congress, First Session]

[AUGUST 14, 1957]

Mr. COOPER, from the Committee on Ways and Means, submitted the following report to accompany H. R. 8794

The Committee on Ways and Means, to whom was referred the bill (H. R. 8794) to provide an exemption from the tax imposed on admissions for admissions to certain musical performances, having considered the same, report favorably thereon with an amendment and recommend that the bill, as amended, do pass.

The amendment is as follows:

Page 1, line 6, after the word "out" insert the following:

"CERTAIN CONCERTS.—" in

I. GENERAL STATEMENT

Present law provides an exemption from the excise tax on admissions for "concerts" conducted by nonprofit civic or community membership associations. This bill substitutes the words "musical performances" for the word "concerts" in this exemption. As a result, an exemption from the admissions tax will be available to nonprofit civic or community membership associations not only in the case of performances by symphony orchestras, bands, and vocal groups and in the case of ballets, operas, and operettas, but also in the case of musical comedies and reviews. This change is to be effective as of the first month which beings more than 10 days after the date of enactment of this bill.

II. REASONS FOR BILL

A number of exemptions are provided under present law in the case of the excise tax of 1 cent for each 10 cents charged for general admissions (if the charge is in excess of 90 cents). One of the exemptions is that provided by section 4233 (a) (3) for certain concerts. This exemption is for any admissions to concerts conducted by a civic or community membership association if no part of the net earnings inures to the benefit of stockholders or members of the association.

A number of nonprofit civic or community associations have assumed that this exemption applied to all of the musical performances they conducted, and as a result they have sold tickets tax free on this assumption. Moreover, the Internal Revenue Service has held a substantial list of musical performances, when conducted by one of these associations, to be exempt from the admissions tax as "concerts." These include performances by symphony orchestras, bands, and vocal groups and also such performances as ballets, classical dances, operas and light operas. Despite this, the Internal Revenue Service recently held that the term "concerts" does not include musical comedies or reviews put on by these associations and that as a result, such performances when conducted by these organizations are subject to the admissions tax.

Your committee believes that the present definition of the Service as to what constitutes a "concert" and therefore, what results in an exemption from the admissions tax when conducted by one of these nonprofit civic or community membership associations, is arbitrary and should be changed. Your committee sees no reason, for example, to exempt "light operas" when conducted by such an association and not to exempt a musical comedy or review which may be presented by the same organization at its next performance.

Your committee's bill, therefore, substitutes the words "musical performances" for the word "concerts" in the exemption from the admissions tax presently provided for nonprofit civic or community membership associations. In the case of these organizations this will provide an exemption not only in the case of all performances previously classified as "concerts" but also in the case of musical comedies and reviews. This change will be effective with respect to amounts

[1] Public Law 85–380, page 633.

paid on or after the first day of the first month which begins more than 10 days after the date of enactment of this bill.

It is estimated that this bill will result in a negligible loss of revenue.

This bill has been reported unanimously by your committee.

[H. R. 5938] [2]

AMENDING SECTION 812(e)(1)(D) OF THE INTERNAL REVENUE CODE OF 1939

[Senate Report No. 1180, Eighty-fifth Congress, Second Session, Calendar No. 1205]

[January 23, 1958]

MR. BYRD, from the Committee on Finance, submitted the following report to accompany H. R. 5938.

The Committee on Finance, to whom was referred the bill (H. R. 5938) to amend section 812(e)(1)(D) of the Internal Revenue Code of 1939 with respect to certain decedents who were adjudged incompetent before April 2, 1948, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. GENERAL STATEMENT

Section 812(e) of the 1939 code provides a marital deduction for estate-tax purposes with respect to interests in property passing to a surviving husband or wife. However, where the spouse's interest in the property may terminate, or where the interest may fail to pass to the spouse, the marital deduction is available only if the termination of the interest or the failure of the interest in property to pass to the surviving spouse may occur only within the 6 months immediately after the decedent's death, or as the result of a common disaster resulting in the death of both the husband and wife. This bill adds another exception whereby another type of terminable interest will be eligible for the marital deduction. It provides that the marital deduction will be available in the case of terminable interests passing to a surviving spouse where the event which could terminate the interest becomes impossible of occurrence within 6 months of the decedent's death. However, this exception to the general rule will be available under the bill only in the case of decedents adjudged incompetent before April 2, 1948, the effective date of the act providing the marital deduction, who were not restored to competency before their death. This provision is effective with respect to decedents dying after April 2, 1948.

II. REASONS FOR THE BILL

The Revenue Act of 1948 provided a marital deduction as a part of a program of equalizing taxes between community property and non-community property States. In general, an individual is allowed a deduction in computing his estate tax for property going to a surviving spouse. The deduction is limited, however, to 50 percent of his gross estate.

Before the passage of the Revenue Act of 1948, it was quite common for wills to provide that a spouse must survive the administration of the decedent's estate in order to receive some specified property. Under the Revenue Act of 1948, however, the marital deduction was made available in these cases only where the property would go to the surviving spouse within 6 months after the death of the decedent and only then if the transfer actually occurred. As a result, many wills were changed after the passage of the 1948 act to provide that property was to pass to the surviving spouse within 6 months after the decedent's death rather than upon the completion of the administration of the decedent's estate.

Cases have come to the attention of your committee, however, where individuals became mentally or otherwise incompetent before the passage of the 1948 act on April 2, 1948, and did not regain competency before their death. These individuals were not in a position to change their wills after the passage of the 1948 act and before their deaths. As a result their estates were denied the benefits of the marital deduction. Your committee believes that it is unfair to deny

[2] Public Law 85-318, page 627.

the benefits of the marital deduction in these cases where, although the instrument under which the property passed to the spouse did not require it, the property actually did pass to the surviving spouse within 6 months after the date of the decedent's death, the same period of time in which the property must pass to the surviving spouse under present law to qualify. In the absence of the incompetency on the part of the decedent, the provisions of the will would normally have been changed to qualify the estates for the marital deduction. Where there is this incompetency, your committee does not believe that it is desirable for the Government to impose a heavier estate tax than in the other situations.

III. EXPLANATION OF THE BILL

Section 812(e)(1)(A) of the 1939 code provides a marital deduction for estate-tax purposes with respect to the value of interest in property passing from the decedent to his surviving spouse to the extent that the interest is includible in determining the value of the decedent's gross estate. Subparagraph (B), however, provides an exception to the general rule in subparagraph (A). It provides that the marital deduction is not to be available if the interest in property passing to the surviving spouse will terminate or fail upon the lapse of a period of time or occurrence or nonoccurrence of an event or contingency.

Subparagraph (D) provides certain exceptions to the rule in subparagraph (B), or in other words provides that despite subparagraph (B) the marital deduction will be available in certain cases where an interest in property passing to a surviving spouse may terminate or fail to occur. The exceptions presently provided in subparagraph (D) relate to terminations or failures of interests which may occur only within a period of not more than 6 months after the decedent's death or may occur only as the result of a common disaster resulting in the death of both the decedent and the surviving spouse (or in the case of either of these events). However, these exceptions are applicable only if the termination or failure of the interest to pass to the surviving spouse does not in fact occur.

The bill adds another exception in subparagraph (D) which will have the effect of making a marital deduction available in the case of another type of terminable interest in property passing to a surviving spouse. It provides that for purposes of subparagraph (B) (the subparagraph which generally denies a marital deduction for terminable interests or those which may fail), an event or contingency is not to be considered as one upon the occurrence of which an interest passing to a surviving spouse will terminate or fail if two specific conditions are met. It must become impossible for the event or contingency to occur within 6 months after the date of the decedent's death. Thus, in effect, the property must actually pass to the surviving spouse within that period of time. In addition, the decedent must have been adjudged incompetent before April 2, 1948, the date of the enactment of the Revenue Act of 1948 and must not have been restored to competency before his death. The determination of incompetency must, of course, have been made in conformity with applicable local law.

The amendment made to the 1939 Code by this act is to apply to decedents dying after April 2, 1948. No interest is to be paid or allowed with respect to refunds resulting from this bill.

It is estimated that this bill will result in a negligible revenue loss.

[H. R. 7762] [3]

USE OF CORPORATION PROPERTY BY A SHAREHOLDER

[Senate Report No. 1181, Eighty-fifth Congress, Second Session, Calendar No. 1206]

[JANUARY 23, 1958]

MR. BYRD, from the Committee on Finance, submitted the following report to accompany H. R. 7762.

The Committee on Finance, to whom was referred the bill (H. R. 7762) to amend section 223 of the Revenue Act of 1950 so that it will apply to taxable years ending in 1954 to which the Internal Revenue Code of 1939 applies, having con-

[3] Public Law 85-319, page 628.

sidered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. GENERAL STATEMENT

Section 502(f) of the Internal Revenue Code of 1939 already provides for years ending after December 31, 1945, and before January 1, 1954, that personal holding company income does not include rents for the use of property of a corporation where the lessee uses the property in the operation of a bona fide commercial, industrial, or mining enterprise. This bill makes this same rule applicable to years ending in 1954 to which the Internal Revenue Code of 1939 applies. Somewhat similar treatment presently is available under the 1954 Code for years beginning after December 31, 1953, and ending after August 16, 1954.

II. REASONS FOR BILL

Both the 1939 and 1954 codes provide that if a closely held corporation receives most of its income from such sources as dividends, interest, certain rents, and royalties, indicating that the company is being used as an "incorporated pocketbook," it is designated for tax purposes as a personal holding company. Generally, such a company, in addition to paying the regular corporate income taxes, is subject to an additional penalty tax at the rate of 75 percent or 85 percent on its undistributed income.

Included in personal holding company income under section 502(f) of the 1939 code (sec. 543(a)(6) of the 1954 code) are amounts received for the use of the corporation's property where 25 percent or more of the stock of the corporation is held by the individual renting the corporate property. However, the Revenue Act of 1950 provided an exception to this rule for taxable years ending after 1945 and before 1950. The exception provided that personal holding company income, despite this 25-percent rule, was not to include property leased by a corporation to an individual if he used the property in the operation of a bona fide commercial, industrial, or mining enterprise. Your committee's report on the Revenue Act of 1950 indicated that this exception to the general 25-percent rule was provided because—

> * * * through a set of fortuitous circumstances, corporations have become closely held and also have rented most of their assets for use in the operation of businesses to the individuals holding the stock of the companies. Thus, unwittingly, the corporations have become personal holding companies and subject to the penalty tax.

This same problem was recognized in the Internal Revenue Code of 1954 with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. In this case, however, the exception to the 25-percent rule is expressed in somewhat different terms. For years beginning in 1954 and ending after August 16, 1954, and also for subsequent years the 25-percent rule with respect to use of corporate property by a shareholder applies only to a corporation which has personal holding company income, wholly apart from rents or other compensation for the use of property, in excess of 10 percent of its gross income.

The report of the House Ways and Means Committee on the Internal Revenue Code of 1954 indicates that this amendment was designed to take care of hardship cases which frequently arise where a corporation rents property to its principal stockholders. That committee's report on the 1954 code stated:

> In the absence of appreciable amounts of other investment income, rental income received from shareholders does not constitute a tax avoidance problem.

Public Law 370, 84th Congress [C. B. 1955-2, 770], amended the Revenue Act of 1950 to extend the exemption from section 502 (f) of the 1939 code to taxable years ending before January 1, 1954. This was intended to remove the anomalous situation whereby the rental of property by a company to its principal stockholders is permitted in certain cases with respect to the years 1946 through 1949 and for 1954 and subsequent years, but was classified as personal holding company income for the years 1950 through 1953. It was the intention of Public Law 370 to remove completely this anomaly for all years intervening between the 1950 action and the Internal Revenue Code of 1954.

By an oversight, however, Public Law 370 did not make the rule provided by the Revenue Act of 1950 applicable to those years ending after December 31, 1953,

which are not covered by the 1954 code. In this area are fiscal years beginning in 1953 and ending in 1954 and short years beginning in 1954 and ending on or before August 16, 1954.

The bill corrects this oversight by extending the exception presently available for years ending after 1945 and before 1954 to years ending after December 31, 1953, to which the 1939 code applies. Thus section 502(f) of the 1939 code (which is the subsection under which compensation for the use of corporate property by a shareholder holding 25 percent or more of the stock of the corporation is classified as personal holding company income) is not to apply to these years ending in 1954 but governed by the 1939 code with respect to rents received for the use by the stockholder in the operation of a bona fide commercial, industrial, or mining enterprise of the property of the corporation. No interest is to be paid on overpayments resulting from this act.

It is estimated that any revenue loss resulting from the enactment of this bill will be negligible.

[H. R. 8865] [4]

ADMINISTRATION OF CERTAIN COLLECTED TAXES

[Senate Report No. 1182, Eighty-fifth Congress, Second Session, Calendar No. 1207]

[JANUARY 23, 1958]

Mr. BYRD, from the Committee on Finance, submitted the following report to accompany H. R. 8865:

The Committee on Finance, to whom was referred the bill (H. R. 8865) relating to the administration of certain collected taxes, having considered the same, report thereon without amendment and recommend that the bill do pass.

I. GENERAL STATEMENT

This bill is designed to secure greater compliance with present law on the part of employers and others in paying over to the Government trust fund moneys withheld from employees, or collected from customers. It provides that where an employer in the future is required to collect and pay over income or social security taxes withheld from an employee, or where a person in the future is required to collect and pay over excise taxes on facilities or services (admissions, club dues, communications, transportation, etc.), and he fails to do so, he can by a notification from the Internal Revenue Service be instructed to collect such taxes and deposit them in a special trust account for the United States Government. Persons who after this notification fail to comply with this provision are, unless they qualify under 1 of 2 exceptions, guilty of a misdemeanor and upon conviction will be fined not more than $5,000, or imprisoned not more than 1 year, or both (together with the costs of prosecution). The exceptions are for cases where the failure was due to reasonable doubt as to the requirements under law, or where the lack of compliance was due to factors beyond the person's control. This bill in the case of the employment taxes is to be effective only for notifications with respect to pay periods beginning after the date of enactment of this bill, and in the case of the excise taxes only with respect to taxes imposed after the date of enactment of the bill.

II. REASONS FOR THE BILL

Although the great majority of employers fully comply with the withholding and collection requirements of the internal-revenue laws, the Government continually has been faced with the problem of a relatively few employers and collection agents who fail to collect and pay over trust-fund moneys representing withheld income and social-security taxes and exise taxes on facilities and services. As of December 31, 1956, the delinquent withheld income and social-security taxes alone amounted to $279 million. This represents the accumulation of delinquent accounts over the last 6 years and is approximately one-fifth of 1 percent of the total of these taxes collected over this period. Although the delinquencies are a relatively small proportion of the amount collected over

[4] Public Law 85-321, page 629.

this period, to permit their continuance places an unfair burden on law-abiding employers and the taxpaying public generally. As a result your committee has concluded that remedial action should be taken to eliminate these delinquencies to the fullest extent possible.

Present law in section 6672 provides a civil penalty of 100 percent for any person who willfully fails to collect or truthfully account for and pay over an internal-revenue tax for which he is responsible. However, this civil penalty is ineffective where the employer has lost the employees' funds in a business venture or where he did not have them in the first place. The latter, which presents one of the most difficult enforcement problems, can be illustrated by a secondary contractor who is without funds, but obtains from the prime contractor just enough to meet his net payroll. The prime contractor in this case, since he is responsible for the completion of the job, is willing to provide the net wage payments, but since he is not the "employer" cannot be required to provide the taxes to be withheld by the "employer." The secondary contractor who is the "employer," apart from the net wage payments, does not have any funds in these cases to set aside as withheld taxes.

A criminal penalty is also provided by section 7202 of present law. This provides a penalty of up to $10,000, or imprisonment for up to 5 years, or both, for willful failure to collect, or truthfully account for or pay over the taxes. This criminal penalty also has proved to be of limited usefulness because of the difficulty of proving willfulness, which to a lesser extent has also been a problem in the case of the civil penalty. The courts, for example, in the criminal cases generally have refused to treat as "willful" those cases where the employer failed to pay over amounts withheld because they used the funds in business ventures which were not successful and no longer had such amounts available to be paid to the Government.

The criminal penalty added by this bill does not require proof of "willfulness" before it applies. Moreover, the penalty is less severe than that now imposed under existing law for "willful" failure. As a result, it is believed that the new penalty can be applied to many of the delinquency cases where the present "willful" failure provision has been ineffective. Nevertheless, it is designed so that it can have no application to the vast majority of taxpayers, since the penalty applies only in the case of failures to make deposits in a special trust fund for the United States, and the requirement that deposits be made in such a trust fund must be based on a notification delivered by hand and a failure to comply with such notice after it is delivered. In addition, your committee has provided two safeguards to give assurance that the penalty will not be applied in an arbitrary manner to those who have previously failed to comply with the laws and are, therefore, required to make the special trust fund deposits. The penalty is not to apply where there was a reasonable doubt that the law required the collection of the tax or that the person in question was required to collect the tax. It also does not apply where it can be shown that the failure to comply was due to circumstances beyond the control of the person in question.

III. EXPLANATION OF THE BILL

The bill adds two new sections to the Internal Revenue Code. The first section of the bill adds a new section 7512, which provides in certain cases for the separate accounting for certain collected taxes, etc., to the end of chapter 77, relating to miscellaneous administrative provisions. Section 2 of the bill adds a new section 7215, which provides a penalty where persons do not comply with the separate accounting requirements of the new section 7512, to the end of part I of subchapter A of chapter 75, relating to general provisions concerning crimes, other offenses and forfeitures.

The new section 7512, relating to separate accounting for certain collected taxes , etc., is divided into three subsections: subsection (a) providing the conditions under which the separate accounting will be required, subsection (b) specifying the requirements which must be met as to this accounting, and subsection (c) providing the conditions under which persons may be relieved of this separate accounting.

Subsection (a) provides that when any person, who is required to collect, account for, and pay over certain specified taxes, fails to do so at the time and in the manner provided by law or regulations (or fails to make deposits, payments, or returns of such taxes under the depository receipt system) and is notified of any failure of this type, then the requirements of subsection (b) as to separate accounting are to apply.

The specified taxes to which this provision is applicable are the employment taxes imposed by subtitle C, including withheld income taxes, and also the excise taxes on facilities and services imposed by chapter 33. Although the employment taxes imposed by subtitle C include both the taxes imposed with respect to employers and also taxes collected by employers from their employees, it is only this latter category, namely, the collected taxes, to which this separate accounting provision is applicable. The excise taxes to which this provision is applicable include the so-called collected taxes imposed by chapter 33. These are the taxes on admissions (not including the cabaret tax which is not a collected tax), club dues, communications, transportation, and safe-deposit boxes.

The notification which must occur after the failure of a person to comply with the requirements of subsection (a) and before the separate accounting requirements of subsection (b) become applicable, must be in the form of a notice delivered personally by a representative of the Internal Revenue Service to the person who has failed to comply with subsection (a). In the case of a corporation, partnership, or trust, it will be sufficient if this notification is delivered in hand to an officer, partner, or trustee. Such delivery will be deemed to be a delivery to all officers, partners, trustees, or employees of the organization.

Subsection (b) of the new section 7512 specifies the requirements as to the separate accounting which must be complied with by those to whom a notice has been delivered in the manner provided by subsection (a). The separate accounting provisions are to be applicable only with respect to taxes which become collectible after the delivery of the notice. In the case of the employment taxes, including the withheld income taxes, this means that the separate accounting provisions are to be applicable only with respect to wages paid after the receipt of the notice. The separate accounting is not to be required with respect to any withholding or collection of taxes which should have occurred prior to the receipt of the notice, although the employer in such cases will still be required to pay these taxes to the Government and will still be subject to all other applicable penalties of law if he fails to do so. The separate accounting would be required, however, with respect to wages earned by employees prior to the notification where payment of the wages occurs after such notification, since the deduction and withholding of the employment taxes are related to the payment of wages.

The accounting procedure provided by subsection (b) makes three requirements with respect to those to whom this subsection is applicable. They are: (1) required to collect the specified taxes, (2) deposit them in a separate account in a bank not later than by the end of the second banking day after the taxes are collected, and (3) keep the deposits in this separate account until payment over to the United States. The account in which the funds are to be deposited is to be designated as a special fund in trust for the United States and is to be payable by the employer or collecting agent only to the United States. This account can be in any bank selected by the employer or collecting agent which meets the definition of the term "bank" as provided in section 851 of the code. The definition in this section provides that it must be a bank or trust company incorporated and doing business under the laws of the United States, any State or any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts and of exercising fiduciary powers which is subject to supervision and examination by State, Territory, or Federal authority having supervision over banks. The definition also includes domestic building and loan associations.

Subsection (c) of the new section 7512 provides a procedure whereby a person who has been subject to the separate accounting requirements of subsection (b) can be relieved of these requirements. This subsection provides that the Secretary of the Treasury or his delegate may cancel the notification which made the separate accounting provisions applicable if he is satisfied that the person involved will henceforth meet the requirements of law and regulations with respect to the specified taxes.

Section 2 of the bill adds the new section 7215, relating to offenses with respect to collected taxes. This new section is divided into two subsections, the first providing a penalty and the second specifying certain exceptions where the penalty will not be applicable.

That penalty imposed by subsection (a) of section 7215 provides that any person to whom the separate accounting provisions of section 7512 (b) are applicable who fails to comply with these requirements is to be guilty of a mis-

demeanor and upon conviction is to be fined up to $5,000, or imprisoned for up to 1 year, or both, together with the costs of prosecution. This penalty is to be in addition to any other penalties provided by law. Thus, the 100 percent civil penalty provided by section 6672 for persons who willfully fail to collect, or truthfully account for, and pay over an internal revenue tax, may also be applicable. This is also true of the criminal penalty provided by section 7202, which provides a fine of not more than $10,000, imprisonment for not more than 5 years, or both, together with the costs of prosecution. The new feature of the penalty provided by the new section 7215 is that it is not limited to the "willful" failure cases to which these other penalties are applicable.

Subsection (b) of the new section 7215 provides that the penalty provided by subsection (a) is not to be applicable in two types of situations. First, it is not to be applicable if the person in question shows that there is reasonable doubt as to whether the law required the collection of the tax or if he shows that there is reasonable doubt that he was the one who was required by law to collect the tax. Thus, the penalty would not apply, for example, in the case of the employment taxes where the person whose status is questioned shows that there was reasonable doubt as to whether he was an employer or engaged in a contract with an independent contractor. The penalty also would not apply, for example, in the case of the excise taxes described in chapter 33, where the person in question can show that there is reasonable doubt as to whether he is the proper collection agent.

The second exception to the penalty in subsection (a) is provided in those cases where the person involved can show that the failure to collect, to deposit and keep the taxes in the separate account was due to circumstances beyond his control. For this purpose, however, a lack of funds immediately after the payment of wages (whether or not resulting from the payment of the wages) is not to be considered circumstances beyond a person's control. This can be illustrated by an employer subject to the requirements of section 7512(b) who has gross payroll requirements of $1,000, with respect to which he is required to withhold $100 of income taxes. If such an employer had on hand only $900 and paid out this entire amount in wages, withholding nothing, the fact that the net wages due equaled this amount would not relieve him of the penalty imposed by section 7215(a).

A lack of funds occuring after the payment of wages (so long as it was not immediately after) would, however, qualify under this exception if it were due to circumstances beyond the person's control. Examples of factors which might result in a lack of funds constituting circumstances beyond the control of the person after (but not immediately after) the payment of wages and within the period before the person was required to deposit the funds are theft, embezzlement, destruction of the business as the result of fire, flood, or other casualty, or the failure of a bank in which the person had deposited the funds prior to transferring them to the trust account for the Government. However, lack of funds arising after payment of wages resulting, for example, from the payment of creditors will not be considered circumstances beyond the person's control.

Section 3 of the bill is concerned with clerical amendments relating to the table of sections for chapter 77 and part I of subchapter A of chapter 75.

Section 4 of the bill provides an effective date. This section provides that the notification provided by section 7512 (a) in the case of the employment taxes can be made only with respect to pay periods beginning after the date of enactment of this bill and in the case of the excise taxes only with respect to taxes, the payment of which is required after the date of enactment of this bill. In the case of the employment taxes, therefore, the notification will not be effective with respect to wages paid after the date of enactment of this bill if the pay periods, with respect to which the wages are paid, began before the date of the enactment of this bill. Since the notification in section 7512 (a) must occur before the separate accounting required by section 7512 (b) becomes applicable, and since the penalties provided by section 7215 are applicable only with respect to failures to meet the requirements specified in section 7512 (b), the separate accounting requirements and penalty applicable thereto also can only apply with respect to failures occurring after the effective date of the bill.

It is anticipated that the passage of this bill will substantially improve revenue collections, but the extent of this improvement is difficult to forecast in advance of experience under these provisions.

[H. R. 9035] [5]

CERTAIN RESTRICTED STOCK OPTIONS

[Senate Report No. 1183, Eighty-fifth Congress, Second Session, Calendar No. 1208]

[January 23, 1958]

MR. BYRD, from the Committee on Finance, submitted the following report to accompany H. R. 9035.

The Committee on Finance, to whom was referred the bill (H. R. 9035) to amend the Internal Revenue Code of 1954 with respect to the basis of stock acquired by the exercise of restricted stock options after the death of the employee, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. GENERAL STATEMENT

This bill amends the restricted stock option provision of present law. In general, it provides substantially the same treatment where one of these options is held by an employee at the time of his death and is exercised by his estate as is presently available where the option is exercised prior to the employee's death. The bill provides that, where an option is held by an employee at the time of his death, it receives a new basis for purposes of determining gain or loss with respect to the income tax. This new basis reflects the spread between the option price and the value of the stock at the date of death (or optional valuation date). Any amount presently taxable as ordinary income at the time of the sale of the stock by the estate or heir, however, still is to be taxable as such under the bill, and, as under present law, a deduction is to be allowed at the time of the reporting of this income for any estate tax paid with respect to the decedent which is attributable to this income. The principal change made by the bill is that any appreciation in value of the stock in which the option is granted, between the time of the granting of the option and the death of the employee (or optional valuation date), no longer is to result in a taxable gain at the time of the sale of the stock by the estate or heir. The changes made by this bill are effective with respect to employees dying after December 31, 1956, in the case of taxable years ending after that date.

II. REASONS FOR THE BILL

Present law in general terms provides that, where an option granted an employee to buy stock qualifies as a "restricted stock option," tax on any gain to the employee is postponed until the time he sells the stock. If the option price was 95 percent or more of the price of the stock at the time of the granting of the option, any gain realized at the time of the sale of the stock is a capital gain. Where the option price is from 85 to 95 percent of the value of the stock at the date of the grant, any gain, to the extent the option price is less than the price of the stock at the date of the grant, is taxed as ordinary income and any additional gain is treated as capital gain. As in the former case, however, this gain generally is not taxed until the time of the sale of the stock; this is true of both the amount taxed as ordinary income and any amount taxed as capital gain.

Where one of these restricted stock options is exercised by an empolyee before his death, but the stock is not sold prior to his death, current law provides that any ordinary income element involved in the option (that is, in the case of an 85- to 95-percent option) is to be taxed to the employee in his last income-tax return. Thus, if an option is granted to buy at $85 stock selling at $100, the option is exercised, and then the employee dies, $15 of ordinary income is included in the last income-tax return of the employee. In such a case, however, and also in the case of options where there is no ordinary income element, the stock held at date of death is included in the estate of the employee for purposes of the Federal estate tax and receives a new basis for purposes of realizing gain or loss on subsequent sale in the case of the income tax. This estate-tax treatment and new basis at death is the same as is generally accorded property held at the time of an individual's death. As a result of this treatment, where an option is exercised prior to an employee's death and there is appre-

[5] Public Law 85-320, page 628.

ciation in value of the stock prior to the employee's death, this amount is not taxed when the stock ultimately is sold. Thus, in the above example, if the price of the stock had risen to $120 at the time of the employee's death, it would be valued for purposes of the employee's estate at this price, or $35 above the money outlay for the stock, although $15 of this would have been taxed as ordinary income in the employee's last return.[6]

A quite different treatment applies under present law, however, where the option is exercised by the estate or an heir after the employee's death. In such a case, although under present law the option is included in the employee's estate for estate-tax purposes, no new basis is available for the option at date of death. Instead, at the time of the disposition the basis for any stock which has been so acquired is the amount which was paid for the stock under the terms of the option (plus any amount taxed as ordinary income upon disposition). Any excess over this amount at the time of the sale of the stock is taxed as a capital gain. If the option was one providing a price between 85 and 95 percent of the price of the stock at the date of grant, and, therefore, giving rise to gain taxable as ordinary income, a deduction is allowed against such income for any estate tax which is payable with respect to this amount taxed as ordinary income. However, no new basis is provided as the result of the employee's death for any rise in the value of the option prior to that time which is attributable to appreciation in the value of the stock in the period between the granting of the option and the death of the employee. (Nor is any deduction for estate tax available with respect to any tax eventually paid with respect to this appreciation.) This discrimination against these options exercised after an employee's death can be seen by examining the tax treatment which would be accorded in the example presented above had the option been exercised by the estate immediately after, rather than before, the employee's death. In this case, as in the prior one, $15 would be reported as ordinary income. A deduction would be allowed for the estate tax attributable to it in lieu of excluding from the estate-tax base the income tax paid on this income. However, with respect to the appreciation in the value of the stock from $100 to $120, no increase in basis would be allowed, even though this value is reflected in the value of the option for estate-tax purposes.

It is this failure to provide a new basis at date of the employee's death which is discriminatory in present law in the case of the option not exercised at the date of death. This bill is designed to remove this inequity by providing a new basis for a restricted stock option at the date of the employee's death. This also requires certain other modifications in the restricted stock option provisions which are explained below.

III. EXPLANATION OF BILL

The first section of the bill adds a new subparagraph providing certain basis rules to section 421(d)(6) of the code, relating to restricted stock options exercised by an estate or heir of a deceased employee. Section 2 repeals subsection (d) of section 1014 of the code, which provides that restricted stock options are not to receive a new basis at the date of an employee's death. And section 3 provides an effective date for the bill.

Subsection (d) of section 1014 of the Internal Revenue Code provides that section 1014 is not to apply in the case of restricted stock options. The repeal of this subsection, which is provided by section 2 of this bill, therefore, means that section 1014 is to be applicable in the case of these restricted stock options. Thus, as is provided by subsection (a) of section 1014, a restricted stock option acquired from a decedent employee, which is exercised, is to have a new basis equal to its value at the date of death of the employee, or, if an election is made under section 2032, its value at its applicable valuation date.

The new subparagraph (C), added to section 421(d)(6) of the code by the first section of this bill, provides certain basis rules which are to be applicable in the case of stock acquired by the estate or heir with one of these restricted stock options which has received a new basis at the date of the employee's death.

Clause (i) of the new subparagraph (C) indicates that, as a general rule, any share of stock acquired as the result of the exercise of one of these restricted

[6] In this and subsequent examples, it is assumed that the estate-tax valuation and the basis of the option are equal to the spread between the option price and the value of the stock at date of death.

stock options is to include its allocable portion of the basis of the option, as well as the money or other payment for the stock. However, an exception is provided to this general rule. The basis otherwise provided is to be reduced by any excess of the amount which would have been taxable at the time of the employee's death (had the option been exercised before that time) over the amount actually taxed as ordinary income. This adjustment is necessary to make sure that the overall effect on income is the same whether the option is exercised before or after the employee's death. This exception can, of course, only affect an option granted at 85 to 95 percent of the then existing stock price, since only such options result in the taxing of a portion of the gain at ordinary income rates.

The exception provided in clause (i) can be illustrated as follows: Assume an option is granted to buy at $85 stock then having a market price of $100, and that the price of this stock advances to $120 at the time of the employee's death (or optional valuation date), but declines to $90 at the time the estate sells the stock acquired with the option. The estate-tax valuation in this case will reflect the spread between the $85 option price and $120, the price of the stock at the time of death (or optional valuation date), and will be $35. The basis for the option will be this same $35. Thus, when the estate or heir exercises the option to acquire the stock, the basis of the stock becomes $120, the $85 of money paid plus the $35 basis for the option. When the stock is sold for $90, $5 becomes taxable as ordinary income, since this is stock subject to the ordinary income-tax treatment provided by section 421(b) and since the stock is sold for more than the option price. If there were no adjustment provided by clause (i) of the new subparagraph (C), there would also be a capital loss of $30, the difference between the $120 basis and the $90 for which the stock was sold. The adjustment required by clause (i), however, reduces the basis of the share of stock at the time of its disposition by $10, thereby reducing the capital loss to $20. The $10 by which the basis is reduced in this case represents the difference between what was taxed as ordinary income—namely, $5—and the $15 which would have been so treated had the option been exercised before death. Thus, there is the same overall effect on income whether the option is exercised before or after the employee's death; in both of the cases presented here the overall effect is a negative effect of $15. Where the option was exercised after death, there was ordinary income of $5 and a capital loss of $20; where it was exercised before death, the ordinary income would be $15 but the capital loss also would be larger—namely, $30. The difference in proportions treated as ordinary income or capital loss in these two cases is a necessary result of not determining the amount of ordinary income until the stock is sold where the option is exercised after the employee's death.

Clause (ii) of the new subparagraph (C) is necessary to prevent a double allowance of basis with respect to the same amount. The last sentence of section 421(b) provides that, in the case of the disposition of a share of stock where the option price is between 85 and 95 percent of the value of the stock, the basis of a share of stock is to be increased by the amount taxed as ordinary income with respect to it. However, with the repeal of subsection (d) of section 1014, that section also may provide a step-up in basis at death with respect to this same amount. This can be illustrated by an option to buy stock at $85 which, at that time, and subsequently, is worth $100. In this case the basis of the option would become $15 at the time of the employee's death, which subsequently would be transferred as basis for the stock along with the $85 of cash paid for the stock. However, when the stock was sold for $100, $15 would be taxed as ordinary income, and the last sentence of section 421(b) (without taking into account the new 421(d)(6)(C)(ii)) would also provide an additional $15 of basis. This would result in a basis of $115 for the stock and would provide a capital loss of $15 where, in reality, no loss occurred.

To prevent this double basis, clause (ii) of the new subparagraph (C) provides that the last sentence of subsection (b) is to apply only to the extent the amount taxable as ordinary income exceeds the basis for the option attributable to the share. Thus, in the above example, the last sentence of subsection (b) will have no effect since the amount taxed as ordinary income ($15) does not exceed the basis for the option (also $15). If, however, the value of the stock at the date of death had been $95 and then subsequently gone back to $100, the basis for the option would be only $10 while the amount taxed as ordinary income would be $15. In this case, section 1014 would give the option, and, subsequently, the stock, a $10 basis, and the last sentence of section 421(b), as limited by clause (ii) of the new subparagraph (C), would

add another $5 to the basis. This $15 of basis plus the $85 of basis for the money paid for the stock provides a total basis of $100, which is equal to the selling price for the stock.

Section 2 of the bill, which repeals subsection (d) of section 1014, has been explained above.

Section 3 of the bill provides that the amendments made by this ball are to apply to taxable years beginning after December 31, 1956, but only with respect to employees dying after that date. The amendments made by the bill are associated with the death of the employee since they are concerned primarily with a new basis for an option upon the employee's death.

It is expected that this bill will result in a negligible revenue loss.

[H. R. 8216] [7]

REFUNDS OF ALCOHOL AND TOBACCO TAXES

[Senate Report No. 1184, Eighty-fifth Congress, Second Session, Calendar No. 1209]

[JANUARY 23, 1958]

Mr. BYRD, from the Committee on Finance, submitted the following report to accompany H. R. 8216.

The Committee on Finance, to whom was referred the bill (H. R. 8216) to amend the Internal Revenue Code of 1954 to prevent unjust enrichment by precluding refunds of alcohol and tobacco taxes to persons who have not borne the ultimate burden of the tax, having considered the same, report favorably thereon with amendments and recommend that the bill, as amended, do pass.

The amendments made by your committee in general apply the provisions of this bill to credits or refunds made on or after May 1, 1958, instead of to those made on or after October 1, 1957, as provided by the bill as it passed the House. Similarly, it changes the references to September 30, 1957 and 1958 to April 30, 1958 and 1959 in connection with the requirements for the filing of claims and in connection with the date for not extending barred claims.

I. PURPOSE OF THE BILL

H. R. 8216 adds a new section 6423 to the Internal Revenue Code to provide that 1 of 2 basic conditions must be met before any refund (or other allowance of a claim) of an alcohol (except occupational taxes) or tobacco tax can be made. These conditions are designed to prevent unjust enrichment by limiting the cases in which refund will be made in general to those where the claimant bore the ultimate burden of the tax or repaid the amount of the tax to the person who bore the ultimate burden. This provision will not apply to claims for drawbacks; for credits or refunds where a commodity is withdrawn from the market, returned to bond, or lost or destroyed; or for amounts claimed where a commodity has been lost where a suit has been filed before June 15, 1957. The provision, as amended by your committee, is to be effective with respect to credits or refunds allowed or made on or after May 1, 1958.

The bill also provides that new claims need not be filed in the case of pending suits. Instead, a procedure is set up whereby the conditions to the allowance of the refund in such cases can be established in the court action.

II. REASONS FOR THE BILL

Under existing law a taxpayer who overpays a retailer's or manufacturer's excise tax, and is not the ultimate purchaser, before obtaining a credit or refund usually must show that he bore the ultimate burden of the tax, that he has repaid the amount of the tax to the purchaser or ultimate purchaser (or in certain cases has repaid or agreed to repay the tax to the ultimate seller) or that he has obtained the consent to the refund of the purchaser or ultimate purchaser (or ultimate seller). Somewhat similar limitations apply in the case of the excise taxes on most admissions, club dues, communications, and trans-

[7] Public Law 85–323, page 630.

portation. The purpose of these limitations is to prevent the taxpayer from realizing a windfall gain from a refund or credit where someone else actually bore the burden of the tax because the price charged for the taxed article, service, or facility included the tax.

Until recently there appeared to be no particular need for limitations on allowance of credits or refunds in the case of alcohol and tobacco taxes such as those provided for most other excise taxes. The claims for credits or refunds with respect to the alcohol or tobacco taxes have ordinarily arisen in situations where the taxed product was lost or destroyed while held by the producer or by the warehouseman, or where the taxed product was withdrawn from the market by the producer. In these cases the taxpayer is not in a position to obtain any special benefit from the refund or credit. However, recently there has been filed with the Internal Revenue Service a series of claims which alleged the unconstitutionality of provisions of the taxing statutes relating to alcohol and tobacco taxes. A tabulation through February 28, 1957, indicates that 2,871 such claims have been filed and that the amount involved in these claims is about $830 million. More recent (but incomplete) data indicate that as of January 1, 1958, more than 3,000 claims have now been filed and that the amount involved in these claims is in excess of $1,378 million. For the most part these refund claims represent cases where the taxes paid were reflected in the prices charged consumers, and, therefore, are comparable to the situations under the other excise taxes where the conditions to the allowance of the refunds or credits are applicable.

Your committee in providing the conditions contained in this bill is in no way attempting to express any view as to the point in litigation. However, it sees no reason, if claims should be allowed for granting refunds or credits to taxpayers who have shifted the burden of the tax to someone else, unless the benefits of the credits or refunds also can be shifted forward to such persons. Title VII of the Revenue Act of 1936, the "unjust enrichment tax" after which the provisions of this bill were patterned, in fact represents a precedent for the action taken by your committee in this bill. The purpose of that act was to preclude payments to persons seeking refunds on the basis of the unconstitutionality of the taxing provisions of the Agricultural Adjustment Act of 1933, unless they established that they bore the ultimate economic burden of the tax. The commodities subject to the processing taxes, like the present alcohol and tobacco taxes, were in general sold at prices which included the amount of such taxes. The validity of limitations on claims for refund of these unjust enrichment taxes was upheld in *Anniston Mfg. Co.* v. *Davis* (301 U. S. 337). Your committee believes that the same reasons which impelled the Congress to act in 1935 and 1936 to prevent windfalls to the milling industry warrant action now to preclude any possibility of windfalls to the distilling industry and other alcohol and tobacco taxpayers.

Your committee has amended the bill as it passed the House to advance the effective date of the bill and the time for filing claims for refund. The effective date of the bill has been advanced from October 1, 1957, to May 1, 1958, in order to provide the Internal Revenue Service with adequate time to prepare regulations under the new provisions. Similar changes have been made in the time for filing claims for refunds in order to accord taxpayers with sufficient time to comply with the provisions of the bill.

III. EXPLANATION OF THE BILL

Section 1 of the bill adds a new section 6423 to subchapter B of chapter 65 of the Internal Revenue Code of 1954 (relating to rules of special application for abatements, credits, and refunds).

Subsection (a) of this section 6423 specifies conditions to the making or allowance of credit or refund of alcohol or tobacco taxes. It denies a credit or refund unless the claimant establishes that he bore the ultimate burden of the amount claimed, or establishes that he has unconditionally repaid the amount claimed to the person who bore the ultimate burden of the amount claimed.

This subsection also makes provision for cases where the taxpayer is not the owner of the taxed commodity. For example, in the case of distilled spirits withdrawn from internal revenue bond, the tax is paid by the warehouseman holding the spirits, and the warehouseman is therefore the only person entitled to file claim for refund of such tax. However, in many instances he is not the owner of the spirits. In such cases the owner is likely to supply the warehouseman with the amount of the tax to secure the release of the

spirits from bond. This subsection recognizes the equities of the owner under these circumstances even though he was not the taxpayer. It permits the warehousemen in these cases to claim the refund or credit where the owner has given his written consent to allowance of the refund to the claimant warehouseman if the owner bore the ultimate burden of the tax or has unconditionally repaid the amount claimed by the person who bore the ultimate burden of the tax.

Interest will be allowed or paid with respect to any amount to which subsection (a) is applicable only with respect to the actual amount of a refund or credit which is made or allowed.

Subsection (b) as a general rule precludes the credit or refund of any amount to which subsection (a) applies unless the claimant files a claim after April 30, 1958, and within the time prescribed by law (in the bill as passed by the House this date was September 30, 1957). All evidence relied on in support of such claim is to be clearly set forth and submitted with the claim. The conditions to allowance would apply in suits for recovery of any amount to which subsection (a) applies, whether brought against the United States or against the collection officer.

Where a claim has been filed on or before April 30, 1958, subsection (b) provides for the filing of a claim, in conformity with the provisions of this section, after April 30, 1958, and before May 1, 1959, which will supersede any prior claim which was not barred from allowance on April 30, 1958. (In the bill as passed by the House, such claims were to be filed after September 30, 1957, and before October 1, 1958, and superseded prior claims which were not barred from allowance on September 30, 1957.) The effect of this provision is to preserve the existing rights of claimants, but to preclude any credit or refund of any amount to which subsection (a) applies unless one of the prescribed conditions to allowance is met.

An exception, however, is provided to this requirement for the filing of a new claim. Any claimant who instituted suit before June 15, 1957, for the recovery of any amount to which subsection (a) applies, is not to be barred by the new section 6423 (b) from the maintenance of such action as to any amount claimed in such action on such date if in such action he establishes one of the conditions to allowance required under subsection (a) with respect to such amount.

Subsection (c) makes it clear that the period of limitations is not extended or opened as to any suit or proceeding which is barred, or as to any claim which is barred from any allowance.

Subsection (d) provides that the new section is not to apply to any claim for drawback, any claim made in accordance with any law expressly providing for credit or refund where a commodity is withdrawn from the market, returned to bond, or lost or destroyed, or to any amount claimed with respect to a commodity which has been lost and where a suit or proceeding was instituted before June 15, 1957. It is not believed necessary to make the conditions to allowance applicable in these circumstances. In the case of the drawback the normal competition in business transactions operates to give the purchaser the benefit of the drawback; where products have been lost, destroyed, or withdrawn from the market, the taxpayer is not in a position to obtain an unjust enrichment.

Subsection (e) states the meaning of the terms "alcohol or tobacco tax," "tax," and "ultimate burden" for the purposes of this section.

The terms "alcohol or tobacco tax" and "tax" are broadly defined to include all amounts paid or collected as tax (other than occupational taxes) with respect to distilled spirits, wines, beer, and tobacco products. They include any amount previously collected as alcohol or tobacco tax, as well as such amounts which may be collected after the date of enactment of the bill.

This subsection states the conditions under which the claimant is to be treated as having borne the "ultimate burden" of an amount of an alcohol or tobacco tax for the purposes of subsection (a) (1), and the conditions under which the owner referred to in subsection (a) (3) is to be treated as having borne such burden for the purposes of such subsection. It provides that the claimant (or owner where subsection (a) (3) is applicable) is to be treated as having borne the burden of the tax only if he has not, directly or indirectly been relieved of the tax or shifted it to someone else and only if there is no understanding or agreement as to such relief or shifting. In fact, this subsection is intended to prevent any refund or credit to which subsection (a) applies

if the claimant in any manner whatsoever has shifted the burden of the amount claimed or is in a position where such burden can be shifted.

The subsection also provides that, where the taxed commodities have not yet been marketed, the claimant must agree not to shift the burden, or to seek relief from it, and must post bond to assure compliance with this agreement.

Section 2 of the bill is a technical amendment to the table of sections in subchapter B of chapter 65 of the code.

Section 3, as amended by your committee, provides that the amendments made by this bill are not to apply to any credit or refund allowed or made before May 1, 1958. (This date was October 1, 1957, under the bill as it passed the House.) The bill thus applies to any credit or refund of any amount to which subsection (a) of the new section 6423 applies, which is made or allowed on or after May 1, 1958, whether in pursuance of a court decision or otherwise, and whether the claim arose on, or before, or after the enactment of this bill.

[H. R. 8794] [8]

ADMISSIONS TO CERTAIN MUSICAL PERFORMANCES AND ATHLETIC EVENTS

[Senate Report No. 1283, Eighty-fifth Congress, Second Session, Calendar No. 1305]

[February 10, 1958]

Mr. BYRD, from the Committee on Finance, submitted the following report to accompany H. R. 8794.

The Committee on Finance, to whom was referred the bill (H. R. 8794) to provide an exemption from the tax imposed on admissions for admissions to certain musical performances, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

In general, the amendments made to the bill provide exemptions from the admissions tax for athletic games between teams composed of students from elementary or secondary schools or colleges: (1) where the gross proceeds are divided between the schools or colleges involved and hospitals for crippled children and (2) where the proceeds inure to an exempt educational, charitable or religious organization operated exclusively for the purpose of aiding and advancing retarded children.

I. GENERAL STATEMENT

This bill makes three changes in the exemptions from the excise tax on admissions. These are as follows:

(1) Present law provides an exemption for "concerts" conducted by nonprofit, civic or community membership associations. This bill, as passed by the House, substitutes the words "musical performances" for the word "concerts." Thus, an exemption will be available to nonprofit civic or community membership associations not only in the case of ballets, operas, operettas, symphonic orchestra concerts, and concerts and performances by local groups, but also in the case of musical comedies and reviews.

(2) In the case of athletic games or exhibitions between teams composed of students from elementary or secondary schools or colleges, present law provides an exemption from the admissions tax if the proceeds inure to the benefit of a hospital for crippled children. Present law also provides an exemption in such cases where the proceeds inure exclusively to the benefit of the educational institutions involved in the athletic event. The bill, as amended by your committee, provides an exemption in the case of these athletic games or exhibitions where the proceeds are divided between the educational institutions involved and hospitals for crippled children.

(3) As indicated above, present law provides an exemption from the admissions tax in the case of athletic games or exhibitions between teams composed of students from elementary or secondary schools or colleges if the proceeds inure to the benefit of a hospital for crippled children. The bill, as amended by your committee, extends this exemption to tax-exempt educational, charitable, or religious organizations operated exclusively for the purpose of benefiting retarded children.

---

[8] Public Law 85–380, page 633.

II. REASONS FOR BILL

A number of exemptions are provided under present law in the case of the excise tax of 1 cent for each 10 cents charged for general admissions (if the charge is in excess of 90 cents). Three changes will be made to this list by H. R. 8794 as amended by your committee.

A. Musical performances

Section 4233(a)(3) of present law exempts certain concerts from the admissions tax. This exemption is for any admissions to concerts conducted by a civic or community membership association if no part of the net earnings inures to the benefit of stockholders or members of the association.

A number of nonprofit civic or community associations have assumed that this exemption applied to all of the musical performances they conducted, and as a result they have sold tickets tax free on this assumption. Moreover, the Internal Revenue Service has held a substantial list of musical performances, when conducted by one of these associations, to be exempt from the admissions tax as "concerts." These include performances by symphony orchestras, bands, and vocal groups, and also such performances as ballets, classical dances, operas, and light operas. Despite this, the Internal Revenue Service recently held that the term "concerts" does not include musical comedies or reviews put on by these associations and that, as a result, such performances when conducted by these organizations are subject to the admissions tax.

Your committee believes that the present definition of the Service as to what constitutes a "concert" and therefore, what results in an exemption from the admissions tax when conducted by one of these nonprofit civic or community membership associations, is arbitrary and should be changed. Your committee sees no reason, for example, to exempt "light operas" when conducted by such an association and not to exempt a musical comedy or review which may be presented by the same organization at its next performance.

The first section of the bill, therefore, substitutes the words "musical performances" for the word "concerts" in the exemption from the admissions tax presently provided for nonprofit civic or community membership associations. In the case of these organizations this will provide an exemption not only in the case of all performances previously classified as "concerts" but also in the case of musical comedies and reviews.

This change will be effective with respect to amounts paid on or after the first day of the first month which begins more than 10 days after the date of enactment of this bill.

It is estimated that this provision will result in a negligible loss of revenue.

B. Athletic games where proceeds are divided between hospitals for crippled children and the schools involved

The attention fo your committee has been directed to cases where athletic games are played between college teams where the colleges involved are paid a flat guaranty and the proceeds remaining are turned over to hospitals for crippled children. Since the proceeds do not inure exclusively to the schools, or exclusively to the hospitals for crippled children, the Internal Revenue Service has held that no exemption is available with respect to the admissions charged for these games. This holding appears to be in accord with the specific words of the statute but has an arbitrary effect. Since an exemption is provided under present law in the case of these athletic games where all of the proceeds inure to the colleges involved, or to hospitals for crippled children, your committee believes that an exemption should also be available where the proceeds are divided between the hospitals for crippled children and the schools or colleges involved. Section 2 of the bill as amended by your committee amends the sentence at the end of section 4233(a)(1)(C) of the code to accomplish this result.

This change will be effective with respect to amounts paid on or after the first day of the first month which begins more than 10 days after the date of enactment of this bill.

It is estimated that this provision will result in a negligible loss of revenue.

C. Athletic games for benefit of retarded children

Instances have also come to the attention of your committee where all-star athletic games are played between teams composed of students from various schools or colleges where the proceeds from the game are turned over to tax-exempt educational, charitable, and religious organizations which are operated exclusively for the purpose of aiding and advancing retarded children. Present

law would exempt admissions to such athletic games if the proceeds were turned over to hospitals for crippled children but not where the funds are used to benefit retarded children. Cases where the proceeds are used for the purpose of aiding and advancing retarded children appears to be a purpose quite similar to that of benefiting hospitals for crippled children and equally to merit exemption from the admissions tax. Therefore, section 3 of the bill, as amended by your committee, adds a new paragraph (11) to section 4233(a) of the Code to accomplish this result.

This new exemption will be effective with respect to amounts paid on or after the first day of the first month which begins more than 10 days after the date of enactment of this bill.

It is estimated that this provision will result in a negligible loss of revenue.

[H. R. 10021] [9]

TAXATION OF LIFE INSURANCE COMPANIES

[House of Representatives Report No. 1296, Eighty-fifth Congress, Second Session]

[JANUARY 23, 1958]

Mr. MILLS, from the Committee on Ways and Means, submitted the following report to accompany H. R. 10021.

The Committee on Ways and Means, to whom was referred the bill (H. R. 10021) to provide that the 1955 formula for taxing income of life-insurance companies shall also apply to taxable years beginning in 1957, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE

The bill would amend the Internal Revenue Code of 1954 by applying the tax imposed by section 802 on the income of life-insurance companies to taxable years beginning in 1957. Under present law this section applies only for taxable years beginning in 1955 or 1956.

REASON FOR THE BILL

Life-insurance companies have been taxed under various stopgap formulas since 1950. Each of these formulas has specified a tax computation for a particular year in lieu of the basic formula contained in the code, the method of taxation for life-insurance companies which was adopted in 1942. Both the 1942 formula and the various stopgap formulas which have applied to date designate a part of investment income as taxable.

Beginning in 1955, life-insurance companies were taxed under a formula provided by H. R. 7201 (Public Law 429 of the 84th Cong.) [C. B. 1956–1, 858], which was originally presented as a permanent method of taxing life-insurance companies in 1955. At that time the Secretary of the Treasury endorsed the formula as a 1-year stopgap for 1955 with the understanding that the Department of the Treasury would shortly submit a recommendation for permanent legislation on the basis of total income rather than on an investment-income formula.

Following the Treasury's recommendation, the formula of H. R. 7201 was applied for 1955. The basic 1942 formula was not repealed and thus would apply to any year for which new legislation is not enacted. Since the Treasury had not developed an alternative plan, the formula of H. R. 7201 was again applied to 1956 (Public Law 785 [10] of the 84th Cong., 2d sess. [C. B. 1956–2, 1179]).

Since the Treasury has not as yet fully developed its proposals for a permanent method of taxation of life-insurance companies, these companies are again faced with uncertainty as to the method under which they will be taxed in respect to their operations for 1957, and unless new legislation is adopted the 1942 formula will apply. This development would nullify several important improvements in the technique of life-insurance company taxation contained in the formula of H. R. 7201. For example, that formula provides, in effect, a lower rate of tax applicable to the first million dollars of investment income, and your committee believes it desirable that this feature be retained in the law as an aid to

---

[9] Public Law 85–345, page 632.

[10] This Public Law number is in error; it should have been shown as Public Law 784.

small life-insurance companies. In addition, that formula provides a method of taxing income allocable to accident and health-insurance business of life-insurance companies which is based upon the actual earnings on the reserves of such business instead of hypothetical earnings, as provided by the 1942 formula.

While the 1942 formula, if allowed to come into operation, would raise more revenue from life-insurance companies than an extension of the formula of H. R. 7201, the reason for abandoning the 1942 formula was that, under the particular conditions existing in 1947 through 1949, the 1942 formula would have provided virtually no revenue at all to the Federal Government. Your committee believes that it would be unreasonable to return to a fundamentally unsound tax formula simply because under the changed conditions of 1957 it would produce a larger amount of revenue.

The Treasury Department approves of extending the formula of H. R. 7201 to 1957.

Accordingly, since the Treasury Department has not as yet fully developed its proposal to provide a permanent method of taxing life-insurance companies, and in view of the fact that the Secretary of the Treasury has informed your committee that specific proposals will be advanced in the very near future, your committee is unanimous in urging the passage of H. R. 10021.

EXPLANATION OF THE BILL

Section 802(a) of the Internal Revenue Code of 1954 imposes a tax on the income of life-insurance companies for taxable years beginning in 1955. Section 802(c) imposes, also for taxable years beginning in 1955, an alternative tax on certain life-insurance companies having non-life-insurance business. Your committee's bill would amend subsections (a) and (c) of section 802 by inserting "beginning after December 31, 1954, and before January 1, 1958" in place of "beginning in 1955 or 1956".

Section 811 imposes tax under a different formula for taxable years beginning after December 31, 1956. This date is amended to December 31, 1957.

[H. R. 10021] [11]

TAXATION OF LIFE-INSURANCE COMPANIES

[Senate Report No. 1368, Eighty-fifth Congress, Second Session, Calendar No. 1390]

[March 10, 1958]

MR. BYRD, from the Committee on Finance, submitted the following report together with minority views to accompany H. R. 10021.

The Committee on Finance, to whom was referred the bill (H. R. 10021) to provide that the 1955 formula for taxing income of life-insurance companies shall also apply to taxable years beginning in 1957, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE

The bill would amend the Internal Revenue Code of 1954 by applying the tax imposed by section 802 on the income of life-insurance companies to taxable years beginning in 1957. Under present law this section applies only for taxable years beginning in 1955 or 1956.

REASON FOR THE BILL

Life-insurance companies have been taxed under various stopgap formulas since 1950. Each of these formulas has specified a tax computation for a particular year in lieu of the basic formula contained in the code, the method of taxation for life-insurance companies which was adopted in 1942. Both the 1942 formula and the various stopgap formulas which have applied to date designate a part of investment income as taxable.

Beginning in 1955, life-insurance companies were taxed under a formula provided by H. R. 7201 (Public Law 429 of the 84th Cong. [C. B. 1956–1,858]), which was originally presented as a permanent method of taxing life-insurance

[11] Public Law 85–345, page 632.

companies in 1955. At that time the Secretary of the Treasury endorsed the formula as a 1-year stopgap for 1955 with the understanding that the Department of the Treasury would shortly submit a recommendation for permanent legislation on the basis of total income rather than on an investment-income formula.

Following the Treasury's recommendation, the formula of H. R. 7201 was applied for 1955. The basic 1942 formula was not repealed and thus would apply to any year for which new legislation is not enacted. Since the Treasury had not developed an alternative plan, the formula of H. R. 7201 was again applied to 1956 (Public Law 785 [12] of the 84th Cong., 2d sess.). [C. B. 1956–2, 1179]

Since the Treasury has not as yet fully developed its proposals for a permanent method of taxation of life-insurance companies, these companies are again faced with uncertainty as to the method under which they will be taxed in respect to their operations for 1957, and unless new legislation is adopted the 1942 formula will apply.

Although a reapplication of the 1942 formula would increase the overall tax liabilities of life-insurance companies by an estimated $124 million or about 43 percent above the stopgap method, it would also involve substantial shifts in burden among, companies, in relation to their total tax load and their taxable capacity.

Several factors account for this varying impact. One is the special treatment for smaller companies provided under the stopgap law but not under the 1942 formula. The 1942 formula provides a 77.66-percent reserve and other policy liability deduction for all companies in 1957, leaving 22.34 percent of their net investment income subject to tax at regular corporate rates. The stopgap method generally allows an 85-percent deduction, leaving 15 percent of the income subject to tax. However, the deduction is 87½ percent on the first $1 million, leaving 12½ percent of this amount subject to tax. Consequently, for very large companies the shift from an 85-percent to a 77.66-percent deduction would mean about a 49-percent increase in the tax base and tax liability. For companies with incomes under $1 million, the shift would be from 87½ percent down to a 77.66-percent allowance, involving about a 79-percent increase in their tax base. Because of the interplay of the insurance company deduction and the surtax exemption for corporations generally, the percentage increase in tax would be still greater at some income levels, ranging as high as 136 percent for a company with $200,000 net investment income.

The Treasury Department in public statement before the Committee on Finance on Wednesday, March 5, 1958, promised to submit its recommendations for a permanent tax formula for life-insurance companies to the House Committee on Ways and Means on Monday, April 7, 1958.

The Secretary of the Treasury in identical letters of January 10, 1958, to the chairmen of the Senate Committee on Finance and House Committee on Ways and Means, said:

> Pursuant to various conversations which we in the Treasury have had with you and other members of your committee, I am writing with reference to the income-tax law which will apply to the 1957 earnings of life-insurance companies, concerning which the members of your committee and the Treasury have been and are receiving a large number of inquiries.
>
> As you know, in the absence of new legislation, life-insurance companies will be taxed for the year 1957 in accordance with the 1942 formula which has not been applied since 1948. I believe it to be generally agreed that the application of the 1942 formula would, after a lapse of 8 years, produce some inequitable results.
>
> For the taxable years 1949 through 1956 a succession of interim laws were adopted, of which the most recent was the law effective for the taxable years 1955 and 1956.
>
> The Treasury Department believes that it is most desirable that a permanent method of taxation of life-insurance companies be worked out, and we hope to propose in the very near future an approach which we believe will be reasonable and equitable for the foreseeable future.
>
> I am sure that the House Ways and Means and the Senate Finance Committees will want to consider any such proposals in the light of

[12] This Public Law number is in error; it should have been shown as Public Law 784.

testimony that will be submitted and other considerations which the members of your committee may want to suggest or evaluate.

Under these circumstances, and because of the complexity of the subject, it is not probable that final legislation, along whatever lines the Congress determines is appropriate for permanent legislation, could be adopted before March 15 when the returns for the 1957 taxable year are due.

An important fact is we are dealing with institutions with responsibility for the insurance policies of millions of American people and final decisions by the life-insurance companies as to policy dividends and surpluses for the year 1957 will depend to some extent on the final determination of their tax liability. In view of this, and in order to assure full consideration of the best permanent method of taxation of insurance-company income, it would seem reasonable to extend the law effective for the taxable years 1955 and 1956 for another year and make it applicable for 1957 income. It would be my hope that we could then proceed to work out a permanent method of taxation in this area which would be fair and equitable.

Accordingly, the Treasury would go along with an extension of the 1955 legislation so that it might be applied to 1957 income of life-insurance companies.

In reiterating the position of the Treasury Department in favoring the extension of the 1955 stopgap formula as proposed in H. R. 10021, the following letter was subsequently submitted to the chairman:

TREASURY DEPARTMENT,
Washington, March 6, 1958.

HON. HARRY F. BYRD,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

MY DEAR MR. CHAIRMAN: I want to make the record clear that no statement which I made yesterday before your committee was intended to indicate any dissent from the statement which the chairman of the House Committee on Ways and Means made before the House on H. R. 10021.

With reference to the tax to be imposed on life-insurance companies, all of use are most interested in permanent legislation which will obviate any need for annual review. Satisfactory permanent legislation, in our opinion, would not be achieved either by the 1942 law or by an indefinite extension of the 1955 stopgap formula.

Under the circumstances, the Treasury advised the Ways and Means Committee that it was agreeable to the application of the stopgap legislation for 1 year, and thus joined with the Ways and Means Committee in such an extension. This is in accord with the statement of the chairman of the House Ways and Means Committee on January 30 in the House.

Sincerely yours,

DAN THROOP SMITH,
Deputy to the Secretary.

MINORITY VIEWS

The evidence presented to the Senate Finance Committee does not, in our opinion, justify passage of H. R. 10021.

The provisions of the Internal Revenue Code with respect to life-insurance companies were enacted in 1942. It is under terms of this law that the 1957 tax liabilities of insurance concerns have accrued and on which payment is due March 15, 1958. Mr. Dan Throop Smith, deputy to the Secretary of the Treasury, testified before the committee that the United States Treasury Department would "go along" with enactment of H. R. 10021. When asked, however, if he knew of "undue hardship that would be imposed or that is imposed by the present tax law," he answered, "Hardship? No; I am not aware of any."

Then, when asked if it would be unreasonable to require insurance companies "to pay their tax liability as levied under the present law," Mr. Smith replied, "Not to my knowledge, that would not be unreasonable either."

Moreover, witnesses from the insurance industry itself did not claim that the 1942 law generally constituted an undue hardship. Indeed, one of the wit-

nesses, Mr. Charles A. Taylor, president of the Life Insurance Company of Virginia, said, "No, sir, I cannot come here begging for relief * * *"

In fairness to the insurance companies, it should be said that the 1942 law has upon several occasions been superseded by temporary legislation, and that many insurance companies presumed, or were led to believe, that it would again be superseded with respect to 1957 income. Congress has not done so, however, and 1957 taxes are now owed.

So, passage of H. R. 10021 now would constitute retroactive tax reduction for insurance companies in an amount estimated to be $124 million.

The record of the hearings before the Senate Finance Committee fails to identify the principal beneficiaries of the enactment of H. R. 10021. Since the bill was reported by the committee, we have conducted a preliminary examination of the financial statements of the 10 largest life-insurance companies. From this examination, it would appear that of the $124 million in tax forgiveness that would be shared by more than 1,000 life-insurance companies, should H. R. 10021 be enacted, the 10 largest companies would receive approximately $75 million. The record of committee hearings contains no evidence whatsoever that existing law levies an unfair or unreasonable tax burden on these principal beneficiaries of the bill.

Retroactive tax reduction, or tax forgiveness, is a highly questionable procedure and should be resorted to only in cases of extreme hardship and clear justification. The record contains no evidence of such hardship or justification in this case.

CLINTON P. ANDERSON.
ALBERT GORE.
JOHN J. WILLIAMS.

[H. R. 8268] [13]

UNRELATED BUSINESS TAXABLE INCOME OF CERTAIN TESTAMENTARY CHARITABLE TRUSTS

[Senate Report No. 1402, Eighty-fifth Congress, Second Session, Calendar No. 1427]

[March 20 (legislative day, March 17), 1958]

Mr. Byrd, from the Committee on Finance, submitted the following report to accompany H. R. 8268:

The Committee on Finance, to whom was referred the bill (H. R. 8268) to amend section 512 of the Internal Revenue Code of 1954, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

I. GENERAL STATEMENT

H. R. 8268, as amended by your committee, revises the definition of the term "unrelated business taxable income" contained in the 1954 code. The general effect of this revision is to accord the same tax treatment for income distributed with respect to limited-partnership interests held by certain testamentary charitable trusts that is presently accorded income derived from dividends received by such trusts. The bill, as amended, excludes from the definition of unrelated business taxable income the income derived from a limited-partnership interest only to the extent that the income attributable to such interest is actually distributed. This provision is to be effective with respect to taxable years of trusts beginning after December 31, 1955.

II. REASONS FOR THE BILL

Under existing law, a charitable trust is taxable with respect to its unrelated business income. The Revenue Act of 1950 first made charitable organizations—whether they were tax-exempt organizations or were trusts otherwise entitled to the unlimited deduction for charitable contributions—taxable with respect

[13] Public Law 85-367, page 633.

to their unrelated business income. Such income was made taxable to prevent unfair competition. It was believed that charitable organizations should not be able to use their tax exemption to obtain tax-free profits with which they could expand their business operations, and that they should not be able to use their tax exemption to acquire businesses. Certain types of income, however, were not made subject to tax. In the words of the report of the Committee on Finance:

"Dividends, interest, royalties, most rents, capital gains and losses, and similar items are excluded from the base of the tax on unrelated income because your committee believes that they are passive in character and are not likely to result in serious competition for taxable businesses having similar income. Moreover, investment-producing incomes of these types have long been recognized as a proper source of revenue for educational and charitable organizations and trusts" (S. Rept. 2375, 81st Cong., 2d sess., pp. 30–31).

No specific exception was made, however, for income received from a partnership interest. Thus, under existing law, income from a partnership interest held by a charitable organization—whether the partnership interest is that of a general partner or that of a limited partner—is unrelated business income except to the extent that the income received by the partnership is specifically excluded as dividends, interest, royalties, and the like. It is the belief of your committee that other income derived from certain limited-partnership interests may also be passive in character and that, to the extent such partnership income is distributed (and subject to other limitations also designed to prevent the forms of abuse which the unrelated business income tax is intended to prevent), such income should be excluded from the tax base.

Where a charitable trust has an interest as a general partner, the income from such interest cannot be considered passive because the charity does not have a mere investment interest in the partnership, but, rather, has the same rights and liabilities with respect to the management, control, and operation of the partnership business that any other partner has. Where, on the other hand, the interest of a charitable trust is solely that of a limited partner in a partnership created under the laws of a State which recognize such interests and which do not permit a limited partner to take part in the control of the business of the partnership and retain liability merely as a limited partner, the income derived from such an interest may be regarded as passive in character and, under the limitations and safeguards provided by this bill, would not be likely to result in serious competition to taxable businesses. Thus, where a limited-partnership interest is held by a charitable trust which is required to distribute currently all of its income exclusively for charitable purposes and which is required ultimately to distribute the trust corpus for such purposes, there is not a problem of unfair competition if the only income from the limited partnership interest which is excluded from the tax base is the income which is received from the partnership, since the partnership cannot retain the income from such interest without subjecting such income to tax. The charity's tax exemption cannot be used to obtain tax-free profits with which to expand the partnership business operations. Your committee believes that, with the addition of this conduit rule—denying the exclusion to the extent that the partnership income is not actually distributed by the partnership—the income from such an interest is passive in character and does not permit the use of the charitable tax exemption for unfair business competition.

H. R. 8268, as amended, provides additional limitations upon the exclusion. It is provided that, if the charitable trust is a general partner in the partnership (or is liable as a general partner in the partnership), the provision shall not apply for income received from the partnership interest in that year or any subsequent year. This restriction insures that the income received from the charitable trust will be wholly passive in character, and will also prevent manipulations intended to use the charitable trust tax exemption for business purposes. Similarly, the bill applies only to limited-partnership interests acquired by virtue of a will, and, therefore, does not apply, for example, to interests which are purchased by a charitable trust. Thus, in addition to subjecting to tax partnership income that is retained by the partnership, the bill prevents a charitable trust from using its other assets to acquire or enlarge a limited-partnership interest and thereby expand the scope of the partnership business activities. Finally, the bill applies only in the case of a trust created by virtue of the provisions of the will of an individual who died after August 16, 1954, and before January 1, 1957. The bill is effective only with respect to taxable years of trusts which begin after December 31, 1955.

III. EXPLANATION OF THE BILL

Subsection (a) of the bill amends section 512(b) of the 1954 code by adding at the end thereof a new paragraph (13). The new paragraph (13) is applicable in the case of a trust which meets the following four conditions:

(1) The trust must be created by virtue of the provisions of the will of an individual who died after August 16, 1954, and before January 1, 1957.

(2) The trust must, by virtue of the provisions of such will, be a limited partner in a partnership which is created under the laws of a State providing for the creation of limited partnerships. In addition, under the laws of that State, a limited partner must not have any right to take part in the control of the business of the partnership without becoming liable as a general partner. This condition prevents a charitable trust from qualifying under the new paragraph by acquiring a limited-partnership interest under a general investment power granted to the trustees. For example, if the terms of the decedent's will do not purport to transfer a limited-partnership interest to a charitable trust created by virtue of the provisions of the decedent's will, but do give broad investment powers to the trustees, a purchase of a limited-partnership interest by the trustees will not qualify the trust for any exclusion under the new paragraph (13), notwithstanding the fact that such an investment is proper or even is specifically contemplated by the trust instrument. However, if the terms of the decedent's will do purport to transfer a limited-partnership interest to the charitable trust, this second condition is complied with (assuming the partnership interest is created under the laws of a State meeting the requirements set forth therein), notwithstanding the fact that the partnership may have to be reconstituted on the decedent's death (as, to convert the decedent's general-partnership interest into that of a limited partner) or that the partnership agreement also makes provision for the transfer of the limited-partnership interest to the charitable trust. Furthermore, if the terms of the will purport to transfer to the charitable trust a limited-partnership interest and, in addition, transfer other assets to the charitable trust, if the trustees acquire an additional interest as a limited partner by the use of the other assets the additional interest does not constitute a limited-partnership interest acquired by virtue of the provisions of the will.

The second condition also limits the exclusion provided by the new paragraph (13) to trusts which are limited partners in a partnership created under the laws of a State which provide for the creation of limited partnerships. For example, the trust may be created under the laws of any State which has adopted the Uniform Limited Partnership Act. Moreover, under this condition, if under State law a limited partner can take part in the control of the business and remain liable merely as a limited partner, the new paragraph (13) will not apply.

(3) The trust may not, either before or during a taxable year of the partnership which ends within or with the taxable year of the trust, be a general partner or be liable as a general partner. This condition prevents a charitable trust from qualifying for the exclusion provided by the new paragraph if the trust has 2 interests in a partnership—1 as a general partner and 1 as a limited partner. Furthermore, if at any time the interest of the trust as a limited partner is converted into that of a general partner, this provision will not apply for that year or for any future year.

(4) The trust must be required, under the terms of the governing instrument and applicable local law, to distribute currently all of its trust income (within the meaning of sec. 643 (b)) exclusively for religious, charitable, scientific, literary, or educational purposes. In addition, the trust must be required ultimately to distribute all of its corpus exclusively for such purposes.

Where all of the four conditions enumerated above are met by a trust, there shall be excluded from the term "unrelated business taxable income" the trust's share of gross income of the partnership as such limited partner (and of the partnership deductions directly connected with such income). The trust's share of gross income and deductions shall be determined under section 512(c), taking into account the exceptions, additions, and limitations contained in section 512(b) except for those contained in the new paragraph (13) and in paragraph (11). However, if the trust's share of gross income exceeds its share of deductions, the exclusion applies only to the extent that the partnership makes distributions during its taxable year (or on or before the 15th day of the 4th calendar month after the close of such taxable year) which are

attributable to such gross income. In determining whether a partnership makes distributions within the requisite period which are attributable to the trust's share of gross income, distributions shall be treated as attributable first to gross income other than the trust's share of gross income excluded under the new paragraph. For example, if a partnership has income which under present law would be excluded from unrelated business taxable income (such as interest or dividends) and in addition has income which would not be so excluded, then, in determining whether and to what extent the trust is taxable, distributions by the partnership will be attributable first to income already exempt. The effect of this rule will be to tax the trust to the extent that the partnership retains any part of the income attributable to the trust's interest in the partnership.

The bill further provides that distributions shall be properly adjusted, under regulations prescribed by the Secretary or his delegate, to the extent necessary to reflect capital contributions to the partnership made by the trust, income of the partnership exempt from tax under the internal-revenue title, and for other items. Thus, for example, if a distribution is made by a partnership to a charitable trust with respect to the limited-partnership interest held by the trust and thereafter the trustees make a capital contribution to the partnership, the amount of the prior distribution may be reduced under this provision. Similarly, a reduction in the amount of a distribution would be made where the partnership received tax-exempt interest and the trust's share of such interest was not distributed by the partnership.

Subsection (b) provides that the amendment made by this bill shall apply to taxable years of trusts beginning after December 31, 1955.

The Treasury Department has raised no objection to the merits of the bill, but is opposed to retroactive legislation.

PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

TABLE OF CONTENTS

	Page
Statement of Organization and Functions (Special Technical Services Division)	663
Statement of Procedural Rules (Amendment)	664
Proclamation 3214	677
Proclamation 3229	678
Treasury Department Order No. 150-46	679
Delegation Order No. 56	679
Delegation Order No. 57	680
Delegation Order No. 58	680
Delegation Order No. 60	681
Delegation Order No. 61	683
Delegation Order No. 62	683
Revenue Procedure No. 58-1	683
Revenue Procedure No. 58-2	684
Revenue Procedure No. 58-3	685
Revenue Procedure No. 58-4	687
Revenue Procedure No. 58-5	688
Revenue Procedure No. 58-6	689
Revenue Procedure No. 58-7	689
Revenue Procedure No. 58-8	690
Revenue Procedure No. 58-9	692

475254°—58——43

PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

ORGANIZATION AND FUNCTIONS SPECIAL TECHNICAL SERVICES DIVISION

Paragraph 1113.62 of the statement on organization and functions of the Internal Revenue Service which was published in 21 F. R. 10424–5, December 28, 1956 [C. B. 1957–1, 679] is hereby amended to read as follows:

1113.62 *Special Technical Services Division.* The Special Technical Services Division conducts a program of technical services which includes the preparation and issuance of replies to communications which relate to general technical information. It provides technical research and reference material and services for National Office personnel. It conducts special studies of tax problems for the purpose of reducing areas of controversy, promoting uniformity and establishing policy guidance. It periodically prepares and publishes summaries of technical developments for Service personnel, prepares tax guides for the public, reviews technical material used for training Service personnel, develop technical materials for use in annual training institutes in district offices, and reviews tax guide material prepared outside the Service. The Division conducts a program for the selection and publication of precedent rulings, decisions, procedures, policy announcements, and other statements in the Internal Revenue Bulletin. It provides expert technical advice on engineering and valuation aspects of tax determinations, and grants (or denies, as the case may be) permission to taxpayers to change the method of accounting for depletion, depreciation, and obsolescence. It replies to and makes determinations on inquiries arising from within the Service, Taxpayers, and others on engineering and valuation matters which do not involve the establishment of precedents. The Division Director is responsible for and supervises the activities of four branches: Technical Reference Branch, Technical Projects Branch, Bulletin Branch, and Engineering and Valuation Branch.

Dated: April 29, 1958.

[SEAL] RUSSELL C. HARRINGTON,
Commissioner.

(Filed by the Division of the Federal Register on May 7, 1958, 8:48 a. m., and published in the issue of the Federal Register for May 8, 1958, 23 F. R. 3070.)

STATEMENT OF PROCEDURAL RULES (AMENDED)
26 CFR—PART 601 [1]

This part, as filed with the FEDERAL REGISTER on June 29, 1955, and as last amended on August 4, 1956 [C. B. 1956-2, 1372], is further amended as follows:

PARAGRAPH 1. The Table of Contents is amended as follows:

(A) By striking out the heading of Subpart C and inserting in lieu thereof the following:

SUBPART C—PROVISIONS RELATING TO DISTILLED SPIRITS, WINE, BEER, TOBACCO PRODUCTS, TOBACCO MATERIALS, CIGARETTE PAPERS AND TUBES, AND CERTAIN FIREARMS

(B) By striking out the heading of section 601.316 and inserting in lieu thereof the following:

601.316 Claims.

(C) By inserting immediately preceding section 601.326 an undesignated center heading as follows:

SEIZED PROPERTY

(D) By striking out the heading of section 601.326 and inserting in lieu thereof the following:

601.326 Seizure and forfeiture of personal property.

PAR. 2. Section 601.101(b), *Scope*, is amended by striking out the seventh sentence and inserting in lieu thereof the following:

The procedural rules of the Service with respect to distilled spirits, wine, beer, tobacco products, tobacco materials, cigarette papers and tubes, and certain firearms are described in Subpart C.

PAR. 3. Section 601.104, COLLECTION FUNCTIONS, is amended as follows:

(A) By striking out ", revenue agent," in the second sentence of paragraph (a)(1).

(B) By striking out the eighth sentence of paragraph (a)(1) and inserting in lieu thereof the following:

In the case of certain individual income taxpayers having gross income not exceeding an amount prescribed by law and consisting of income from specified sources, a special form (Form 1040A) is prescribed upon which the taxpayer may set forth the information necessary to a determination of his tax liability. The taxpayer may compute the tax on Form 1040A and transmit with the return any unpaid balance of the tax, or he may have the district director compute the tax and mail him a notice stating the amount of tax due.

(C) By striking out the last sentence of paragraph (c)(2) and inserting in lieu thereof the following:

28 U. S. C. 2463.

PAR. 4. Section 601.105, EXAMINATION OF RETURNS AND CLAIMS FOR REFUND, CREDIT OR ABATEMENT; DETERMINATION OF CORRECT TAX LIABILITY, is amended as follows:

(A) By striking out "deficiency" in the third sentence of paragraph (a) and inserting in lieu thereof "additional tax".

(B) By striking out "by the Collection Division" in the fourth sentence of paragraph (a).

(C) By striking out "collection" in the third sentence of paragraph (b)(1) and inserting in lieu thereof "revenue".

[1] 23 F. R. 3124.

(D) By striking out the second sentence of paragraph (b)(2) and inserting in lieu thereof the following:

Ordinarily these are returns which do not disclose activities involving the conduct of a business, and, in some cases, returns which disclose business activities and which involve adjustments of a minor nature.

(E) By striking out the third and fourth sentences of paragraph (b)(4) and inserting in lieu thereof the following:

The taxpayer will be furnished a statement explaining the proposed adjustments as a basis for requesting an informal conference, if desired. Such informal conference will afford the taxpayer an opportunity to discuss orally the proposed adjustments prior to the preparation of the examining agent's final report.

(F) By striking out the last three sentences of paragraph (c)(1).

(G) By striking out the second sentence of paragraph (c)(2) and inserting in lieu thereof the following:

This procedure, however, is not applicable in the determination of liability for any excise tax imposed by subtitle E of the Internal Revenue Code (relating to alcohol, tobacco, machine guns and certain other firearms), or by subchapter D of chapter 78 (relating to certain import taxes) insofar as it relates to alcohol and tobacco.

(H) by inserting "final" after "agent's" in the second sentence of paragraph (c)(3).

(I) By striking out paragraph (d) and inserting in lieu thereof the following:

(d) *Thirty-day letters and protests*—(1) *General.*—The report of the examining agent, as approved after review, recommends one of four determinations:

(i) Acceptance of the return as filed and closing of the case;

(ii) Assertion of a given deficiency or additional tax;

(iii) Allowance of a given overassessment, with or without a claim for refund, credit, or abatement;

(iv) If a claim for refund, credit, or abatement has been filed and has been found wholly lacking in merit, denial of the claim.

If any one of the last three determinations is made (except a full allowance of a claim in respect of any tax), unless the taxpayer has previously agreed with the finding by signing an agreement form as above described in this section, the district director sends to the taxpayer a preliminary or "30-day letter". This is a form letter which states the determination proposed to be made. It is accompanied by a copy of the examining agent's report explaining the basis of the proposed determination. It suggests to the taxpayer that if he concurs in the recommendation, he indicate his agreement by executing and returning the enclosed form of waiver or acceptance. The preliminary letter also advises the taxpayer that if he disagrees with the proposed determination, he may file a written protest under oath within 30 days (from the date of the letter) stating the grounds for his disagreement and may have a hearing in the Appellate Division of the region if requested, and if that Division has jurisdiction (see § 601.106(a)(3)). Failure by the taxpayer to make any response within 30 days will result in the issuance of a statutory notice of deficiency or other appropriate action, such as the issuance of a notice of adjustment or the denial of a claim in income, profits, estate and gift tax cases, and appropriate adjustment of the tax liability or denial of a claim in excise and employment tax cases.

(2) *Protests.*—(i) If the taxpayer chooses to file a protest against the proposed determination set forth in the "30-day letter", his protest should be filed in the district director's office and, following review of the protest, the case will be referred to the Appellate Division of the region if that Division has jurisdiction. The taxpayer will also be accorded a conference in the Appellate Division if he requests it. Protests should be filed in triplicate. No particular form of protest has been prescribed. However, instructions for the prepara-

tion of protests are sent with the "30-day letter". For a description of the procedure in the Appellate Division, see section 601.106.

(ii) Protests against proposed determinations of excise taxes imposed by chapter 35 of the Code (relating to wagering), and subchapter A of chapter 39 (relating to narcotic drugs and marihuana), which are excluded from Appellate Division jurisdiction, are reviewed in the Audit Division of the district director's office. In the event that an agreement with the taxpayer is reached, he will be requested to execute an appropriate agreement form. If consideration of the protest does not result in closing the case on an agreed basis, the taxpayer is notified of the conclusions reached. Any additional tax will then be assessed or any overpayment will be credited or refunded.

(J) By striking out "Claims" in the first sentence of paragraph (e)(2) and inserting in lieu thereof "Generally, claims".

(K) By adding at the end of paragraph (e) the following new subparagraph:

(6) For special procedure applicable to claims for payment in respect of gasoline used on a farm for farming purposes, for nonhighway purposes, or by local transit systems, see sections 6420 and 6421 of the Code and section 601.402(c)(3).

PAR. 5. Section 601.106, APPELLATE FUNCTIONS, is amended as follows:

(A) By striking out the first sentence of paragraph (b) and inserting in lieu thereof the following:

In any case in which the district director has issued a preliminary or "30-day letter" and the taxpayer files a written protest under oath against the proposed determination of tax liability, except as to those taxes described in paragraph (a)(3) of this section, the taxpayer has the right (and will be so advised by the district director) of administrative appeal to the Appellate Division of the region.

(B) By striking out the last sentence of paragraph (d)(1)(i) and inserting in lieu thereof the following:

As an incident to such settlement the taxpayer may also be required to execute an agreement providing that prompt payment of the agreed deficiency or additional tax, together with interest due thereon, will be made and that no claim for refund will be filed or prosecuted other than for the agreed amount of any overassessment.

(C) By striking out the last sentence of paragraph (d)(1)(ii) and inserting in lieu thereof the following:

In any other unagreed case, the case and its administrative record will be returned to the district director with directions to take such action with respect to the tax liability determined in the Appellate Division as may be appropriate, such as the issuance of a statutory notice of disallowance of a claim for refund or credit in whole or in part, the preparation of a notice of adjustment or other appropriate action, or the collection of any additional tax (excise and employment tax cases).

(D) By striking out paragraph (f)(5) and inserting in lieu thereof the following:

(5) *Rule V.*—In order to bring an income, profits, estate or gift tax case in prestatutory notice status or an unagreed employment or excise tax case before the Appellate Division, the taxpayer must first file with the district director of internal revenue a written protest setting forth specifically the reasons for his refusal to accept the district director's findings. The protest and any new facts, law, or argument presented therewith will be reviewed by the district director for the purpose of deciding whether further development and action is required prior to referring the case to the Appellate Division.

PAR. 6. Section 601.108, REVIEW OF OVERASSESMENTS EXCEEDING $100,000, is amended as follows:

(A) By striking out the last sentence of paragraph (b).

(B) By striking out the last two sentences of paragraph (c) and inserting in lieu thereof the following:

If the final determination involves a rejection of a claimed overpayment in whole or in part, a statutory notice of disallowance will be sent by registered mail to the taxpayer, except where the taxpayer has filed a written waiver of such notice of disallowance. See section 6532(a)(1) and (3) of the Code.

PAR. 7. Section 601.201, RULINGS AND DETERMINATION LETTERS, is amended as follows:

(A) By striking out paragraph (c)(4) and (5) and inserting in lieu thereof the following:

(4) District directors of internal revenue are authorized to issue determination letters involving the exempt status of an organization described in section 501(c) or (d) or section 521 of the Code with respect to the filing of returns or the payment of income tax. Such determination letters are restricted to routine determinations in which the application of the law to the facts shown on the exemption application filed by the organization is clear and which do not present an involved or questionable issue. District directors are not authorized to issue determination letters involving questions concerning the provisions of section 502 (relating to feeder organizations), section 503 (relating to prohibited transactions), section 504 (relating to accumulations of income), or sections 511 through 515 (relating to unrelated business income tax). Exemption applications presenting involved or questionable issues will be forwarded by the district director of internal revenue to the National Office in Washington, D. C., for the issuance of a ruling. Requests for determination letters involving the provisions of sections 502, 503, 504, or 511 through 515 should be submitted to the Commissioner of Internal Revenue, Washington 25, D. C. See also paragraph (k) of this section.

(5) District directors are authorized to issue determination letters, if requested by taxpayers, involving the qualifications of pension, annuity, profit-sharing, and stock bonus plans under section 401(a) of the Code, and the status for exemption under section 501(a) of the Code of trusts forming a part of such plans, as provided in paragraph (l) of this section. However, advance determination letters as to the qualification of such plans under section 401(a), and the status for exemption under section 501(a) of trusts forming a part of such plans, are not required under the Code or corresponding regulations as a condition precedent for obtaining any of the tax benefits pertaining to qualified plans and exempt trusts.

(B) By striking out the first sentence of paragraph (f)(1) and inserting in lieu thereof the following:

Except as provided in subparagraph (2) of this paragraph, requests for determination letters and rulings should be submitted in duplicate if more than one issue is presented in the request.

(C) By striking out paragraph (f)(2) and inserting in lieu thereof the following:

(2) If the request is an application for exemption from income tax as an organization described in section 501(c) or (d) or section 521 of the Code, see paragraph (k) of this section. If the request is with respect to the qualification of a plan under section 401 (a) of the Code, see paragraph (l) of this section. It is not required that the application or request described in this subparagraph, or that the information required to be filed with such application or request, be submitted in duplicate.

(D) By striking out paragraph (l)(1) and inserting in lieu thereof the following:

(1) Advance determination letters as to the qualification of pension, annuity, profit-sharing, and stock bonus plans under section 401(a) of the Code are

issued if requested by taxpayers. Such determination letters are issued with respect to consummated or proposed transactions and are restricted to:

(i) The initial qualification of a plan under section 401(a) of the Code, and if trusteed, the status for exemption under section 501(a) of the Code of a trust forming part of the plan;

(ii) Compliance with the applicable requirements of a foreign situs trust for the purpose of determining taxability of beneficiaries (section 402(c) of the Code) and deductions for employer contributions (section 404(a)(4) of the Code);

(iii) Amendments to a plan and trust;

(iv) Curtailment of a plan;

(v) Termination of a plan and trust; and

(vi) The effect upon the qualification of the plan and upon the status for exemption of the trust forming a part of such a plan of an investment of trust funds in the stock or securities of the employer or controlled corporation. (For purposes of this subdivision, control of a corporation exists through ownership of 50 percent or more of all voting stock or of 50 percent or more of the total value of shares of all classes of stock.)

(E) By striking out paragraph (1)(2)(iv) and inserting in lieu thereof the following:

(iv) In the case of a pooled fund arrangement (individual trusts under separate plans pooling their funds for investment purposes through a master trust), the request on behalf of the master trust is to be filed with the district director where the principal place of business of such trust is located, but requests for participating trusts and related plans are to be filed where the principal place of business of each employer is located or, in the case of parent and subsidiary companies, where the principal place of business of the parent company is located, regardless of whether consolidated returns are filed;

(v) In the case of a plan of multiple employers not provided for in the categories set forth in subdivisions (ii) and (iii) of this subparagraph, where the trustee's principal place of business is located or, if more than one trustee, or if non-trusteed, where the usual place of meeting of the trustees or principal supervisors is held.

(F) By redesignating subparagraph (3) of paragraph (1) as subparagraph (4)

(G) By inserting after paragraph (1)(2) the following:

(3) Determination letters authorized by this paragraph do not include determinations or opinions under section 403, relating to taxability of beneficiaries, section 502, relating to feeder organizations, section 503, relating to prohibited transactions, and sections 511 through 515, relating to the unrelated business tax, and, except as provided in subparagraph (1) of this paragraph, do not include determinations or opinions under section 402, relating to taxability of distributees, or section 404, relating to deductions for employer contributions. Where determinations by district directors under a section are not authorized by this paragraph, requests for rulings under such section should be submitted to the Commissioner of Internal Revenue, Washington 25, D. C. Determination letters authorized by this paragraph are subject to review by the National Office.

(H) By adding at the end of paragraph (1) the following new subparagraph:

(5)(i) Where an issue arises in a district director's office with respect to matters within the contemplation of this paragraph, the taxpayer may request the district director to refer such issues to the National Office. The taxpayer will be advised through the district director's office whether the request will be complied with, and if so, when referral to the National Office is made. If referral to the National Office is made, the taxpayer will be granted a conference in the National Office, if requested, and he may furnish a brief or memorandum with respect to the points at issue.

(ii) Where the district director does not refer an issue with regard to matters described in this paragraph to the National Office, the taxpayer may request

National Office consideration. A notice of intention that National Office consideration will be requested must be filed with the district director's office where the case is pending. The taxpayer may request National Office consideration immediately after the district director has made a determination adverse to the taxpayer on the issue with regard to which a determination letter was requested. The taxpayer may also request National Office consideration if no referral to the National Office is made by the district director or if no determination on the issue submitted by the taxpayer is made by the district director within 30 days after the notice of intention to request National Office consideration has been filed with such district director. Requests for National Office consideration will be entertained by the National Office upon a clear showing of the following circumstances:

(*a*) That the position of the field office is contrary to the law or regulations on the points at issue;

(*b*) That the position of the field office is contrary to the position of the Internal Revenue Service as set forth in a published ruling currently in effect;

(*c*) That the position of the field office is contrary to a court decision which is followed by the Service, i. e., acquiescence in an adverse Tax Court decision;

(*d*) That the contemplated field action is in conflict with a determination made in a similar case in the same or another district; or

(*e*) That the issues arise because of unique or novel facts which had not been previously passed upon, as indicated by published rulings or announcements.

If the National Office decides to consider a case, the taxpayer will be afforded an opportunity to furnish a brief or memorandum on the points at issue and to indicate whether a conference in Washington is desired or whether a determination is to be made on the written submission only. Copies of all written submissions are to be furnished the district director. The district director may submit rebuttal memoranda to the National Office. If a conference is requested, the time and place will be set and the taxpayer will be advised. After full consideration of all the facts presented, taxpayer's briefs or memoranda, the district director's rebuttal memoranda, and conference discussions, the taxpayer will be notified by the National Office of the determination made and the district director's office will dispose of the case in accordance with such determination.

PAR. 8. Section 601.202 (d), *Applicability of ruling requirements*, is amended by inserting "requests for" before "rulings".

PAR. 9. Section 601.203, OFFERS IN COMPROMISE, is amended as follows:

(A) By striking out paragraph (b) and inserting in lieu thereof the following:

(b) *Use of prescribed form.* Offers in compromise are required to be submitted on Form 656 (Rev. 7-57), properly executed, and accompanied by a financial statement on Form 433. Form 656 is used in all cases regardless of whether the amount of the offer is tendered in full at the time the offer is filed or the amount of the offer is to be paid by deferred payment or payments. Copies of Form 656 may be obtained from district directors of internal revenue. An offer in compromise should be filed with the district director charged with the duty of collecting the tax sought to be compromised.

(B) By striking out the third sentence of paragraph (d) and inserting in lieu thereof the following:

If the offer is one with respect to which the district director has processing jurisdiction and the proponent does not agree with the rejection or proposed rejection, and neither the internal revenue agent nor the conferee of the district director's office has been able to convince the proponent of the correctness of the conclusion reached, the proponent will be apprised of his privilege of submitting a request in writing for a hearing before the Appellate Division of the region.

PAR. 10. The heading of Subpart C is amended to read as follows:

SUBPART C—PROVISIONS RELATING TO DISTILLED SPIRITS, WINE, BEER, TOBACCO PRODUCTS, TOBACCO MATERIALS, CIGARETTE PAPERS AND TUBES, AND CERTAIN FIREARMS

PAR. 11. Section 601.301(c), *Regulations*, is amended as follows:

(A) By striking out "52–F," in the third sentence.

(B) By striking out "formulas for denaturation," in the second sentence of subparagraph (1).

(C) By revising subparagraph (18) as follows:

(1) By striking out ", *tobacco products*" in the heading, and

(2) By striking out "and tobacco and tobacco products," in the first sentence.

(D) By striking out subparagraph (21) and inserting in lieu thereof the following:

(21) *Drawback of tax on distilled spirits, wine, and beer.*—Part 252 of this chapter contains the regulations relative to the allowance of drawback of internal revenue tax on (i) distilled spirits and wines packaged or bottled especially for export, and beer brewed and manufactured in the United States, when exported or used as supplies on vessels or aircraft, (ii) distilled spirits exported in distillers' original packages containing not less than 20 wine gallons each, and (iii) domestic alcohol used in the manufacture or production of flavoring extracts, and medicinal or toilet preparations (including perfumery), upon exportation of such products.

(E) By striking out subparagraph (25) and inserting in lieu thereof the following:

(25) *Production of vinegar by the vaporizing process.*—Part 195 of this chapter contains the regulations relative to the production of vinegar by the vaporizing process (fermentation and distillation of alcoholic liquid), and covers requirements governing the location, use, construction, equipment and proprietorship, plant operations, and records and reports of operations at vinegar plants.

(F) By striking out "chapters 51 and 52" in the second sentence of subparagraph (29) and inserting in lieu thereof "chapter 51".

(G) By striking out the parenthetical expression "(26 CFR (1939) Parts 182, 183, 184, 185)" in subparagraph (32) and inserting in lieu thereof the parenthetical expression "(26 CFR (1939) Parts 182, 183, 184, and 185, superseded, respectively, by 26 CFR (1954) Parts 182, 220, 221, and 225)".

(H) By striking out subparagraph (33) and inserting in lieu thereof the following:

(33) *Formulas for denatured alcohol.*—Part 212 of this chapter relates to formulas used for the denaturation of alcohol. The regulations give formulas for the production of specially and completely denatured alcohol, the specifications for denaturants, a listing of processes and products in which specially denatured alcohol is used and specific formulas authorized for each use, a listing of denaturants and the formulas in which used, and a table of weights of the formulas of specially denatured alcohol. (The procedural requirements relative to permits, and the production, disposition and use of denatured alcohol are prescribed in 26 CFR Part 182.)

PAR. 12. Section 601.302(a), *Collection*, is amended by striking out the first seven sentences and inserting in lieu thereof the following:

Taxes on distilled spirits are paid principally by stamps purchased from the district director of internal revenue. In the case of distilled spirits taxpaid in bulk gauging tanks for removal in tank cars, tank trucks or by pipeline, there is the optional method of paying by purchase of a certificate of payment (Form 1595) or by use of distilled spirits excise tax sheet stamps issued in various

denominations. Form 1595 is attached to the tank and later, in the case of removal by pipeline, canceled and surrendered to the appropriate internal revenue officer. In the case of removals in tank cars and tank trucks it is canceled and attached to the route board of such container for removal and scalping at the consignee premises. The distilled spirits excise tax sheet stamps are canceled and surrendered in the exact amount to the appropriate internal revenue officer. In the case of distilled spirits taxpaid with distilled spirits excise tax sheet stamps and removed in tank cars, tank trucks, or barrels or similar bulk containers, a wholesale liquor dealer stamp is issued by the appropriate internal revenue officer for attachment to the container (the route board in the case of a tank car or tank truck) for removal and scalping at the consignee premises. Distilled spirits excise tax sheet stamps are also used to taxpay distilled spirits bottled in bond and the cases are marked appropriately to indicate taxpayment.

PAR. 13. Section 601.303, CLAIMS, is amended by adding at the end thereof the following new paragraph:

(d) *Claims for allowance, credit, or relief.*—Where sparkling wine or artificially carbonated wine produced in the United States and removed subject to tax, has been returned to a bonded wine cellar as unmerchantable and for conversion into still wine or for destruction, or where beer has been returned to the brewery for reconditioning or destruction, proprietors may obtain allowance, credit, or relief for the tax provided the quantity of wine converted or destroyed totals 30 wine gallons or title to the beer so returned has not passed from the brewer to any other person. Procedural instructions for such claims with respect to wine are contained in Part 240, and with respect to beer, in Part 245 of this chapter.

PAR. 14. Section 601.304, PREPARATION AND FILING OF CLAIMS, is amended as follows:

(A) By striking out paragraph (h) and inserting in lieu thereof the following:

(h) *Drawback of tax on distilled spirits, wine, and beer.*—Claims for drawback of internal revenue tax paid on (1) distilled spirits and wines packaged or bottled especially for export, and beer brewed and manufactured in the United States, when exported or used as supplies on vessels or aircraft; (2) distilled spirits exported in distillers' original packages containing not less than 20 wine gallons; and (3) domestic alcohol used in the manufacture or production of flavoring extracts, and medicinal or toilet preparations (including perfumery), upon exportation of such products, must be prepared and filed in accordance with Part 252 of this chapter. The regulations in Part 252 of this chapter contain full information in respect to the procedure to be followed, the forms to be used, the time within which the claims must be filed, and the supporting documents which must be submitted with the claim.

(B) By striking out the second sentence of paragraph (i) and inserting in lieu thereof the following:

Such claims must be filed within the 3 months next succeeding the quarter in which the spirits are used except that, subject to the filing of a proper bond and other requirements, claims may be filed on a monthly basis in lieu of a quarterly basis.

PAR. 15. Section 601.305 (a), *Liability under Internal Revenue Code*, is amended to read as follows:

(a) *Liability under Internal Revenue Code.* Persons desiring to submit offers in compromise in order to avoid forfeiture or prosecution proceedings, and taxpayers who disclaim liability for the amount of taxes assessed, or claim inability to pay the taxes in full, may submit offers in compromise to the district director of internal revenue, or to an internal revenue officer. The Director, Alcohol and Tobacco Tax Division, has the authority to accept or reject offers in compromise of liability to forfeiture of personal property seized in connection with liquor, firearms, tobacco, and wagering tax violations, and each assistant regional commissioner (alcohol and tobacco tax) has the authority to accept or reject offers in compromise of (1) tax liabilities arising from (i) the

illegal production of untaxpaid distilled spirits, wines, or beer, and (ii) the failure to file returns of, or to pay, occupational taxes with respect to distilled spirits, wines, or beer, and (2) criminal liabilities of retail dealers in liquor arising from violations of the internal revenue laws relating to liquor, including the reuse of liquor bottles. The Commissioner accepts or rejects all other offers in compromise except those in compromise of violations under paragraph (b) of this section. (For offers in compromise generally, see section 601.203.) Form 656 (Rev. 7–57) is used in all cases regardless of whether the amount of the offer is tendered in full at the time the offer is filed or the amount of the offer is to be paid by deferred payment or payments. Such offers are forwarded by the district director to the assistant regional commissioner (alcohol and tobacco tax) for consideration and appropriate action. When the offer is acted upon, the district director and the proponent are notified of the acceptance or rejection of the offer. If the offer is rejected, the sum submitted with the offer is returned to the proponent and forfeiture, prosecution, or collection proceedings are resumed. If the offer is accepted, the taxpayer is notified and the case is closed. Acceptance of an offer in compromise of civil liabilities does not remit criminal liabilities, nor does acceptance of an offer in compromise of criminal liabilities remit civil liabilities.

PAR. 16. Section 601.311(b), *Regulations*, is amended by adding at the end thereof the following new subparagraphs:

(7) Part 253 of this chapter, relating to the removal of tobacco products (manufactured tobacco, cigarettes and cigars) and cigarette papers and tubes, without payment of tax, from bonded domestic internal revenue factories and from bonded internal revenue tobacco export warehouses for delivery to foreign-trade zones.

(8) Part 200 of this chapter, relating to the procedure and practice in connection with the disapproval of applications for permits, and the suspension and revocation of permits, under chapter 52 of the Code.

PAR. 17. Section 601.312, SPECIAL QUALIFICATION AND BONDING REQUIREMENTS, is amended as follows:

(A) By striking out the second sentence of paragraph (b) and inserting in lieu thereof the following:

A proprietor of a customs bonded manufacturing warehouse, Class 6, desiring to remove from a warehouse, without payment of tax, for export to a foreign country or a possession of the United States, cigars on which customs duties have been paid shall, prior to making the first removal, file a bond on the prescribed form with the assistant regional commissioner (alcohol and tobacco tax).

(B) By adding at the end of paragraph (b) the following sentence:

A proprietor of a customs bonded manufacturing warehouse who elects to taxpay cigars, removed for domestic consumption, by return is required to file a bond as provided in paragraph (a) of this section.

(C) By striking out paragraph (c) and inserting in lieu thereof the following:

(c) *Drawback of tax.* Tobacco products, and cigarette papers and tubes, on which the tax has been paid may be exported with benefit of drawback of such tax. Where a claim for allowance of drawback of tax is filed, the claimant is required to file bond as set forth in section 601.316(b).

PAR. 18. Section 601.313, COLLECTION OF TAXES, is amended as follows:

(A) By striking out "cigars, cigarettes," in the first sentence of paragraph (a) and inserting in lieu thereof "cigarettes".

(B) By inserting after the first sentence of paragraph (a) the following:

The taxes on cigars are paid by stamps or by return, Form 2135, at the option of the manufacturers, importers, and proprietors of customs bonded man-

ufacturing warehouses, Class 6. Tobacco products tax stamps are purchased from, and cigar tax returns are filed with, the appropriate district director.

(C) By striking out the first sentence of paragraph (b) and inserting in lieu thereof the following:

The taxes on cigarette papers and tubes are payable by the manufacturer or importer by return.

PAR. 19. Section 601.316, ADMINISTRATIVE REMEDIES AVAILABLE TO TAXPAYERS AFTER THE PURCHASE OF TOBACCO TAX STAMPS OR AFTER ASSESSMENT OR PAYMENT OF TOBACCO TAXES, is amended as follows:

(A) By striking out the heading and inserting in lieu thereof "*Claims*".

(B) By striking out the next to the last sentence of paragraph (c) and inserting in lieu thereof the following:

In either case, the procedure to be followed by the claimant is the same as that set forth in the case of claims for abatement or refund of taxes as described in section 601.303(b) and (c) except that the claims are filed with the assistant regional commissioner (alcohol and tobacco tax).

(C) By striking out paragraph (d) and inserting in lieu thereof the following:

(d) *Claims for remission of tax.*—Where tobacco products, before removal from the factory or after removal for tax-exempt purposes, are lost (otherwise than by theft) or destroyed by fire, casualty, or act of God, while in the possession or ownership of the manufacturer, a claim for remission of such tax may be filed. Such claim is filed, in letter form, with the assistant regional commissioner (alcohol and tobacco tax) and must be accompanied by evidence necessary to support the claim.

(D) By striking out paragraph (e) and inserting in lieu thereof the following:

(e) *Claims for allowance of tax.*—Where cigars, after removal from the factory subject to tax payable by return, and prior to the time for payment of such tax, are lost (otherwise than by theft) or destroyed by fire, casualty, or act of God, or are withdrawn from the market while in the possession or ownership of the manufacturer of such cigars, relief from the payment of such tax may be extended to the manufacturer by allowance of the tax. The claim for allowance shall be filed by the manufacturer with his tax return, Form 2135, on which the removal of such cigars is reported. The manufacturer may take a credit or deduction on such tax return of the amount of tax on the cigars so lost, destroyed, or withdrawn from the market.

(f) *General.* Detailed instructions as to the requirements necessary to be complied with in connection with the filing of claims for redemption, drawback, refund, abatement, allowance, and remission are fully set forth in the regulations referred to in § 601.311(b).

PAR. 20. Section 601.318, FORMS, is amended by striking out the second sentence and inserting in lieu thereof the following:

Copies of all necessary forms, and instructions as to their preparation and filing, may be obtained from assistant regional commissioners (alcohol and tobacco tax).

PAR. 21. Immediately preceding section 601.326, *Seizures of vessels, vehicles, and aircraft in connection with contraband firearms*, insert an undesignated center heading as follows:

SEIZED PROPERTY

PAR. 22. Section 601.326, SEIZURES OF VESSELS, VEHICLES, AND AIRCRAFT IN CONNECTION WITH CONTRABAND FIREARMS, is amended to read as follows:

§ 601.326 SEIZURE AND FORFEITURE OF PERSONAL PROPERTY.—Part 172 of this chapter contains the regulations relative to the personal property seized by officers of the Internal Revenue Service as subject to forfeiture as being used, or intended to be used, to violate certain Federal laws; the remission or mitigation of such forfeitures; and the administrative sale or other disposition, pursuant to forfeiture, of such seized property other than firearms seized under the National or Federal Firearms Act. For disposal of firearms under such Acts, see 26 U. S. C. 5852(b) and 15 U. S. C. 905(b), respectively.

PAR. 23. Section 601.401, EMPLOYMENT TAXES, is amended as follows:

(A) By striking out the fifth sentence of paragraph (a)(1) and inserting in lieu thereof the following:

Chapter 23 (Federal Unemployment Tax Act) imposes a tax on employers of four or more individuals with respect to "wages" paid.

(B) By striking out the last six sentences of paragraph (a)(3) and inserting in lieu thereof the following:

All other returns of Federal employment taxes (with the exception of returns filed for agricultural employees) are required to be filed for each calendar quarter. The employer and employee taxes imposed by chapter 21 (other than the employer and employee taxes on wages paid for agricultural labor) and the tax required to be deducted and withheld upon wages by chapter 24 are combined in a single return on Form 941. In the case of wages paid by employers for domestic service performed in a private home not on a farm operated for profit, the return of both the employee tax and the employer tax imposed by chapter 21 is on Form 942. However, if the employer is required to file a return for the same quarter on Form 941, he may at his election include the taxes with respect to such domestic service on Form 941. The employer and employee taxes imposed by chapter 21 with respect to wages paid for agricultural labor are required to be reported annually on Form 943. Under the Railroad Retirement Tax Act, the return required of the employer is on Form CT–1, and the return required of each employee representative is on Form CT–2.

(C) By striking out paragraph (a)(5) and inserting in lieu thereof the following:

(5) *Use of Federal Reserve banks and authorized commercial banks in connection with payment of Federal employment taxes.* If

(i) during any calendar month, other than the last month of a calendar quarter, the aggregate amount of the employee tax deducted and the employer tax under chapter 21 and the income tax withheld at source on wages under chapter 24, exclusive of taxes reportable on Form 942 and Form 943, exceeds $100, or

(ii) at the end of any month or period of two or more months ending prior to December 1 of any calendar year, the total amount of undeposited taxes imposed by chapter 21 (employee tax deducted plus employer tax), with respect to wages paid for agricultural labor, exceeds $100,

it is the duty of the employer to deposit such amount within 15 days after the close of such calendar month with a Federal Reserve bank or a commercial bank authorized in accordance with Treasury Department Circular No. 848, as revised, to accept remittance of these taxes for transmission to a Federal Reserve bank.

The remittance of such amount must be accompanied by a Federal Depositary Receipt (Form 450). After the Federal Reserve bank has validated the depositary receipt, it will be returned to the employer. The validated receipts must be attached to the return on Form 941 for the calendar quarter, or Form 943 for the calendar year, with respect to which such deposits are made, and the employer shall pay to the district director the balance, if any, of the taxes due for the quarter or the year, as the case may be. In the case of the last month of any calendar quarter (last month of the calendar year in the case of agricultural employers) the employer may either include with his return direct remittance to the district director for the amount of such taxes or attach to the return a depositary receipt validated by a Federal Reserve bank. If a deposit is made for the last month of the quarter (last month of the year

for agricultural employers), it must be made in ample time to enable the Federal Reserve bank to return the validated receipt to the employer so that it can be attached to and filed with the employer's return at the time prescribed for filing such return. A procedure similar to that prescribed above for non-agricultural employers is prescribed with respect to the tax on employers and employees imposed by chapter 22, except that the depositary receipt for use in such cases is Form 515 (Railroad Retirement Depositary Receipt).

(D) By inserting "or Form 943" after "Form 941" in the first and third sentences of paragraph (b)(1).

(E) By striking out paragraph (b)(3) and inserting in lieu thereof the following:

(3) *Reporting of wages.*—Forms 941, 942, and 943 each require, as a part of the return, that the wages of each employee paid during the period covered by the return be reported thereon. It is necessary at times that employers correct wage information previously reported. A special form, Form 941c, has been adopted for use in correcting erroneous wage information or omissions of such wage information on Forms 941, 942, or 943. Instructions on Forms 941, 941c, 942, and 943 explain the manner of preparing and filing the forms. Any further instructions should be obtained from the district director for the district in which the returns are filed.

(F) By striking out "*Quarterly adjustments*" in the heading of paragraph (c) and inserting in lieu thereof "*Adjustments*".

(G) By striking out the first sentence of paragraph (c)(2) and inserting in lieu thereof the following:

Errors in withholding during any return period under the Federal Insurance Contributions Act or the Railroad Retirement Tax Act should be corrected in the return for such period, if such errors are ascertained prior to the time the return is required to be filed with the district director.

(H) By striking out "quarterly" in the second sentence of paragraph (c)(2).

PAR. 24. Section 601.402(c), *Returns, refunds, and credits*, is amended by adding at the end thereof the following new subparagraph:

(3) *Payments in respect of gasoline used on a farm for farming purposes, for non-highway purposes, or by local transit systems.* Section 6420 prescribes the circumstances and conditions under which the ultimate purchaser of gasoline used on a farm for farming purposes may obtain a payment in respect of such gasoline. Form 2240 is prescribed for use in filing a claim in respect of any such payment. Section 6421 prescribes the circumstances and conditions under which the ultimate purchaser of gasoline used for certain nonhighway purposes or by local transit systems may obtain a payment in respect of such gasoline. Claims in respect of gasoline so used shall be filed on Form 843. Claims referred to in this subparagraph should be filed with the district director for the district in which the claimant's principal place of business is located.

PAR. 25. Section 601.403, MISCELLANEOUS EXCISE TAXES COLLECTED BY RETURN, is amended as follows:

(A) By redesignating subparagraphs (6), (7), (8), and (9) of paragraph (a) as subparagraphs (7), (8), (9), and (10).

(B) By inserting after paragraph (a)(5) the following new subparagraph:

(6) *Highway motor vehicle use.*—Subchapter D of chapter 36 of the Code imposes a tax for each taxable year (commencing after June 30, 1956, and ending before July 1, 1972) upon the use, at any time during the taxable year, on the public highways in the United States of any highway motor vehicle which (together with certain semitrailers and trailers) has a taxable gross weight in excess of 26,000 pounds.

(C) By striking out the last two sentences of paragraph (c)(1) and inserting in lieu thereof the following:

The tax on the use of highway motor vehicles, the tax on wagers, the tax on hydraulic mining, and the tax on circulation other than of national banks are also collected by means of returns. The returns of the tax on wagers are required to be filed monthly; returns of the taxes on hydraulic mining and on the use of highway motor vehicles are required to be filed annually; and the returns of the tax on circulation are required to be filed on June 1, and December 1 of each calendar year.

(D) By striking out the first sentence of paragraph (c)(3) and inserting in lieu thereof the following:

A procedure similiar to the Depositary Receipt procedure with respect to the payment of certain Federal employment taxes, described in section 601.401-(a)(5), is prescribed with respect to the miscellaneous excise taxes (except the taxes on the use of highway motor vehicles, wagers, hydraulic mining, and circulation other than of national banks) referred to in paragraph (a) of this section.

(E) By redesignating paragraph (d) as paragraph (e).

(F) By inserting after paragraph (c) the following new paragraph:

(d) *Refunds and credits.*—The procedure in section 601.402(c)(2) regarding refunds and credits in respect of sales taxes collected by return is, in general, applicable with respect to the miscellaneous excise taxes collected by return, except that in the case of the collected taxes referred to in paragraph (c)(2) of this section, the person upon whom the tax is imposed may file a claim on Form 843 for refund of erroneous or illegal payment of tax, but cannot take a credit since he is not required to file a return with respect to such taxes.

PAR. 26. Section 601.404, MISCELLANEOUS EXCISE TAXES COLLECTED BY SALE OF REVENUE STAMPS, is amended as follows:

(A) By striking out the first two sentences of paragraph (f)(4) and inserting in lieu thereof the following:

Payments for such stamps may be made by means of cash, post office money order, or certified check, or by personal check to the extent provided by regulations.

(B) By striking out the last sentence of paragraph (k) and inserting in lieu thereof the following:

The following forms are prescribed for registration: Form 678 (relating to occupational taxes with respect to narcotics and marihuana), Form 11 (relating to adulterated and process or renovated butter and filled cheese), Form 11-B (relating to occupational taxes with respect to coin-operated amusement and gaming devices, bowling alleys, and billiard and pool tables), Form 11-C (relating to occupational tax with respect to wagering).

PAR. 27. Section 601.510, DELIVERY OF CHECKS IN PAYMENT OF REFUNDS, is amended as follows:

(A) By changing the heading to read as follows:

Delivery of checks in payment of refunds—(a) *In general.*—

(B) By adding at the end of such section the following new paragraph:

(b) *Cases in litigation.*—Checks in payment of claims which have either been reduced to judgment or settled in the course or as a result of litigation will be drawn in the name of the person or persons entitled to the money and, in the case of actions arising in the United States district courts, will be sent to the appropriate United States Attorney, and, in actions arising in the United States Court of Claims, to the Assistant Attorney General, Tax Division, Department of Justice, for delivery to the taxpayer or the counsel of record in the court proceeding.

PAR. 28. Section 601.601(a), *Formulation*, is amended by striking out the last sentence of subparagraph (1) and inserting in lieu thereof the following:

After approval by the Commissioner (and, in the case of regulations relating to narcotics and certain regulations relating to alcohol and tobacco taxes, the approval of the Commissioner of Narcotics or the Commissioner of Customs, as the case may be), regulations and Treasury decisions are forwarded to the Secretary or his delegate for further consideration and final approval.

PAR. 29. Section 601.702(b), *Final opinions and orders*, is amended as follows:

(A) By striking out the period at the end of the heading of subparagraph (1) and inserting in lieu thereof the following:

—(i) *Income, profits, estate or gift tax.*—

(B) By adding at the end of subparagraph (1)(i) the following new subdivision:

(ii) *Refilling of liquor bottles.*—For each offer in compromise submitted and accepted on or after December 21, 1956, pursuant to section 7122 of the Internal Revenue Code of 1954, in any case arising under sections 5641 and 5643 of the Internal Revenue Code of 1954, relating to refilling of liquor bottles, a copy of the abstract and statement relating to the offer shall be available for public inspection for a period of one year in the office of the assistant regional commissioner (alcohol and tobacco tax) accepting the offer and in the office of the district director for the internal revenue district in which the offer is submitted. Information, however, is not disclosed concerning any trade secrets, processes, operations, style of work, or apparatus, or confidential data, amount or source of income, profits, losses, or expenditures, or any other matter within the prohibition of section 1905 of Title 18 of the United States Code.

(R. S. 161; 5 U. S. C. 22)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

(Filed by the Division of the Federal Register on May 9, 1958, 8:50 a. m., and published in the issue of the Federal Register for May 10, 1958, 23 F. R. 3124.)

PROCLAMATION 3214

Determining 1-(2) Morpholinoethyl)-4-Carbethoxy-4-Phenylpiperidine, and *d*-2, 2-Diphenyl-3-Methyl-4-Morpholino-Butyril-Pyrrolidine, To Be Opiates.

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION

WHEREAS section 4731(g) of the Internal Revenue Code of 1954 provides in part as follows:

OPIATE.—The word "opiate", as used in this part shall mean any drug (as defined in the Federal Food, Drug, and Cosmetic Act; 52 Stat. 1041, section 201(g); 21 U. S. 821) found by the Secretary or his delegate, after due notice and opportunity for public hearing, to have an addiction-forming or addiction-sustaining liability similar to morphine or cocaine, and proclaimed by the President to have been so found by the Secretary or his delegate. * * *;

AND WHEREAS the Secretary of the Treasury, after due notice and opportunity for public hearing, has found that each of the following-named drugs has an addiction-forming or addiction-sustaining liability

similar to morphine, and that in the public interest this finding should be effective immediately:

1-(2 Morpholinoethyl)-4-carbethoxy-4-phenylpiperidine.

d-2, 2-Diphenyl-3-methyl-4-morpholino-butyryl-pyrrolidine.

NOW, THEREFORE, I, DWIGHT D. EISENHOWER, President of the United States of America, do hereby proclaim that the Secretary of the Treasury has found that each of the aforementioned drugs has an addiction-forming or addiction-sustaining liability similar to morphine and that in the public interest this finding should be effective immediately.

IN WITNESS WHEREOF, I have hereunto set my hand and caused the Seal of the United States to be affixed.

DONE at the City of Washington this tenth day of December in the year of our Lord nineteen hundred and fifty-seven, [SEAL] and of the Independence of the United States of America the one hundred and eighty-second.

DWIGHT D. EISENHOWER

By the President:

JOHN FOSTER DULLES, *Secretary of State.*

(Filed by the Division of the Federal Register on December 13, 1957, 10:25 a. m., and published in the issue of the Federal Register for December 14, 1957, 22 F. R. 10025.)

PROCLAMATION 3229

Determining alpha and beta 3-ethyl-1-methyl-4-phenyl-4-propionoxypiperidine to be opiates.

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION

WHEREAS section 4731(g) of the Internal Revenue Code of 1954 provides in part as follows:

OPIATE.—The word "opiate", as used in this part shall mean any drug (as defined in the Federal Food, Drug, and Cosmetic Act; 52 Stat. 1041, section 201(g); 21 U. S. C. 321) found by the Secretary or his delegate, after due notice and opportunity for public hearing, to have an addiction-forming or addiction-sustaining liability similar to morphine or cocaine, and proclaimed by the President to have been so found by the Secretary or his delegate * * *;

WHEREAS the Secretary of the Treasury, after due notice and opportunity for public hearing, has found that each of the following-named drugs has an addiction-forming or addiction-sustaining liability similar to morphine, and that in the public interest this finding should be effective immediately:

α-3-Ethyl-1-methyl-4-phenyl-4-propionoxypiperidine

β-3-Ethyl-1-methyl-4-phenyl-4-propionoxypiperidine;

AND WHEREAS a previous finding with respect to the beta isomeric form of the drug, described in Proclamation No. 2851 of August 26, 1949, and discovered to have been prematurely made, has been withdrawn by the Secretary of the Treasury as of August 26, 1949, and replaced by the above-described finding:

NOW, THEREFORE, I, DWIGHT D. EISENHOWER, President of the United States of America, do hereby proclaim that the Secretary of the Treasury has found that each of the following-named drugs

has an addiction-forming or addiction-sustaining liability similar to morphine, and that in the public interest this finding should be effective immediately:

α-3-Ethyl-1-methyl-4-phenyl-4-propionoxypiperidine
β-3-Ethyl-1-methyl-4-phenyl-4-propionoxypiperidine

And I do further proclaim that a previous finding with respect to the beta isomeric form of the drug, described in Proclamation No. 2851 of August 26, 1949, and discovered to have been prematurely made, has been withdrawn by the Secretary of the Treasury as of August 26, 1949, and replaced by the finding herein proclaimed; and the said Proclamation No. 2851 is modified accordingly.

IN WITNESS WHEREOF, I have hereunto set my hand and caused the Seal of the United States to be affixed.

DONE at the City of Washington this 28th day of March in the year of our Lord nineteen hundred and fifty-eight, and of the [SEAL] Independence of the United States of America the one hundred and eighty-second.

DWIGHT D. EISENHOWER.

By the President:

JOHN FOSTER DULLES,
Secretary of State.

(Filed by the Division of the Federal Register on April 1, 1958, 1:38 p. m., and published in the issue of the Federal Register for April 3, 1958, 23 F. R. 2169.)

TREASURY DEPARTMENT ORDER NO. 150-46

ASSISTANT COMMISSIONER OF INTERNAL REVENUE (PLANNING AND RESEARCH)

Establishment of new office

There shall be in the National Office of the Internal Revenue Service the office of Assistant Commissioner of Internal Revenue (Planning and Research).

The provisions of Treasury Department Order No. 150-24[2] are revised accordingly by this order.

Dated May 19, 1958.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on May 27, 1958, 8:47 a. m., and published in the issue of the Federal Register for May 28, 1958, 23 F. R. 3676)

DELEGATION ORDER NO. 56[3]

(Effective December 7, 1957)

Authority to determine amount of gasoline and lubricating oil bonds.

Authority is hereby delegated to District Directors of Internal Revenue to make final determination as to the amount of bond re-

[2] Date April 10, 1953, and published in 18 F. R. 2152.
[3] Delegation Order No. 55 was not published.

quired to be given by producers or importers of gasoline and manufacturers or producers of lubricating oil under the provisions of section 314.9 of Regulations 44, in cases where the amount of the bond calculated under such section would exceed $30,000.

The authority herein delegated may not be redelegated.

O. GORDON DELK,
Acting Commissioner.

(Filed by the Division of the Federal Register on Jan. 8, 1958, 8:49 a. m., and published in the issue of the Federal Register for Jan. 9, 1958, 22 F. R. 166.)

DELEGATION ORDER NO. 57

(Effective March 5, 1958)

Notice of Additional Inspection of Taxpayers' Books of Account Under Section 7605 (b), Internal Revenue Code of 1954.

Pursuant to the authority vested in me by Delegation Order No. 33 dated June 6, 1956 [C. B. 1956–2, 1375], I hereby delegate authority, subject to the provisions of Paragraph 4011 of the Internal Revenue Manual where applicable, to the Director of International Operations Division to sign in his name, after investigation, the notice to a taxpayer, required by Section 7605(b) of the Internal Revenue Code of 1954, that an additional inspection of such taxpayer's boks of account is necessary.

This authority may not be redelegated.

C. W. STOWE,
Assistant Commissioner (Operations).

(Filed by the Division of the Federal Register on March 17, 1958, 8:49 a. m., and published in the issue of the Federal Register for March 18, 1958, 23 F. R. 1818.)

DELEGATION ORDER NO. 58

(Effective March 11, 1958)

Delegation of certain additional functions to Deputy Commissioner.

Pursuant to the authority vested in me as Commissioner of Internal Revenue, it is hereby ordered, subject to my continuing supervision:

(1) There is delegated to the Deputy Commissioner in addition to his present duties, responsibility for supervising the Regional Commissioners of Internal Revenue, and for making allocations of funds and personnel to them.

(2) Without limitation, this authority includes authority to redelegate any functions vested in the Deputy Commissioner and to amend or revoke existing delegations respecting such activities; provided, that in the absence of such amendment or revocation, delegations respecting such activities shall remain in effect.

(3) The Assistant Commissioner (Operations) retains all of his existing authority and responsibility for supervising the

activities of the Alcohol and Tobacco Tax, Appellate, Audit, Collection, Intelligence and International Operations Divisions of the National Office, and for functional supervision of these activities in the field.

(4) Any existing delegation order, mimeograph, instruction, circular or other issuance that is inconsistent with any provision of this order is modified to the extent of such inconsistency.

RUSSELL C. HARRINGTON,
Commissioner.

DELEGATION ORDER NO. 60 [4]

CHIEF COUNSEL'S ORDER NO. 1958-5

(Effective May 1, 1958)

Cases in the Tax Court of the United States

1. Pursuant to the authority vested in the undersigned, it is ordered that cases in the Tax Court of the United States shall be handled as provided in this Order, as follows:

(a) *Pre-Session Cases.* Prior to the opening date of the session at which a case is calendared for trial or of any pre-trial hearing of or report session on a case, as to each such case:

(1) Settlement negotiations with the petitioner or his counsel or both shall be conducted by the Regional Appellate Division, with Regional Counsel invited to participate; and

(2) A settlement or concession of the case in whole or in part, negotiated or made by the Regional Appellate Division and concurred in by Regional Counsel will dispose of the case or the issue or issues involved; and

(3) If the Regional Appellate Division and Regional Counsel fail to agree (i) as to a proposed settlement or concession or (ii) that there should not be a settlement or concession the views of each office shall be submitted by Regional Counsel to the Chief Counsel; and the decision of the Chief Counsel in such a case shall be controlling and action shall be taken in accordance with his memorandum as to the whole case, or as to the issue or issues on which there was a failure to agree at the regional level.

(b) *Session Cases.* On and after the opening date of the session at which a case is calendared for trial, or of any pre-trial hearing of or report session on a case, as to each such case:

(1) The conclusion of Regional Counsel, whether the case, in whole or in part, should be settled, conceded, or tried shall be controlling; and Regional Counsel's memorandum on the settlement or concession shall be the basis for disposition of the case, in whole or in part, as the case may be; and

(2) Regional Counsel is authorized to execute stipulations of settlement of an issue or issues or of the whole case, and of concession of the case in whole or in part.

(c) *Continuance of Authority of Counsel.* The authority of Regional Counsel under paragraph (b) shall continue:

---

[4] Delegation Order No. 59 was not published.

(1) During the session at which the case is calendared for trial, or during the pre-trial or report session, as the case may be; and

(2) If a pre-trial or report session is held on the case after notice has been given that the case is calendared for trial: from the opening day of the pre-trial or report session, whichever is earlier, to and during the session for which the case is calendared for trial; and

(3) If a case is continued other than generally from a pre-trial, report, or trial session: during such continuance; and

(4) From the time when any action is taken by Regional Counsel, during any period of time prescribed in (1), (2) and (3) of this paragraph, which modifies a pre-session conclusion of the Regional Appellate Division with respect to any issue or issues of the case.

(d) *Reversion to Pre-Session Status.* If a case is continued generally from a pre-trial, report, or trial session without action having been taken by Regional Counsel to modify a pre-session conclusion of the Regional Appellate Division with respect to any issue or issues of the case, it shall revert to the status of a pre-session case and paragraph (a) shall apply until paragraph (b) again becomes effective.

(e) *Responsibility of Regional Counsel.* Regional Counsel shall act for the Chief Counsel, and shall be responsible for, and have power of decision in, proceedings before the Court. In the post-trial processing of a case Regional Counsel shall have all the authority stated in subparagraphs (1) and (2) of paragraph (b). Regional Counsel may consult at any time with the Regional Appellate Division to the full extent desirable. With the approval of the Chief Counsel, Regional Counsel may redelegate any function by this Order vested in Regional Counsel.

(f) *Supervision by Chief Counsel.* In the performance of his functions under this Order, Regional Counsel shall be subject to the general supervision and control of the Chief Counsel.

2. The instructions contained in this Order supersede prior instructions to the extent that the prior instructions are inconsistent herewith.

3. This revision shall be effective May 1, 1958.

RUSSELL C. HARRINGTON,
Commissioner.

ARCH M. CANTRALL,
Chief Counsel.

Approved April 17, 1958.

NELSON P. ROSE,
General Counsel for the Treasury Department.

Approved April 17, 1958.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on April 25, 1958, 2:17 p. m., and published in the issue of the Federal Register for April 29, 1958, 23 F. R. 2846.)

DELEGATION ORDER NO. 61

(Effective June 2, 1958)

Assessment, claim and compromise authority pertaining to firearms taxes.

1. With respect to firearms taxes arising under subchapter B, chapter 25 and Part VIII, subchapter A, chapter 27, Internal Revenue Code of 1939, or chapter 53 of the Internal Revenue Code of 1954, each Assistant Regional Commissioner (A&TT) is delegated the authority:

(a) to make determinations of tax liabilities,

(b) to allow or reject claims for abatement or refund of taxes and penalties or redemption of stamps, and

(c) to accept or reject offers in compromise of tax liabilities.

2. The exercise of the authority delegated herein to each Assistant Regional Commissioner (Alcohol and Tobacco Tax) shall be under the direction and supervision of his Regional Commissioner.

3. The authority herein delegated may not be redelegated.

O. GORDON DELK,
Acting Commissioner.

(Filed by the Division of the Federal Register on June 9, 1958, 8:48 a. m., and published in the issue of the Federal Register for June 10, 1958, 23 F. R. 4062.)

DELEGATION ORDER NO. 62

(Effective June 2, 1958)

Acceptance or rejection of offers in compromise of liabilities under Chapter 52, Internal Revenue Code.

1. Pursuant to authority vested in me by Treasury Department Order 150–25, dated June 1, 1953, there is hereby delegated to each assistant regional commissioner (alcohol and tobacco tax) the authority to accept or reject offers in compromise of liabilities arising under Chapter 52, Internal Revenue Code (tobacco, cigars, cigarettes, and cigarette papers and tubes).

2. The exercise of the authority delegated herein to each assistant regional commissioner (alcohol and tobacco tax) shall be under the direction and supervision of his regional commissioner, and in accordance with existing policy and procedures.

3. The authority herein delegated may not be redelegated.

O. GORDON DELK,
Acting Commissioner.

(Filed by the Division of the Federal Register on June 9, 1958, 8:48 a. m., and published in the issue of the Federal Register for June 10, 1958, 23 F. R. 4062.)

---

26 CFR 601.313: Collection of taxes. (Also Part I, Section 5703: 270.148.) Rev. Proc. 58–1

Authorization has been given for a new size of the Class A, denomination 10, Internal Revenue cigarette tax stamp for use in payment of tax by manufacturers and importers of cigarettes.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to advise that a new Class A, denomination 10, cigarette tax stamp three-fourths of an inch wide and one and three-eighths inches in length, for use in the payment of tax on cigarettes, has been authorized.

SEC. 2. INSTRUCTIONS.

Manufacturers and importers of cigarettes desiring to use the new Class A, denomination 10, internal revenue cigarette tax stamps may purchase them from the offices of District Directors of Internal Revenue or branches of such offices. The new stamps are identical in every respect to the stamps now in use except as to the difference in size. In preparing Form 485, Order for Stamps—Cigarette and Small Cigar, or Form 923, Order for Stamps—Imported Manufacturers, as the case may be, a manufacturer or importer who desires to purchase the new size cigarette tax stamps should place on the form the notation "New ¾″ by 1⅜″ stamps."

SEC. 3. INQUIRIES.

Inquiries concerning purchase of the new stamps should be addressed to the office of the appropriate District Director of Internal Revenue. Other inquiries regarding this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

---

26 CFR 601.602: Forms and instructions. Rev. Proc. 58–2
(Also Part I, Sections 852, 6001; 1.852–4.)

Substitutes for Form 2439, Notice to Shareholder of Undistributed Long-term Capital Gains, may be used by regulated investment companies in lieu of the official form, subject to prescribed conditions.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to permit the use by regulated investment companies of substitutes for Form 2439, Notice to Shareholder of Undistributed Long-term Capital Gains, and to state the requirements of the Internal Revenue Service with respect to such substitutes.

SEC. 2. SPECIFICATIONS.

.01 *General requirements.*—The substitute forms must be black ink on white paper, both of quality as good as that used by the Government; the paper must be of substantially the same weight and texture, unless printed on card stock, as that used in the official form. Punch card substitutes also will be acceptable. If the punching of information into the punch cards will affect the legibility of the instructions for Form 2439, the instruction to the regulated investment company on the reverse of Copy A may be omitted and the instructions to the shareholder on the reverse side of Copy C of the form may be printed on a separate sheet.

.02 *Size of type.*—Type may not be smaller than the corresponding type on the official form and as nearly as possible of the same font.

.03 *Size of form.*—The official form is seven and three-eighths inches wide by three and one-fourth inches high. The substitute form may vary in width from seven inches to eight inches, and in height from three and one-sixth inches to three and two-thirds inches.

.04 *Government Printing Office symbols.*—The Government Printing Office symbols must be omitted.

.05 *Additional copies.*—Additional copies may be prepared if desired. However, such additional copies may not be placed ahead of Copies A and B. Any additional copies should be clearly labeled to indicate the purpose for which they are intended and should not bear any part of the designation, "Form 2439—U. S. Treasury Department, Internal Revenue Service."

.06 *Instructions on the form.*—No deviation from the instructions on the back of Copies A, B, or C will be permitted. See section 2.01 above, for an exception in the case of punch card substitutes.

.07 *Number of shares.*—It will be permissible to show the number of shares on the substitute forms.

SEC. 3. APPROVAL OF SUBSTITUTE FORMS.

Substitutes for Form 2439 meeting the above conditions may be used without prior approval of the Internal Revenue Service. However, proposed substitutes on which it is desired to show information in addition to that outlined above or in the instructions, or for which specific approval is desired, should be forwarded by letter to the Commissioner of Internal Revenue, Attention: O:C:PF, Washington 25, D. C., for approval.

---

26 CFR 601.602: Forms and instructions. (Also Part II, Section 1500, Regulations 114, Section 411.301.) **Rev. Proc. 58–3**

Computation of employer tax and employee tax to be reported on Form CT–1, Employer's Railroad Retirement Tax Return, with respect to compensation for services rendered after 1936 and before 1947.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide instructions for the computation of employer tax and employee tax to be reported on Form CT–1, Employer's Railroad Retirement Tax Return, with respect to compensation for services rendered after 1936 and before 1947.

SEC. 2. BACKGROUND.

Form CT–1 has been revised as of January 1958. Prior to such revision, Form CT–1 (Revised January 1956), Employer's Quarterly Tax Return under the Railroad Retirement Tax Act contained a schedule and related instructions for the separate computation and reporting of employer tax and employee tax with respect to compensation paid for services rendered to any employer after 1936 and before 1947. Form CT–1 (Revised January 1958) calls for the reporting of the taxes on payments of such compensation but, because of the in-

frequency of such payments, does not provide a schedule for computation of the taxes.

SEC. 3. COMPUTATION OF TAXES ON COMPENSATION FOR SERVICES RENDERED AFTER 1936 AND BEFORE 1947.

The schedule shown below is provided as a guide for computing the taxes applicable to payments of compensation for services rendered after 1936 and before 1947.

1. Computation of employee tax on compensation for services rendered before 1947:

Period in which compensation, paid during quarter, was earned	Compensation paid during quarter for such services, subject to employee tax	Rate of employee tax on such compensation	Amount of employee tax (col. (b) x col. (c))
(a)	(b)	(c)	(d)
Calendar year 1946	$	3½ percent	$
Calendar years 1943, 1944, and 1945	$	3¼ percent	$
Calendar years 1940, 1941, and 1942	$	3 percent	$
Calendar years 1937, 1938, and 1939	$	2¼ percent	$
Totals	$	xxxxxxxx	$

2. Compensation, subject to employer tax, paid during quarter for services rendered before 1947	$
3. Employer tax (6¼ percent of line 2)	$
4. Employee tax (total of column (d), above)	$
5. Total taxes (line 3 plus line 4) (Enter on Form CT-1 and attach explanation, in duplicate)	$

(NOTE: If the total of column (b) differs from the amount in line 2, include in the explanation a statement of the computations which cause the amounts to be different. See sections 4 and 5, below.)

SEC. 4. EMPLOYEE TAX.

The employee tax imposed by section 2(a) of the Carriers Taxing Act of 1937, 50 Stat. 435, 45 U. S. 261, and by section 1500 of the Internal Revenue Code of 1939 prior to its amendment by the Act of July 31, 1946, Public Law 572, 79th Cong., C. B. 1946–2, 269, applies to compensation, not in excess of $300, earned by an employee from one or more employers in a calendar month before 1947. If an employee earned compensation of more than $300 in a calendar month before 1947, only $300 thereof is subject to the employee tax irrespective of the year or years in which such compensation is paid to the employee. If an employee earned compensation from two or more employers in a calendar month before 1947, and if the aggregate compensation paid (at any time) to such employee by all employers is more than $300 for such calendar month, each employer must report and pay employee tax with respect to that proportion of $300 which such employer's payment to the employee bears to the aggregate compensation paid (at any time) to such employee by all of his employers for that calendar month.

SEC. 5. EMPLOYER TAX.

The employer tax applies to compensation, not in excess of $300, paid to an employee after 1946 by one or more employers for services rendered in any calendar month before 1947. The amount of such compensation which is subject to employer tax must be computed without regard to any payment made to the employee before 1947 by such employer or by any other employer. If an employee is paid total compensation of more than $300 after 1946 by two or more employers for services rendered in a calendar month before 1947, the amount of such compensation which is subject to employer tax should be computed by each employer in accordance with the rules stated in section 31.3221–1(b)(1) of Subpart C of the Employment Tax Regulations, C. B. 1956–2, 700, at page 707, except that the employer tax does not apply to compensation in excess of $300 (instead of $350 as stated in such rules).

It should be noted that the amount of compensation, if any, subject to employee tax (column (b) in section 3, above) generally will be less than the amount of compensation subject to employer tax (line 2 in section 3, above) for the reason that the latter amount must be computed without regard to compensation paid to the employee before 1947.

---

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Section 5212; 182.405, 220.536, 225.632.) Rev. Proc. 58–4

Sampling of bulk distilled spirits at the time of guage for taxpayment as a means of checking the accuracy of proof determination.

Revenue Procedure 57–36, C. B. 1957–2, 1109, modified.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to modify the requirements prescribed by Revenue Procedure 57–36, C. B. 1957–2, 1109, for the taking of samples of distilled spirits for verification of proof determination.

SEC. 2. BACKGROUND.

As a result of information received pursuant to the inauguration of the procedure for the sampling of bulk spirits at the time of gauge for taxpayment, it has been determined that because of the variation in plant operations, practices, and procedures, it may not be desirable to prescribe rigid requirements for taking and proofing samples from gauge tanks in all cases. Therefore, it has been decided that Assistant Regional Commissioners, Alcohol and Tobacco Tax, will institute procedures which, in their judgment, are necessary to carry out the objective of this sampling program.

SEC. 3. PROCEDURE.

Wherever practicable, a one-pint sample will be taken from each lot, after thorough agitation but before the spirits are weighed for taxpayment. Each week a representative number of such samples will be selected for submission to the regional chemist or for proof checking, on the premises. The unused samples and remnants of samples tested on the premises will be returned to the proprietor and

may be dumped into lots of untaxpaid homogeneous spirits, returned to the distilling system, or destroyed. Where it is not practicable to verify the proof determinations in this manner, the Assistant Regional Commissioner, Alcohol and Tobacco Tax, will institute such other procedures for testing samples of distilled spirits which he deems necessary to accomplish effective control and appraisal of proofing and to check the accuracy of the official instruments used.

SEC. 4. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure modified section 3 of Revenue Procedure 57–36, C. B. 1957–2, 1109.

---

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Section 5331; Section 212.16(c).) — Rev. Proc. 58–5

Permittees holding approved formulas for the manufacture of alcoholado or bay rum which do not require each gallon of the finished product, when made with specially denatured alcohol, to contain 32 grains of tartar emetic or 0.5 avoirdupois ounce of sucrose octa-acetate should submit new formulas. Permittees who wish to use rubber hydrocarbon solvent instead of gasoline as a denaturant should also submit their formulas for approval.

SECTION 1. PURPOSE.

This purpose of this Revenue Procedure is to advise users of specially denatured alcohol and others concerned of the amendments to the Regulations relating to Formulas for Denatured Alcohol, governing the use of certain specially denatured alcohol formulas. The amendments are contained in Treasury Decision 6274, C. B. 1957–2, 960, effective February 1, 1958.

SEC. 2. NATURE OF AMENDMENTS.

The amendments permit the use of rubber hydrocarbon solvent as a substitute for gasoline in the production of proprietary solvents formulations and require bay rum, alcoholado, or alcoholado type toilet waters made with specially denatured alcohol to contain 32 grains of tartar emetic or 0.5 avoirdupois ounce of sucrose octa-acetate in each gallon of finished product.

SEC. 3. INSTRUCTIONS TO PERMITTEES.

Permittees holding approved formulas for the manufacture of alcoholado or bay rum that do not contain provisions for the addition of the required tartar emetic or sucrose octa-acetate must submit new formulas on Form 1479–A, Formula for Preparation made with specially Denatured Alcohol, for approval before any alcoholado or bay rum in manufactured on or after February 1, 1958. Any permittee holding an approved Form 1479–A for the manufacture of proprietary solvents, who wishes to use rubber hydrocarbon solvent instead of gasoline on or after February 1, 1958, should submit an additional Form 1479–A for approval showing the use of rubber hydrocarbon solvent or gasoline.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to the number thereof and should be addressed to the office of the Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Sections 7271, 7805; 225.1017, 230.255, 235.794.) Rev. Proc. 58–6

Serial numbers, marks, and brands on cases of bottled distilled spirits or bottled wine are not required by internal revenue law or regulations to be destroyed when such cases are emptied.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the requirements of law and regulations with respect to the destruction of serial numbers, marks, and brands on cases of bottled distilled spirits or bottled wine.

SEC. 2. REQUIREMENTS.

.01 There are no requirements in the Internal Revenue Code of 1954 and regulations for either the preservation or destruction of serial numbers, marks, and brands on cases from which the contents (bottled distilled spirits or wine) have been removed.

.02 Section 7271 of the Code, among other things, prohibits any person, with respect to any tax payable by stamp, from transferring or receiving any container which is stamped, branded, or marked so as to show compliance with the internal revenue laws with respect to the contents, or intended contents, thereof, knowing such container to be empty or to hold contents other than those it held when it was lawfully stamped, branded, or marked.

SEC. 3. POLICY.

.01 In the event that cases are reused by any person to contain distilled spirits or wine, such person must first remove, efface, or obliterate any numbers or markings thereon which are inconsistent with the serial numbers, marks, or brands required to be placed by him on such cases by applicable internal revenue regulations.

.02 In view of the requirements of section 7271 of the Code, when any person reuses emptied distilled spirits cases he is advised to remove, efface, or obliterate the marks, brands, or serial numbers placed thereon at the time they were first packed.

SEC. 4. INQUIRIES.

Any inquiries with respect to this Revenue Procedure should refer to the number thereof and should be addressed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

---

26 CFR 601.311: Imposition of taxes; regulations. (Also Part I, Section 5721; 270.141, 275.131.) Rev. Proc. 58–7

Manufacturers of tobacco products are no longer required to prepare annual inventories of tobacco materials, tobacco products, and tax stamps held in each factory as of January first of each year.

Rev. Rul. 56–73, C. B. 1956–1, 539, modified.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to advise manufacturers of tobacco products that inventories of tobacco materials, tobacco products, and tax stamps, held in each factory as of January first of each year, are no longer required.

SEC. 2. BACKGROUND.

In the past, manufacturers of tobacco products have been required to furnish inventories, as of the first of each calendar year, of tobacco materials, tobacco products, and tax stamps. In recent years, such inventories have been used principally for the compilation of statistics, particularly in the area of "tobacco materials used."

SEC. 3. DETERMINATION.

In order to effect economies by eliminating requirements and services no longer considered necessary, it has been determined to discontinue the compilation and release of statistics relating to tobacco materials used in the manufacture of tobacco products. This determination is based upon the finding that such statistics are no longer necessary in the administration of the internal revenue laws or for industry purposes. The discontinuance of such statistics makes it possible to eliminate the requirement for the furnishing of inventories by manufacturers of tobacco products, as of January first of each year, of tobacco materials, tobacco products, and tax stamps. This determination is not intended in any way to modify the provisions of section 270.141(c) of the Regulations relating to Cigars and Cigarettes (Manufacturers, Importers, and Dealers) or section 275.131(c) of the Regulations relating to Manufactured Tobacco (Manufacturers, Importers, and Dealers).

SEC. 4. EFFECT ON OTHER DOCUMENTS.

Revenue Ruling 56–73, C. B. 1956–1, 539, is modified to apply only to inventories which may be required under sections 270.141 and 275.131 of the regulations. Revenue Procedure 57–11, C. B. 1957–1, 739, and Revenue Procedure 57–34, C. B. 1952–2, 1107, as they relate to inventories, will continue to be followed as to inventories which may be required under the above sections.

SEC. 5. INQUIRIES.

Inquiries with respect to this Revenue Procedure should refer to the number thereof and should be addressed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

---

26 CFR 601.319: Applicable laws. (Also Part I, Sections 5812, 5848; Sections 179.95 and 179.20.)

Rev. Proc. 58–8

On and after July 1, 1958, only a natural person lawfully possessing a firearm which was duly registered, made, transferred, or imported by or to such person in accordance with the applicable provisions of the Internal Revenue Code, may transform such firearm into a deactivated war trophy.

Revenue Ruling 55–590, C. B. 1955–2, 483, and Revenue Ruling 57–227, C. B. 1957–1, 433, modified.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce the termination of the war trophy firearms deactivation program conducted in connection with the administration of the National Firearms Act, and to specify necessary changes in the policy and procedure applicable to the firearms program.

SEC. 2. POLICY AND PROCEDURE.

.01 On and after July 1, 1958, only a natural person lawfully possessing a firearm which, prior to such date, was duly (1) registered, as provided by section 5841, of the Internal Revenue Code of 1954; (2) made, in accordance with the provisions of section 5821 of the Code; (3) transferred, in accordance with the provisions of section 5812 or 5814(a) of the Code; or (4) imported, in accordance with the provisions of section 5845 of the Code, by or to such person, may, upon written request addressed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax, transform such firearm into a deactivated war trophy (DEWAT) by steel welding, as distinguished from brazing or any other method, the chamber of the firearm shut and welding the barrel solidly into the frame or receiver. The firearm must be deactivated under the supervision of an Alcohol and Tobacco Tax investigator who will certify as to its deactivated condition. Also, the costs of deactivation must be assumed by the owner. After deactivation of a firearm has been completed, the investigator will endorse the appropriate Form 1 (Firearms), Application for Registration of Firearm; Form 1A (Firearms), Declaration of Intent to Make a Firearm; Form 4 (Firearms), Application and Order for Transfer of Firearm; Form 5 (Firearms), Notice of Tax-exempt Domestic Transfer of Firearm; or Form 6 (Firearms), Application for Importation of Firearms, as the case may be, which is held by the owner. Such endorsement shall read as follows:

> Removed from the Classification of a firearm by steel welding in the prescribed manner on _____
> (Date)
> Investigator, Alcohol and Tobacco Tax _____
> (Signed)

.02 Since such a deactivated war trophy (DEWAT) falls in the category of a harmless ordnance curio, rather than a "unserviceable" firearm, as contemplated by section 5812(a)(3) of the Code, notification of subsequent transfers of "DEWATs" need not be given.

.03 Any unregistered firearm coming within the purview of the National Firearms Act (Chapter 53 of the Internal Revenue Code) will be considered a contraband article subject to forfeiture to the United States under section 5862 of the Code.

SEC. 3. EFFECTIVE ON OTHER DOCUMENTS.

Revenue Ruling 55–590, C. B. 1955–2, 483, and Revenue Ruling 57–227, C. B. 1957–1, 433, are hereby modified to the extent that they are inconsistent with the procedure described above as to firearms deactivated on and after July 1, 1958.

SEC. 4. EFFECTIVE DATE.

This Revenue Procedure is effective July 1, 1958.

SEC. 5. INQUIRIES.

Inquiries relating to this Revenue Procedure should be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

---

26 CFR 601.316: Administrative remedies available to taxpayers after the purchase of tobacco tax stamps or after assessment or payment of tobacco taxes. (Also Part I, Section 5705, 270.164, 270.197.) — Rev. Proc. 58–9

Means for establishing that claims, filed after June 30, 1959, by manufacturers and importers of cigars, for refund of tax paid by return on cigars withdrawn from the market, were filed within the statutory period of limitation.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to call to the attention of manufacturers and importers of cigars the advisability of their having a means for establishing that claims, filed after June 30, 1959, for refund of tax paid by return on cigars withdrawn from the market, were filed within the statutory period of limitation.

SEC. 2. BACKGROUND.

Because the return system for the taxpayment of cigars became effective July 1, 1956, any claim filed on or before June 30, 1959, for refund of cigar taxes paid by return, is within the three-year time limitation imposed by section 5705(c) of the Internal Revenue Code of 1954. In such claim, a general statement that the cigars were taxpaid on or after July 1, 1956, in lieu of a more specific fixing of the time of taxpayment, is acceptable. After June 30, 1959, failure or inability of the claimant to establish the timely filing of a claim will result in its rejection. Since cigars which are now being taxpaid by return and which are withdrawn from the market may be the subject of a claim filed after June 30, 1959, the matter is being called to the attention of manufacturers and importers of cigars.

SEC. 3. MEANS OF ESTABLISHING TIMELY FILING OF CLAIMS.

It is suggested that the manufacturers and importers of cigars devise some means for establishing the timely filing of claims filed after June 30, 1959, such as by marking the packages of cigars, in code or otherwise, to indicate the date of taxpayment. Where it is not feasible to indicate the date of taxpayment, it may be desired to mark the packages to indicate an earlier date, from which date to measure the period for the timely filing of claims, such as the date of packaging of the cigars, or the date of removal of the cigars from the factory or from customs' custody. This marking may represent the week or month of the year, in lieu of the specific date. The key to any code in use or to be adopted, for this purpose, should be immediately furnished to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

SEC. 4. EFFECT OF PROPOSED LEGISLATION.

The future need for such marking for the purpose of claims for refund of taxes paid by return on cigars withdrawn from the market may be eliminated if the Excise Tax Technical Changes Act of 1957, H. R. 7125—85th Congress, 1st Session, is enacted into law, since section 5705(c), as proposed in such Bill, would replace the existing limitation, that claims be filed within three years of the date of tax-payment, with a provision that such claims for refund shall be filed within six months after the date of withdrawal from the market, loss, or destruction of the cigars, as the case may be.

SEC. 5. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to the number thereof and should be directed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

---

26 CFR 601.403(c)(2): Provisions special to certain employment and excise taxes; miscellaneous excise taxes collected by return, collected taxes.

The Internal Revenue Service discusses the procedure pertaining to so-called "collected" taxes whereby direct assessment may be made against a taxpayer who refuses to pay the tax to a collecting agency. See Rev. Rul. 58–300, page 454.

INDEX

ADMINISTRATIVE: Page

Accounting period, returns erroneously filed on different basis 215
Administration:
Delegated authority:
Firearms taxes 683
Tobacco taxes 683
Delegation of authority, notice of additional inspection of records 680
Delegation of responsibility for supervising Regional Commissioners 680
Establishment of the office of Assistant Commissioner of Internal Revenue (Planning and Research) 679
Organization and functions of Internal Revenue Service, statement amended 663
Tax Court settlements 681
Aliens (See: Nonresidents).
Appeals:
Hearing before Appellate Division § 601.203(d) 664
Informal conferences, §§ 601.105(b)(4), 601.105(c)(2), 601.105(c)(1) 664
Preliminary or thirty-day letters, appellate functions, § 601.106(b) 664
Requirements for referral of unagreed cases to Appellate Division, § 601.106(f)(5) 664
Assessments:
Collected excise taxes, limitation period 562
Direct, "collected" excise taxes 454
Limitation period, retailers tax, several categories on same return 495
Bond:
Exempt organization, deferment of gain from installment obligation 511
Gasoline and lubricating oil, authority to determine amount 679
Claims (See *also:* Credits and refunds).
Corporation income tax returns § 301.6402–3 476
Filing after April 30, 1958, credit and refund, alcohol and tobacco taxes 630
Research expenses, patent costs 148
Timely filing, mailing requirements § 301.7502–1 476
Closing agreements:
Applicability of rulings requirements, § 601.202(d) 664
Incident to settlement by Appellate Division, § 601.106(d)(1) 664
Collection:
Collected taxes, penalties, failure to make deposits, payments, and returns 629
Excise taxes:
Circulation, state bank notes, § 601.403(c)(1) 664
Forms prescribed for registration, § 601.404(k) 664
Highway motor vehicles, § 601.403(c)(1) 664
Hydraulic mining, § 601.403(c)(1) 664
Miscellaneous excise taxes, depository receipt procedure, § 601.403(c)(3) 664
Sale of revenue stamps, procedure, § 601.404(f)(4) 664
Wagering, § 601.403(c)(1) 664
Limitation period, retailers tax, several categories on same return 495
Compromises (See: Offers in compromise).
Court decisions (See: COURT DECISIONS).
Court proceedings (See: Suits).
Credits and refunds:
Alcohol and tobacco taxes, conditions to allowance 630
Claims timely filed, mailing requirements § 301.7502–1 476
Corporation income tax return as claim § 301.6402–3 476
Current deduction of capitalized cost of railway roadbed pole-driving 92
Delivery of checks, cases in litigation, § 601.510(b) 664

ADMINISTRATIVE—Continued Page

Credits and refunds—Continued
- Excise taxes:
  - Garbage collection body mounted on truck chassis by exporter 489
  - Miscellaneous taxes collected by return, § 601.403(d)(2) 664
  - Playing cards sold tax-paid to United States 463
- Firearms taxes, delegated authority 683
- Gasoline tax:
  - Crop dusting 491
  - Feed lot 490
  - Orchard sprayer 492
- Litigated cases, mailing of checks § 301.6402–2 476
- Manufacturers tax:
  - Articles installed on war vessels 428
  - Conversion of automobile bodies and chassis purchased tax-paid 391
  - Tread rubber lost in processing 402
- Nonhighway use of gasoline, spraying and cultivating lawn areas 492
- Payments in respect of gasoline used for nonhighway purposes, § 601.402(c) 664
- Review of overassessments exceeding $100,000, §§ 601.108(b), 601.108(c) 664
- Unagreed cases, action by Appellate Division, § 601.106(d)(1) 664

Criminal prosecutions:
- Admissibility of wiretap evidence 567
- Evidence, preliminary hearing to determine admissibility 540
- Newly discovered evidence, remand for new trial 535

Deficiences:
- Net worth method of computing income, authority of Tax Court to require details 549
- Protests, thirty-day letters, § 601.105(d)(2) 664

Delegation of authority:
- Determination of amount of gasoline and lubricating oil bonds 679
- Notice of additional inspection of records 680
- Supervision of Regional Commissioners 680
- Tax Court settlements 681

Effective date, regulations relating to nonrecognition of gain or loss, corporate liquidations, § 1.392–1 191

Elections:
- Accounting methods; accrual of real property taxes, § 1.461–1 215
- Amortization, emergency facilities, §§ 1.168–2, 1.168–3 63
- Amounts received under royalty contract for disposal of coal, § 1.631–3 159
- Amounts received under royalty contract for disposal of timber, § 1.631–2 159
- Effective date, nonrecognition of gain or loss in liquidations, § 1.392–1 191
- Mineral lease co-owners, exclusion from partnership provisions 324
- Ministers' self-employment coverage, release from poverty oath 331
- Timber cutting as sale or exchange, § 1.631–1 159

Estimated tax:
- Corporations, additions to tax for underpayment, § 1.6655–2 114
- Underestimate based on reconstructed income, penalties 508

Evasion of tax (See: Fraud)

Evidence:
- Admissibility, preliminary hearing 540
- Criminal prosecution, remand for new trial 535
- Proof of intentional tie-in liquor sales by wholesaler 611
- Wiretap, obtained by state agents, admissibility in Federal court 567

Examination, books and records (See: Records)

Exempt organization, gain from installment obligation 511

Forms (See: Returns)

Fraud:
- Criminal prosecution, newly discovered evidence, remand for new trial 535
- Evidence, preliminary hearing to determine admissibility 540
- Net worth method of computation, authority of Tax Court to require details 549
- Net worth method of reconstruction of income 508

ADMINISTRATIVE—Continued Page

Government depository, employment and excise taxes, §§ 601.401(a)(5), 601.403(c)(2) ---- 664
Inspection of returns or records:
Additional delegation of authority to notify ---- 680
Support of child, amount claimed by former spouse ---- 498
Interest:
Deficiencies:
Allocation of partial payment ---- 94
Direct assessment, "collected" excise taxes ---- 454
Redetermination of tax as result of refund of foreign tax ---- 265
Overpayments, rent paid to personal holding company by shareholder ---- 628
Levy, railroad retirement benefits, § 301.6334–1 ---- 476
Limitation period:
Assessment and collection, retailers tax, several categories on same return ---- 495
Assessments, collected excise taxes ---- 562
Claims, research expenses, patent costs ---- 148
Mitigation of effect of limitation (See: INCOME TAX: Mitigation of effect of limitation)
Nonresidents, departing aliens, layover of five days or less, Certificate of Compliance ---- 497
Offers in compromise:
Firearms taxes, delegated authority ---- 683
Tobacco taxes, delegated authority ---- 683
Use of prescribed forms, § 601.203(b) ---- 664
Overassessments (See: Credits and refunds)
Partnerships, unincorporated organizations having members in common ---- 257
Penalties:
Direct assessment, "collected" excise taxes ---- 454
Failure to make deposits, payments, and returns, collected taxes ---- 629
Underestimate of tax, reconstructed income ---- 508
Period of limitation (See: Limitation period)
Publication, final opinions in adjudication of income, profits, estate or gift tax cases, § 601.702(b) ---- 664
Publicity of returns and information, support of child, amount claimed by former spouse ---- 498
Records:
Adequacy, reconstruction of income ---- 508
Notice of additional inspection, delegation of authority ---- 680
Work sheets reconciling book and tax depreciation ---- 123
Refunds (See: Claims, Credits and refunds)
Returns:
Amended, research expenses, patent costs ---- 148
Collections, tax shown on Form 1040A, § 601.104(a)(1) ---- 664
Corporation, form to claim for credit or refund, § 301.6402–3 ---- 476
Employment taxes:
Adjustments with respect to income tax withheld, § 601.401(c)(2) ---- 664
Collection methods, prescribed forms, § 601.401(a)(3) ---- 664
Depository receipt procedure, § 601.401(a)(5) ---- 664
Employers' identification numbers, § 601.401(b)(1) ---- 664
Imposition, employers of four or more, § 601.410(a)(1) ---- 664
Penalties, failure to make deposits, payments and returns ---- 629
Railroad retirement, Form CT–1 (Revised January 1958) ---- 685
Reporting of wages, § 601.401(b)(3) ---- 664
Examination:
Determination of liability:
Protests, § 601.105(d)(2) ---- 664
Thirty-day letters, § 601.105(d)(1) ---- 664
Office audit, §§ 601.105(b)(1), 601.105(b)(2) ---- 664
Exise taxes:
Manufacturers, computation and prepayment of tax by exporter ---- 473
Penalties, failure to make deposits, payments, and returns ---- 629
Failure to file, "collected" excise taxes ---- 454

ADMINISTRATIVE—Continued Page

Returns—Continued
Forms:
1040A, computation of tax, § 601.104(a)(1) 664
CT—1 (Revised January 1958), instructions for computations of railroad retirement taxes 685
Substitutes for Form 2439, private printing 684
Husband and wife, common-law marriage 60
Individual:
Form 1040A, computation of tax, § 601.104(a)(1) 664
Self-employment tax, optional tax table 320
Information:
Departing aliens, layover of five days or less, Certificate of Compliance 497
Dividends, except organizations 474
Unincorporated organizations having members in common 257
Inspection, support of child, amount claimed by former spouse 498
Partnerships, unincorporated organizations having members in common 257
Period covered, change to conform to accounting period 215
Reproduction, Form 2439 684
Withholding, penaltics, failure to make deposits, payments, and returns 629
Rulings:
Employees trusts or plans, advance determination letters, § 601.201 (l)(1) 664
Exempt organizations, § 601.201(c)(4) 664
Pension, annuity, profit-sharing, and stock bonus plans, § 601.201(c)(5) 664
Requests for rulings or determination letters, §§ 601.201(f)(1), 601.201(f)(2) 664
Suits:
Alcohol and tobacco taxes, filing credit or refund claims 630
Commencement, right to retroactive retirement pay 314
Delivery of checks in payment of refunds, § 601.510 (b) 664
Evasion of tax, remand for new trial 535
Tax:
Computations:
Income attributable to several years, §§ 1.1301–1 through 1.1304–1, 1.1306–1 288
Interest, foreign tax credit redetermined 265
Self-employment tax, optional tax table 320
Credits, alcohol and tobacco taxes, rightful claimant 630
Liability, firearms, delegated authority 683
Payments:
Failure to make deposits, payments, and returns, collected taxes 629
Receipts for public debt securities, § 301.6312–1 476
Tax Court of the United States:
Authority to require details of net worth reconstruction of income 549
Responsibility for settlements 681
Timely filing of petitions, § 301.7502–1 476
Withholding, penalties, failure to make deposits, payments, and returns 629
Advertising, display, use of empty liquor bottles 590

ALCOHOL TAX:

Alcohol:
Content in wine, instruments and methods for determination 598
Denatured, formulas, § 601.301(c)(33) 664
Government reports, use of reproduction methods 599
Proof verification, sampling program modification 687
Receipt from General Services Administration, storage and recording 601
Specially denatured:
Addition of ethyl acetate 595
Formulas for alcholado, bay rum, proprietary solvents 688
Production, use of quassin 596
Products produced or purchased, Record 134 595
Tax-free, storage by hospitals 594

ALCOHOL TAX—Continued

	Page
Alcohol—Continued	
Tax-free aircraft supplies:	
Dominican Republic, et al	593
Mexico	592
Spain	593
Applications:	
Form 2323, consolidation of tanks of consolidated spirits	603
Importer, destruction abroad, unused red strip stamps	572
Beer:	
Claims, allowance, credit or relief, § 601.303(d)	664
Export drawback, § 601.304(h)	664
Government reports, use of reproduction methods	599
Imported, release from customs custody	618
Sales within National park, special tax	587
Tax-free aircraft supplies:	
Dominican Republic, et al	593
Mexico	592
Spain	593
Trade with Hawaii	606
Use on vessels and aircraft, § 601.301(c)(21)	664
Bonded wine cellars:	
Instruments and methods to determine alcohol content of wine	598
Use of "Amberlite–IR–120," treatment of wine	599
Use of SAF Cation Exchange and SAF Anion Exchange Resins, treatment of wine	598
Bottlers:	
Proof determination for immediate bottling of imported bulk spirits	605
Use of empty liquor bottles for display	590
Claims:	
Allowance, credit or relief, § 601.303 (d)	664
Credit or refund, filing after April 30, 1958	630
Distilled spirits, destroyed after withdrawal from bond	573
Drawback, § 601.301(c)(21)	664
Drawback:	
Aircraft liquor supplies:	
Dominican Republic, et al	593
Mexico	592
Spain	593
Trade with Hawaii	606
Distilled spirits used in High-Alcoholic and Low-Alcoholic Elixirs	586
Export spirits removal from wholesaler coastal storage	583
Export drawback, § 601.304 (h)	664
Nonbeverage drawback, period covered, § 601.304(i)	664
Construction, hospital storage of tax-free alcohol	594
Containers:	
Barrels, distillate over 110 proof, labeling as whisky	613
Bottles:	
Emptied of liquor, use for display	590
Indication of net contents, location	590
Refill cases, inspection, § 601.702(b)(1)(i)	664
Cases, emptied, destruction of serial numbers, marks and brands	689
Non-taxpaid spirits, seizure, admissibility of wiretap evidence	567
Court decisions:	
Benanti, Salvatore v. *United States*	567
Black, Joseph F., v. *Magnolia Liquor Company, Inc*	609
Erie Railroad Company and Atlantic Mutual Insurance Company v. *United States*	573
Magnolia Liquor Co., Inc. v. *Black*	611
Credits:	
Conditions to allowance, rightful claimant	630
Extension to state liquor commission	612
Customs:	
Collector, destruction abroad, unused red strip stamps	572
Release of imported malt beverages, Form 1649	618
Release of imported spirits, Form 1649	613

ALCOHOL TAX—Continued Page

Dealers and users, specially denatured alcohol, formulas 688
Denaturants:
Ethyl acetate, ester content 595
Ethyl acetate for proprietary and industrial solvents 597
Formulas, § 601.301(c)(33) 664
Quassin as substitute for brucine, production of specially denatured alcohol 596
Denaturing plants, production of specially denatured alcohol, use of quassin 596
Distillate, proof over 110 degrees, labeling as whisky 613
Distilled spirits:
Bulk, taxpayment, § 601.302(a) 664
Consolidated, combined in warehouse tank, original entry date 603
Destroyed after withdrawal from bond, refund 573
Emptied cases, destruction of serial numbers, marks and brands 689
Export drawback, § 601.304(h) 664
Export, red strip stamps, imprinted "EXPORT" 583
Exportation to Canada, attachment of Canadian stamps 604
Flavored vodkas, neutral spirits statement on labels 613
Government reports, use of reproduction methods 599
Imported, certificates of origin 613
Imported bulk, immediately bottled, proof determination 605
Imported fruit brandies, blending, rectification tax 581
Liquor sales within National park, special tax 587
Manufacture of High-Alcoholic and Low-Alcoholic Elixirs, drawback 586
Nonbeverage drawback claims, § 601.304(i) 664
Non-taxpaid spirits, admissibility of wiretap evidence 567
Proof verification, sampling program modification 687
Sales to state liquor commission requesting extension of credit 612
Tax-free aircraft supplies:
Dominican Republic, et al 593
Mexico 592
Spain 593
Trade with Hawaii 606
Tie-in sales forced on retailers by wholesalers 611
Tie-in sales resulting in violations 609
Two half cases, combined in corrugated sleeve 600
Unused red strip stamps, destruction abroad 572
Use by successor nonbeverage manufacturer, formulas 587
Use on vessels and aircraft, § 601.301(c)(21) 664
Vodka:
Production by extractive distillation, or use of activated carbon 588
Reclassification, use as neutral spirits 581
Whisky, stored at between 110 and 160 degrees of proof 590
Wholesaler, coastal storage pending exportation 583
Distilleries:
Denaturing bonded warehouse, gauging denatured rum by volume, weighing tanks 589
Registered, vodka produced by extractive distillation, or use of activated carbon 588
Equipment and supplies:
Instruments for determining alcohol content of wine 598
New still, construction from various parts of distilling units 584
Rubber stamp, imprinting "EXPORT" on red strip stamps 585
Exporters, drawback claims, § 601.304(h) 664
Fermented malt liquors (See: Beer)
Forms:
1451, receipt and use of alcohol from General Services Administration 601
1479–A, proprietary and industrial solvents, use of ethyl acetate 597
1479–A, use of tartar emetic, sucrose octa-acetate, rubber hydrocarbon 688
1649, release from customs custody, imported malt beverages 618
2323, consolidated spirits combined in warehouse tank 603
Offers in compromise, filing, § 601.305(a) 664

ALCOHOL TAX—Continued Page

Formulas:
- Ester content of ethyl acetate for proprietary and industrial solvents.. 597
- Predecessor use by successor nonbeverage manufacturer 587
- Production of alcoholado, bay rum, proprietary solvents 688
- Specially denatured alcohol:
  - Use of ethyl acetate 595
  - Use of quassin 596

Gauge:
- Bulk spirits, taxpayment, modification in proof verification 687
- Denatured rum by volume, weighing tanks 589

Government use, wiretap evidence, resultant seizure of nontaxpaid spirits. 567

Hospitals and clinics:
- Storage and reporting alcohol received from General Services Administration 601
- Storage of tax-free alcohol 594

Importers:
- Applications, destruction abroad, unused red strip stamps 572
- Use of empty liquor bottles for display 590

Inducements:
- Combination "deals" in spirits offered retailers by wholesalers 609
- Extension of credit to state liquor commission 612
- Tie-in sales, retailers required to buy undesired brands 609
- Wholesaler tie-in sales of liquors to retailers 611

Labels:
- Blended Scotch Type Whisky, removal from standards of identity 613
- Bottles of spirits, indication of net contents 590
- Certificate of approval, imported malt beverages, release from customs custody 618
- Flavored vodkas, neutral spirits statement 613
- Proof of imported bulk spirits immediately bottled 605

Marks and brands:
- Bottles of spirits, indication of net contents 590
- "EXPORT" imprinted on red strip stamps, export spirits 583
- Removal from emptied cases of spirits 689
- Reuse clause, use of empty liquor bottles 590
- Two half cases of spirits combined in corrugated sleeve 600

Materials:
- Activated carbon, treatment of neutral spirits, vodka production 588
- "Amberlite–IR–120", use in treatment of wine 599
- Distilled spirits, High-Alcoholic and Low-Alcoholic Elixirs, drawback. 586
- Ethyl acetate, ester content as a denaturant 595
- Ethyl acetate used for proprietary and industrial solvents 597
- Flavoring, crushed cherry pits, addition to cherry product 613
- Quassin as substitute for brucine, production of specially denatured alcohol 596
- SAF Cation Exchange, SAF Anion Exchange Resins, use in treatment of wine 598
- Tartar emetic, sucrose octa-acetate, rubber hydrocarbon, formulas.. 688

Nonbeverage manufacturers:
- Drawback claims, § 601.304(i) 664
- Successor use of predecessor formulas 587

Nonbeverage products, Low-Alcoholic Elixir, drawback on distilled spirits. 586

Offers in compromise:
- Acceptance or rejection, § 601.305(a) 664
- Refill cases, inspection, § 601.702(b)(1)(i) 664

Penalties, permit suspension, tie-in sales to retailers 611

Permits, suspension, wholesaler forcing tie-in sales on retailers 611

Proprietary solvents, production, use of rubber hydrocarbon, formulas 688

Records:
- Original entry, date, consolidated spirits combined in warehouse tank. 603
- Record 134, production or purchase of specially denatured alcohol products 595
- Wholesaler, storage of export spirits at coastal port 583

ALCOHOL TAX—Continued Page

Rectifying plants:
- Attachment of Canadian stamps to spirits bottled for export to Canada 604
- Blending imported fruit brandies, exemption 581
- Combining two half cases of spirits in corrugated sleeve 600
- Immediate bottling of imported bulk spirits, proof determination 605
- Reclassification of vodka, use as neutral spirits 581
- Vodka produced by use of activated carbon 588

Refunds:
- Claims, distilled spirits destroyed after withdrawal from bond 573
- Conditions to allowance, rightful claimant 630

Regulations:
- 26 CFR 175.42, 220.548a (added), 230.206, 231.82, 235.631, 240.579; whisky stored between 110 and 160 degrees of proof 590
- 26 CFR 182.671a (added); storage and recording alcohol received from General Services Administration 601
- 26 CFR 212.44(a), 212.45(a), use of ethyl acetate 595
- 26 CFR 251.89a (added); destruction abroad, unused red strip stamps 572
- 27 CFR 5.21–5.73, and intermediate sections; labeling and advertising distilled spirits 613
- 27 CFR 7.31(b), 7.31(c); release of imported malt beverages from customs custody 618

Reports:
- Customs chemist's, imported bulk spirits immediately bottled 605
- Government, preparation by use of reproduction methods 599

Retail liquor dealers:
- Forced purchases of liquors, wholesaler tie-in sales 611
- Liquidation of stock in fiscal year following business termination 585
- Required to buy undesired brands, violations 609
- State liquor commission, extension of credit 612

Returns, claims, allowance, credit or relief, § 601.303(d) 664

Sales:
- Alcoholic beverages to state liquor commission, extension of credit 612
- Alcoholic liquors within National park, special tax 587
- Liquors, during liquidation of stock by retailer, special tax 585
- Specially denatured alcohol products, Record 134 595
- Spirits, combination "deals" offered retailers by wholesalers 609
- Tie-in, decreasing retailer purchase of liquors from wholesaler competitors 611

Samples, bulk spirits, program for proof verification, modification 687

Seizures, non-taxpaid spirits, result of wiretap evidence 567

Special tax:
- Liability, sales of alcoholic liquors within National park 587
- Manufacturer, distiller constructing new still from various parts of distilling units 584

Stamps:
- Canadian, attachment to spirits bottled for export to Canada 604
- Distilled spirits excise sheet, § 601.302(a) 664
- "Display", on empty liquor bottles, use for display 590
- Non-taxpaid spirits seizure, admissibility of wiretap evidence 567
- Red strip, imprinted "EXPORT", spirits for export 583
- Red strip unused, destruction abroad 572
- Removal from cases emptied of bottled spirits 689
- Special tax, retailer or wholesaler, liquidation of stock, time limit termination 585

States, local agents wiretap, evidence admissibility in seizure of non-taxpaid spirits 567

Stills, new, construction from various parts of distillery units, special tax 584

Tanks:
- Warehouse storage, consolidated spirits, original entry date 603
- Weighing, gauging denatured rum by volume 589

Taxes:
- Bulk spirits, sampling for proof verification, modification 687
- Credit or refund allowance, rightful claimant 630
- Payment, excise sheet stamps, § 601.302(a) 664

ALCOHOL TAX—Continued Page

Taxes—Continued
- Rectification:
  - Blending imported fruit brandies ... 581
  - Use of vodka reclassified as neutral spirits ... 581
- Refunds, distilled spirits destroyed after withdrawal from bond ... 573
- Special, retailer or wholesaler liquidation of stock in next fiscal year ... 585

Taxpaid bottling houses:
- Attachment of Canadian stamps to spirits bottled for export to Canada ... 604
- Combining two half cases of spirits in corrugated sleeve ... 600
- Immediate bottling of imported spirits, proof determination ... 605

Vinegar, production by vaporizing process, § 601.301(c)(25) ... 664

Violations:
- Extension of credit to state liquor commission ... 612
- Intentional tie-in sales by wholesale liquor dealer ... 611
- Refill liquor bottles, offers, § 601.702(b)(1)(1) ... 664
- Tie-in sales to retailers ... 609
- Transported non-taxpaid spirits, wiretap evidence in resultant seizure ... 567
- Wholesaler's combination "deals" in spirits offered to retailers ... 609

Warehouses:
- Distillery denaturing, gauging denatured rum by volume, weighing tanks ... 589
- Internal Revenue:
  - Attachment of Canadian stamps to spirits bottled for export to Canada ... 604
  - Consolidated spirits, first-in, first-out of tank ... 603
  - Export spirits, stamping red strip stamps "EXPORT" ... 583

Wholesale liquor dealers:
- Coastal port storage of spirits pending exportation ... 583
- Liquidation of stock in fiscal year following business termination ... 585
- Offering combination "deals" in spirits to retailers ... 609
- Permit suspension, tie-in sales to retailers ... 611
- Tie-in sales requiring retailer to buy undesired brands ... 609

Wine:
- Alcohol content determination, instruments and methods ... 598
- Bottles, indication of net contents ... 590
- Claims, allowance, credit or relief, § 601.303(d) ... 664
- Emptied cases, destruction of serial numbers, marks and brands ... 689
- Export drawback, § 601.304(4) ... 664
- Government reports, use of reproduction methods ... 599
- Sales within National park, special tax ... 587
- Tax-free aircraft supplies:
  - Dominican Republic, et al ... 593
  - Mexico ... 592
  - Spain ... 593
  - Trade with Hawaii ... 606
- Treatment:
  - Use of "Amberlite–IR–120" ... 599
  - Use of SAF Cation Exchange, SAF Anion Exchange Resins ... 598
- Two half cases, combined in corrugated sleeve ... 600
- Use on vessels and aircraft, § 601.301(c)(21) ... 664
- Wholesaler, coastal storage pending exportation ... 583

Wineries (See: Bonded wine cellars)

COURT DECISIONS:

Benanti, Salvatore, v. *United States* ... 567
Black, Joseph F., v. *Magnolia Liquor Company, Inc* ... 609
Erie Railroad Company and Atlantic Mutual Insurance Company v. *United States* ... 573
Fidelity-Philadelphia Trust Co. et al., executors (Will of Mary H. Haines v. *Smith* ... 557
Fleming, William, et al. v. *Commissioner* ... 516
Haines, Will of Mary H. (See: *Fidelity-Philadelphia Trust Co., et al., executors (Will of Mary H. Haines)* v. *Smith*) ... 557
Hoover Motor Express Co., Inc. v. *United States* ... 505

COURT DECISIONS—Continued Page

Lake, P. C., Inc., et al; Commissioner v. 516
Lawn, Howard; Giglio, William and Livorsi, Frank v. *United States* 540
Licavoli, Peter; Commissioner v. 549
Magnolia Liquor Co., Inc., v. *Black* 611
O'Connor, Dennis M., et al.; Scofield v. 516
Schwarzkopf, George, v. *Commissioner* 508
Shotwell Manufacturing Company, Byron A. Cain and Harold E. Sullivan; United States v. 535
Sullivan, Neil, et al. v. *Commissioner* 506
Tank Truck Rentals, Inc. v. *Commissioner* 502
Weed, W. F., Commissioner v. 516
Wrather, John and Nell; Commissioner v. 516

EMPLOYMENT TAXES:

American employer (See: Employer)
Collections (See: ADMINISTRATIVE: Collections)
Employer:
- Foreign subsidiary of domestic partnership 358
- Surety completing school construction 354

Employer-employee:
- Drivers, contract for operation and maintenance 347
- Hygienist, dental assistant 353
- Insurance salesmen:
  - Industrial debit, related companies 351
  - Industrial debit agents 349

Exempt organizations, retroactive Social Security coverage 356
Foreign employees, subsidiary of domestic partnership 358
Forms (See: ADMINISTRATIVE: Returns)
Insurance agents:
- Industrial debit salesmen, remunerated by commission 349
- Industrial debits, related companies 351

Penalties (See: ADMINISTRATIVE: Penalties)
Railroad retirement:
- Returns (See: ADMINISTRATIVE: Returns)
- Tax computations, instructions for use of Form CT–1 (Revised January 1958) 685

Wages:
- Award by union for service with one employer 41
- Bonus, taxes to be absorbed by employer 362
- Bonuses, baseball players 360
- Compensation paid corporate organizer for services prior to incorporation 344
- Gratuities accounted for to employer for compensation determination 343
- Lockout benefits 14
- Lump-sum payment in cancellation of employment agreement 23
- Predecessor employer, wages attributed to successor 345
- Supplemental unemployment benefits 89

Waivers, exempt organizations, retroactive Social Security coverage 356

ESTATE TAX:

Annuities (See: Transfers)
Bonds, District of Columbia Armory Board 626
Court decisions (See: COURT DECISIONS)
Credits against tax, property previously taxed, widow's statutory allowances 340
Domicile, visiting alien intending to become citizen 341
Life insurance, transferred or assigned, combination single-premium insurance and annuity contract 557
Marital deductions, terminable interest, decedent adjudged incompetent before April 2, 1948 627
Nonresidents, domicile, visiting alien intending to become citizen 341
Transferees, credits against tax, widow's statutory allowance 340
Transfers:
- Income retained, single-premium life insurance and annuity combination 557
- Survivorship annuities, single-premium life insurance and annuity combination 557

EXCESS PROFITS TAX: Page

Excess profits credits, taxable acquisitions, deposit liabilities of selling bank assumed by purchasing bank ... 555
Industry base period rates of return, deposit, liabilities of selling bank assumed by purchasing bank ... 555
Mining, natural resources, etc., excess output of strategic minerals, computation of nontaxable income ... 554
Regulations, 26 CFR 40.453–3, 40.453–6 amended, computation of nontaxable income, exempt excess output of strategic minerals ... 554

EXCISE TAXES:

Admissions:
- Athletic game for benefit of eye clinic ... 432
- Exemption:
  - Dance to raise funds for policemen's insurance ... 432
  - Musicals or revues, athletic games ... 633
  - Policemen's or firemen's benefit fund ... 431

Assessments (See: ADMINISTRATIVE: Assessments)
Bowling alleys, pool tables, etc., home for the aged ... 466
Claims (See: ADMINISTRATIVE: Credits and refunds)
Coconut and palm oil, processing of fatty acids ... 468
Coin-operated devices:
- Gum dispenser with amusement device ... 465
- Vending machines dispensing novelties ... 465

Collections (See: ADMINISTRATIVE: Collections)
Communications:
- Exemptions:
  - Connecticut River Valley Flood Control Commission ... 456
  - Municipal associations ... 389
  - North Jeffco Metropolitan Recreation District ... 428
- Telephone directory listings ... 436

Credits (See: ADMINISTRATIVE: Credits and refunds)
Dues, initiation fees, etc.:
- Amounts deposited in escrow by club subscribers ... 435
- 20-year non-dues paying membership ... 434

Interest (See: ADMINISTRATIVE: Interest)
Limitation period (See: ADMINISTRATIVE: Limitation period)
Manufacturers:
- Appliances:
  - Article produced under patent rights ... 395
  - Articles produced in Armed Forces disciplinary barracks ... 394
  - Electric hair dryer ... 410
  - Fans ... 410
  - Hand and face dryer ... 408
  - Lawn mower, self-propelled sulky ... 410
  - Prepayment of tax by exporter ... 473
  - Quick recovery type electric water heaters ... 409
  - Rug cleaning attachment for floor polisher ... 408
- Automobiles, etc.:
  - Ambulances converted from automobiles ... 391
  - Article produced under patent rights ... 395
  - Articles produced in Armed Forces disciplinary barracks ... 394
  - Garbage collection units, body mounted on truck chassis by exporter ... 489
  - Imported used cars of foreign manufacture ... 401
  - Line marking machine ... 399
  - Miniature vehicles ... 399
  - Parts and accessories:
    - Battery operated vacuum cleaner ... 393
    - Combination flashlight—mirror ... 397
    - Grain or feed loader-unloader ... 401
    - Immersion heaters ... 401
    - Radiator cores ... 396
    - Rim flange strip and sidewall ring for tires ... 394
    - Special controls for physically handicapped ... 398
    - Trailer hitches ... 397

EXCISE TAXES—Continued Page

Manufacturers—Continued
Automobiles, etc.—Continued
Prepayment of tax by exporter 473
Purchase by veteran with Government funds 397
Rotary snow plow 393
Three-wheel vehicle for delivery of mail 400
Trailer mounted storage tank 390
Business machines:
Article produced under patent rights 395
Articles produced in Armed Forces disciplinary barracks 394
Perforating machines 422
Portable stapler designed for wall mounting 423
Prepayment of tax by exporter 473
Typewriter carrying cases 423
Cigarette, etc., lighters, unpatented articles manufactured exclusively for one company 424
Electric light bulbs, etc.:
Article produced under patent rights 395
Articles produced in Armed Forces disciplinary barracks 394
Glow lamps 412
Prepayment of tax by exporter 473
Exemptions:
Articles installed on war vessels 428
Connecticut River Valley Flood Control Commission 456
Municipal associations 389
North Jeffco Metropolitan Recreation District 428
Sales to public schools 430
State, donation by purchaser of tax-paid article 429
Firearms, shells, etc.:
Article produced under patent rights 395
Articles produced in Armed Forces disciplinary barracks 394
Prepayment of tax by exporter 473
Spear gun used for underwater fishing 421
Gasoline:
Agricultural commodities transported on State-owned farm-to-market roads 494
Aviation fuel 403
Claim for refund:
Crop dusting 491
Feed lot 490
Crude oil producers and dealers 404
Nonhighway use, spraying and cultivating lawn areas 492
Nursery as farm 494
Orchard sprayer 492
Prepayment of tax by exporter 473
Tree planting, cultivating, etc 492
General:
Repackaging charges 427
Service charge on installment sales 426
Lubricating oil:
Castor oil sold for nonlubriacting purposes 405
Liquid grease, solvent additive 406
Saws used in the lumber business 406
Matches:
Articles produced in Armed Forces disciplinary barracks 394
Prepayment of tax by exporter 473
Produced under patent rights 395
Musical instruments:
Articles produced under patent rights 395
Articles produced in Armed Forces disciplinary barracks 394
Prepayment of tax by exporter 473
Pencils, pens, etc.:
Article produced under patent rights 395
Articles produced in Armed Forces disciplinary barracks 394
Prepayment of tax by exporter 473

EXCISE TAXES—Continued Page

Manufacturers—Continued
Phonographs, etc. (See: Radio and TV receivers, phonographs, etc.)
Photographic apparatus:
Article produced under patent rights 395
Articles produced in Armed Forces disciplinary barracks 394
Microfilm reels 420
Prepayment of tax by exporter 473
Radio and TV receivers, phonographs, etc.:
Article produced under patent rights 395
Articles produced in Armed Forces disciplinary barracks 394
Prepayment of tax by exporter 473
Toy radio receivers 413
Tuning units 414
Refrigerators, etc.:
Article produced under patent rights 395
Articles produced in Armed Forces disciplinary barracks 394
Prepayment of tax by exporter 473
Sporting goods:
Archery equipment, catapults, boomerangs, blow guns 415
Article produced under patent rights 395
Articles produced in Armed Forces disciplinary barracks 394
Fishing creel 416
Golf balls designed as part of a child's game 417
Prepayment of tax by exporter 473
Racket produced from tax-paid frame and string 418
Simulated golf sets 418
Skis and ski poles designed for children 416
Spear gun used for underwater fishing 421
Tires and tubes, etc.:
Articles produced under patent rights 395
Articles produced in Armed Forces disciplinary barracks 394
Prepayment of tax by exporter 473
Tread rubber lost in processing 402
Narcotics:
Alpha and beta 3-ethyl-1-methyl-4-phenyl-4-propionoxypiperidine 678
Drugs and compounds, addiction liability 470
1-(2 Morpholinoethyl)-4-carbethoxy-4-phenylpiperidine, and *d*-2, 2-Diphenyl-3-methyl-4-morpholino-butyril-pyrrolidine 677
Penalties (See: ADMINISTRATIVE: Penalties).
Playing cards, credit or refund, tax-paid sales to United States 463
Refunds (See: ADMINISTRATIVE: Credits and refunds).
Regulations, narcotics, 26 CFR 151.172a narcotic drugs and compounds for which oral prescription is authorized 470
Retailers:
Exemptions:
Connecticut River Valley Flood Control Commission 456
Municipal associations 389
North Jeffco Metropolitan Recreation District 428
Fuels, diesel, used as weed killer 386
Furs:
Customs Service and Post Office sales of confiscated or unclaimed articles 363
Definition of term "sold at retail" 561
Guides to taxability 370
General:
Customs Service and Post Office sales of unclaimed or confiscated articles 363
Installment accounts, sale and collection 388
Jewelry:
Antique clocks 370
Combination clock, barometer, thermometer, and hygrometer 368
Customs Service and Post Office sales of confiscated or unclaimed articles 363
Definition of term "sold at retail" 561

EXCISE TAXES—Continued Page

Retailers—Continued
- Jewelry—Continued
  - Executor's sale of decedent's collection 368
  - Hair ornament 369
  - Miniature Christmas tree and artificial flowers 364
  - "Party" credits applied to purchase price 365
  - Watch bands, bracelets, or straps 366
- Luggage:
  - Cigarette and eyeglass cases made of beads 385
  - Coin holders 383
  - Customs Service and Post Office sales of confiscated or unclaimed articles 363
  - Definition of term "sold at retail" 561
  - Insurance card folder 383
  - Rain hoods and carrying cases 384
  - Shoe mittens 584
- Toilet preparations:
  - Containers suitable for reuse 387
  - Customs Service and Post Office sales of confiscated or unclaimed articles 363
  - Definition of term "sold at retail" 561
  - Guides to taxability 376

Stamp (Documentary):
- Bonds, etc., mortgage bonds, change in payments dates 457
- Conveyances:
  - Municipal property acquired by state 462
  - Realty transferred in corporate liquidation 461
- Stocks, etc.:
  - Bequest to beneficiaries as tenants in common, subsequent partition 460
  - Transfer to custodian of a minor 458

Transportation—Oil by pipeline, liquefied petroleum gas 453

Transportation—Persons:
- Exemptions:
  - Connecticut River Valley Flood Control Commission 456
  - Municipal associations 389
  - North Jeffco Metropolitan Recreation District 428
- General:
  - Maintenance and operation of aircraft for owner 439
  - Sightseeing tours, allocation of charges 436

Transportation—Property:
- Accessorial services:
  - Planning removal of office equipment and related services 444
  - Warehousing and assembling frozen food 446
  - Weighing of tank cars 442
- Exemptions:
  - Commercial bills of lading, consignment to Armed Services for export 449
  - Connecticut River Valley Flood Control Commission 456
  - Municipal associations 389
  - North Jeffco Metropolitan Recreation District 428
- Exports, commercial bills of lading, consigned to Armed Services 449
- General, logging operations 440
- Tax computation, allowance for cargo insurance 448
- Transportation business:
  - Drayage services by cotton warehouses 447
  - Hauling from farm to processing plant 443
  - Logging contractors 440
  - Regular carrier, incidental business 444
  - Truck broker 451

Use tax:
- Highway motor vehicles, § 601.403(a)(6) 664
- Mobile milling unit mounted on single-unit vehicle 467

FIREARMS: Page

Assessments, tax liabilities, delegated authority 683
Claims, abatement or refund, delegated authority 683
Classification, war trophies, deactivation procedure 690
Dealers, license requirements, interstate transactions 565
Forfeitures, unregistered war trophies 690
License, dealer selling in intrastate but buying in interstate commerce 565
Offers in compromise, delegated authority 683
Registration, war trophies 690
Stamps, redemption, delegated authority 683
Taxes, liabilities, delegated authority 683
Transfers, war trophies 690

GIFT TAX:

Real estate, evaluation, dower interest not relinquished 342
Valuation:
- Income from reversionary trust 251
- Real estate, dower interest not relinquished 342

INCOME TAX:

Accounting methods:
- Accrual, § 1.446–1 215
- Cash receipts and disbursements, § 1.446–1 215
- Change of, § 1.446–1 215
- Computation of taxable income, § 1.446–1 215
- Constructive receipt of income, year of inclusion, § 1.451–2 215
- Contracts, completed, § 1.451–3 215
- Decedent's income, § 1.451–1 215
- Net worth method of reconstruction of income 508
- Reductions, when taken, § 1.461–1 215
- Trading stamp redemption, § 1.451–4 215
- Year income taxable, § 1.451–1 215

Accounting period, returns erroneously filed on different basis 215
Adjusted basis:
- Emergency facilities, §§ 1.168–1, 1.168–5, 1.168–7 63
- Excessive depreciation, no tax benefit to consolidated group 513
- Jointly owned depreciable property of survivor 121

Adjusted gross income:
- Deductibility of North Carolina sales and use taxes 106
- Deductibility of West Virginia cigarette, sales and use taxes 111
- Outside salesmen, industrial insurance debit agents 28

Advertising, deductibility as business expenses, § 1.162–14 63
Aliens (See: Nonresidents)
Alimony:
- Abandoned wife, state support decree without divorce 35
- Characterization by state court as property settlement 34
- Court order to apply portion on indebtedness on jointly-owned real estate 29
- Payments pursuant to agreement subsequent to divorce 32
- Tax deficiency of wife paid by husband 31

Allocation of income and deductions, compensation attributable to several years, §§ 1.1301–1 through 1.1304–1, 1.1306–1 288
Allowances, rental, employee of Jewish community center 53
Amortization:
- Emergency facilities:
  - Definitions, § 1.168–4 63
  - Elections, §§ 1.168–2, 1.168–3 63
  - General rules, § 1.168–1 63
  - Inventory costs 238
  - Payment by United States of unamortized cost § 1.168–7 63
- Emergency facility partially certified, salvage value 124
- Pole-driving in railway roadbed 92

Annuities, taxability:
- Employee death benefits, installment payments 43
- Employees' trust terminated, subsidiary separated from parent 202
- Foreign employees' trust, community property country 37
- Purchased from charitable organization, § 1.170–2 127

INCOME TAX—Continued Page

Armed Forces:
Pay, alien, training period in United States 260
Retirement pay:
Retroactive 314
Sick pay exclusion, eligibility 45
Artistic works, allocation of income attributable to several years, § 1.1302–1 288
Assignments:
Bond back-interest coupons 22
Oil payment rights 516
Quiz prize paid to exempt organization 26
Associations:
Business league, promotion of interests of dealer in particular product 244
Labor union, benefit payments to members, effect on exempt status 239
Awards, prizes, etc.:
Contest award won by parent made payable to child 42
House won in contest 233
Maria Moors Cabot prize for journalism 40
Payments by union for service with one employer 41
Quiz show money assigned to exempt organization 26
Bad debts, reserve:
Bail forfeitures 117
Bank's pre-1952 excess transferred to undivided profits 13
Elimination of deduction by net operating loss carryback 246
Title I F. H. A. loans 116
Back pay:
Allocation to prior years, limitation on tax, § 1.1303–1 288
Retroactive retirement pay 314
Rewards to tax evasion informers 287
Banks:
Bad debt reserve:
Pre-1952 excess transferred to undivided profits 13
Title I F. H. A. loans 116
Depositors' guaranty fund, deductibility as business expense, § 1.162–13 63
Mutual savings, etc., bad debt reserve, elimination of deduction, net operating loss carryback 246
Savings and loan association, interest on investment certificates, nonresident owners 333
Basis:
Federal National Mortgage Association stock 86
Jointly owned depreciable property of survivor 121
Property received in liquidation of subsidiary 177
Restricted stock options, exercise by estate 628
Securities, optioner's put transaction 279
Beneficiaries:
Employees' trust, relinquishment of rights attributable to employer contributions 206
Reversionary trust terminable in more than 10 years 251
Benefits under plans:
Employees, optional early retirement 192
Part-time absences due to injury 50
Retirement pay of military personnel 45
Sickness and disability insurance 88
Supplemental unemployment payments 89
Teacher on sabbatical leave for restoration of health 49
Bonds:
District of Columbia Armory Board 626
Wash sales, substantially identical securities 523, 529
Interest:
Back-interest, gift of coupons 22
Series E bonds transferred to personal trust 236
Bonuses, paid:
General rules for deductibility, § 1.162–9 63
Taxes to be absorbed by employer 362

INCOME TAX—Continued — Page

Building and loan association, interest on investment certificates, nonresident owners — 333
Business expenses:
Deductible (See: Deductions)
Campaign expenses, contributions to influence legislation — 91
Capital assets:
Artistic works, sales attributable to several years, allocation of income, § 1.1302–1 — 288
Copyrights (See: Copyrights)
Patents (See: Patents)
Stock and bonds:
Deceased nonresident's estate, administrator in United States — 261
Purchase as contract guarantee or to gain inventory — 275
Capital expenditures:
Advertising or promotion of good will, § 1.162–14 — 63
Farmers, items not deductible as business expenses, § 1.162–12 — 63
Payments to facilitate transfer of ship to foreign registry — 276
Property improvements by lessee, § 1.162–11 — 63
Capital gains and losses:
Business property:
Assignment of oil payment rights — 516
Federal National Mortgage Association stock — 86
Payment to retain ships in American registry — 276
Returnable containers, forfeiture of deposit — 118
Securities, tie-in purchases as contract guarantee — 275
Unsuitable for purpose acquired — 277
Carryovers, allocation of income attributable to several years, § 1.1301–2 — 288
Estates and trusts, additions to corpus of reversionary trust — 251
Individuals:
Liquidation of collapsible corporation — 179
Total distribution by employees' trust:
Corporate dissolution — 202
Corporate liquidation — 200
Corporate reorganization — 194
One division of corporation sold — 201
Subsidiary liquidated — 197
Subsidiary separated from parent — 202
Nonresidents:
Australian convention, total distribution from employees' trust — 621
Canadian convention, total distribution from employees' trust — 623
Sale of decedent's assets, administrator in United States — 261
Short sales, puts and calls, treatment of optioner's premium — 279
Timber and coal:
Coal disposal under royalty contract, § 1.631–3 — 159
Contract right to cut, proprietary interest — 249
Determination of when timber is "cut" — 519
Direct expenses attributable to disposal — 520
Timber cutting, sale or exchange, § 1.631–1 — 159
Timber disposed of under royalty contract, § 1.631–2 — 159
Carrybacks and carryovers:
Allocation of income attributable to several years, § 1.1301–2 — 288
Charitable contribution in excess of limitation, § 1.170–3 — 127
Contributions by deceased employer to pension trust — 208
Net operating loss:
Affiliated group, separation of loss member during taxable year — 337
Inactive corporation, change in ownership — 190
Reserve for bad debts, elimination of deduction — 246
Soil and water conservation expenditures, termination of trust engaged in farming — 149
Carrying charges, expenditures under royalty contract for disposal of coal, election to capitalize, § 1.272–1 — 159
Charitable contributions (See: Contributions (deductibility))
Child care expenses, abandoned wife, state support decree — 35
Citizens, physical presence rule, employment in foreign country — 271
Claims (See: ADMINISTRATIVE: Credits and refunds)

INCOME TAX—Continued Page

Collapsible corporations, liquidation ... 179
Collections (See: ADMINISTRATIVE: Collections)
Compensation paid:
  Employee benefits, § 1.162–10 ... 63
  Personal serices, §§ 1.162–7, 1.162–8 ... 63
Compensation received:
  Miscellaneous:
    Award by union for service with one employer ... 41
    Lockout benefits ... 14
    Reimbursement for lost wages ... 15
  Salaries, fees, etc.:
    Bonus, taxes to absorbed by employer ... 362
    Crew members, vessel operated in foreign waters by United States agency ... 268
    Excessive compensation, § 1.162–8 ... 63
    Lump-sum payment in cancellation of employment agreement ... 23
    Payments from patients to doctors while full-time employees of hospital ... 26
  Services, 36 months or more:
    Allocation of income, §§ 1.1301–1 through 1.1304–1, 1.1306–1 ... 288
    House won in contest ... 233
    Rewards to tax evasion informers ... 287
  Sickness or injuries:
    Insurance premium paid by employer ... 88
    Lump-sum payment for accumulated vacation leave, retirement due to disability ... 51
    Part-time absences due to injury ... 50
    Sabbatical leave for restoration of health ... 49
Consolidated returns:
  Adjustment to basis for excessive depreciation ... 513
  Imposition of two percent additional tax, surtax exemption ... 339
  Net operating loss carryover, separation of loss member during taxable year ... 337
  Western Hemisphere corporations, special deduction ... 335
Constructive receipt of income:
  Employees' trust, withdrawal of part of funds ... 204
  Sale of wheat by cash method farmer, payment contractually deferred ... 234
Contracts:
  Completed, accounting methods, § 1.451–3 ... 215
  Cutting timber, proprietary interest ... 249
  Disposal of coal under royalty contract, deductibility of expenditures, § 1.272–1 ... 159
  Lump-sum payment in cancellation of employment agreement ... 23
Contributions (deductibility):
  Corporations:
    Allowance of charitable deduction, §§ 1.170–1, 1.170–3 ... 127
    Fund to provide state unit for inaugural parade ... 127
  Individuals:
    Advance support payment for father, home for aged ... 61
    Allowance of charitable deduction, §§ 1.170–1, 1.170–2 ... 127
    Bonds purchased from a church ... 143
    Books donated to library, exempt organization ... 146
    Campaign funds to influence legislation ... 91
    Cemetery organization for perpetual care ... 15
    Clergymen, pension fund administered by church ... 144
    Delegate to convention, unreimbursed expenses ... 141
    Expenses incurred by Civil Air Patrol volunteers ... 145
    Fund to provide state unit inaugural parade ... 127
    Organizations improving welfare of research animals ... 146
    Part interest in patent donated to exempt organization ... 126
    Undivided interest in realty ... 143
  Limitation:
    Charitable contributions as business expenses, § 1.162–15 ... 63
    Individuals and corporations, §§ 1.170–2, 1.170–3 ... 127
  Partnerships, computation of taxable income, § 1.170–1 ... 127

INCOME TAX—Continued Page

Contributions (deductibility)—Continued
Trusts:
Computation of taxable income, § 1.170–1 127
Employee benefit plans, general rules, § 1.162–10 63
Employees':
Carryover to estate, deceased employer's contributions 208
Donations by third party to municipal system 125
Previous service with subsidiary 209
Joint apprenticeship and training fund 90
Unlimited, individuals, § 1.170–2 127
Copyrights, allocation of income attributable to several years, § 1.1302–1 288
Corporations:
General, charitable contributions, deductibility, §§ 1.170–1, 1.170–3 127
Liquidation:
Basis, property received from liquidated subsidiary 177
Collapsible corporation 179
Election of nonrecognition of gain or loss, effective date, § 1.392–1 191
Stock and securities "acquired after December 31, 1953" 174
Court decisions (See: COURT DECISIONS)
Credits (See: ADMINISTRATIVE: Credits and refunds)
Credits against tax (*See also:* Foreign tax credit)
Credits against tax, foreign tax refund, rate of exchange 534
Community property and income, annuity payments from foreign employees' trust 37
Damages, patent infringement, allocation of income, § 1.1304–1 288
Dealers in securities, put and call transactions 279
Death benefits, employee, receivable in installments 43
Decedents:
Deductions, accounting methods, § 1.461–1 215
Nonresident having administrator in United States, sale of assets 261
Deductions:
Business expenses:
Advertising or promotion of good will, § 1.162–14 63
Amortization of emergency facilities:
Adjusted basis, § 1.168–5 63
Definitions § 1.168–4 63
Election to amortize, § 1.168–2 63
Election to discontinue amortization, § 1.168–3 63
General rule, § 1.168–1 63
Payment by United States of unamortized cost, § 1.168–7 63
Portion not subject to amortization, § 1.168–6 63
Banks, depositors' guaranty fund, § 1.162–13 63
Bonuses paid, § 1.162–9 63
Charitable contributions, § 1.162–15 63
Compensation paid:
Employee benefits, § 1.162–10 63
Personal services, §§ 1.162–7, 1.162–8 63
Contributions to apprenticeship program 90
Contributions to campaign fund to influence legislation 91
Contributions to trust providing supplemental unemployment benefits 89
Education, § 1.162–5 63
Farmers, § 1.162–12 63
Federal National Mortgage Association stock purchases and mortgage fees 86
Fines paid for violation of state maximum weight laws 502, 505
General rules, § 1.162–1 63
Improvements to leased property, § 1.162–11 63
Materials or supplies, § 1.162–3 63
Payments to advertising membership corporation 19
Pole-driving in railway roadbed 92
Professional expenses, § 1.162–6 63
Property contributed to charitable organization, § 1.170–1 127
Rent paid, § 1.162–11 63
Rents, wages paid by bookmakers 506

INCOME TAX—Continued	Page
Deductions—Continued	
Business expenses—Continued	
Repairs, § 1.162–4	63
Sickness and disability insurance premiums	88
Taxes of lessor paid by lessee, § 1.162–11	63
Traveling expenses, §§ 1.162–2, 1.162–5	63
Child care expenses (See: Child care expenses).	
Contributions (See: Contributions (deductibility)).	
Employees, industrial insurance debit agents	28
General:	
Computation of taxable income, § 1.161–1	63
Prepaid interest refunded in subsequent year	318
Medical expenses (See: Medical expenses).	
Nonbusiness expenses:	
Appraisal fee to establish casualty loss	153
Mortgage interest, occupancy of residence prior to settlement	93
Net operating loss computation	147
Penalties (See: Fines and penalties).	
Personal expenses (See: Personal expenses).	
Taxes (See: Taxes).	
When taken:	
Accrued expenses deducted in year paid	317
Prepaid expenses, grantor of revocable trust	152
Real property taxes, accounting methods, § 1.461–1	215
Taxable year of taxpayer using accrual or cash basis accounting method, § 1.461–1	215
Vacation pay, accrual	237
Vacation pay deducted in wrong year	318
Deferments (See: ADMINISTRATIVE: Deferments).	
Dependents (See: Exemptions).	
Depletion:	
Cost, percentage, deductibility from royalties received under coal disposal contract, § 1.631–3	159
Intangible drilling and development costs, determination of allowable percentage depletion	247
Depreciation:	
Auxiliary records work sheets, reconciling book and tax depreciation	123
Emergency facilities, portion not subject to amortization, §§ 1.168–5, 1.168–6	63
Emergency facility partially certified, salvage value	124
Excessive allowance, no tax benefit to consolidated group	513
Jointly owned property of survivor	121
Public buildings, financing, construction and sales agreements	235
Returnable containers	118
Vehicle used by Civil Air Patrol volunteers	145
Development expenses (See: Research expenses)	
Disability benefits, part-time absences due to injury	50
Distributions:	
Bargain rentals to shareholders	173
Employees' trust terminated:	
Corporate dissolution	202
Corporate liquidation	200
Corporate reorganization	194
One division of corporation sold	201
Subsidiary liquidated	197
Subsidiary separated from parent	202
Employees' trust, withdrawal rights of participant restricted	204
Spin-off:	
Cancellation of indebtedness in connection with merger	183
Division of single business	181
Stock of new controlled corporation for minority shareholder's old corporation stock	184
Dividends:	
Definition, bargain rentals to shareholders	173
Gross income, foreign corporation operating in United States	262

INCOME TAX—Continued Page

Dividends—Continued
- Patronage, exempt organizations, information returns ... 474
- Received, guaranty fund returned to insurance underwriters pursuant to reorganization ... 185
- Stock, spin-off:
  - Cancellation of indebtedness in connection with merger ... 183
  - Division of single business ... 181

Earned income (sources without United States):
- Citizen employed abroad, flight over foreign country during first day's travel, rule of presence ... 271
- Crew members, vessel operated in foreign waters by United States agency ... 268

Education (See: Training)
Elections (See: ADMINISTRATIVE: Elections)
Employees' trusts (See: Trusts: Employees')
Estates and trusts (See: Trusts: Estates and trusts)
Estimated tax (See: ADMINISTRATIVE: Estimated tax)
Exchanges of property:
- Conversion of insurance underwriters association into stock corporation ... 185
- Corporate merger after exchange of assets for stock of controlled corporation ... 188
- Oil payment rights for realty ... 516
- Spin-off, stock of new controlled corporation for minority shareholder's old corporation stock ... 184

Exempt income:
- Bonds and obligations of District of Columbia Armory Board ... 626
- Canadian convention, total distribution from employees' trust ... 623
- Derived directly from Indian lands ... 12
- Indians, unallotted lands ... 24
- Per capita payments, judgment funds, Otoe and Missouria Indians ... 634

Exempt organizations:
- Bond deferring gain from installment obligation ... 511
- Business league:
  - Conducting trade shows ... 242
  - Promotion of interests of dealers in particular product ... 244
- Labor union, benefit payments to members, effect on status ... 239
- Patronage dividends, information returns ... 474
- Royalties on interest in patent donated by owner ... 126
- Patronage dividends, information returns ... 474
- Royalties on interest in patent donated by owner ... 126
- Rulings and determination letters, § 601.201(c)(4) ... 664
- Store and restaurant for university student body ... 240
- Trust to administer perpetual care cementery funds ... 15

Exemptions:
- Dependents:
  - Definition of items of support ... 62
  - Father, lump-sum payment to home for aged ... 61
  - Support, value of lodging furnished ... 62
- Nonresidents, French convention, purse won in horse race ... 624
- Spouse, common-law marriage ... 60

Expenses (Nontrade or nonbusiness) (See: Deductions: Nonbusiness expenses)
Experimental expenses (See: Research expenses)
Farmers and farming:
- Business expenses, general rules, § 1.162-12 ... 63
- Cattle raised on allotted Indian lands ... 12
- Rentals paid in crop shares, participation in production by lessor, retirement income ... 9
- Sale of wheat, payment contractually deferred ... 234
- Trust expenditures for soil and water conservation, carryover to beneficiary ... 149

Fellowships (See: Scholarships)
Fiduciaries, administratators of nonresident's estate, ancillary and domiciliary ... 261

INCOME TAX—Continued Page

Fines and penalties, violation of state maximum weight laws ... 502, 505
Foreign corporations, taxes paid to foreign country on United States income ... 262
Foreign currency, annuity payments from foreign employees' trust ... 37
Foreign exchange and foreign money (See: Foreign currency)
Foreign tax credit:
- Adjustment for refund, rate of exchange ... 534
- Contested tax, year in which credit is taken ... 266
- Interest, redetermination of tax as result of erroneous refund ... 265
- Limitation, Western Hemisphere corporation deduction ... 335
- Mexican Mercantil Revenue Law ... 263

Fraud (See: ADMINISTRATIVE: Fraud)
Gain or loss:
- Basis:
  - Federal National Mortgage Association stock ... 86
  - Restricted stock options, exercise by estate ... 628
- Liquidation:
  - Election of nonrecognition, effective date, § 1.392–1 ... 191
- Stock or securities "acquired after December 31, 1953" ... 174
- Recognition:
  - Bond deferring gain from installment obligation transmitted at death, exempt organization ... 511
  - Coal disposal under royalty contract, § 1.631–3 ... 159
  - Conversion of insurance underwriters association into stock corporation ... 185
  - Corporate merger after exchange of assets for stock of controlled corporation ... 188
  - Liquidation of collapsible corporation ... 179
  - Optionor, amount received for writing put or call ... 279
  - Spin-off, stock of new controlled corporation exchanged for minority shareholder's old corporation stock ... 184
  - Timber cutting as sale or exchange, § 1.631–1 ... 159
  - Timber disposal under royalty contract, § 1.631–2 ... 159
  - Wash sales, substantially identical securities ... 523, 529

Gifts:
- Bond back-interest coupons ... 22
- Charitable organization, allowance of deduction, § 1.170–1 ... 127
- Employee's relinquishment of trust rights, employer contributions ... 206
- Undivided interest in realty, charitable organization ... 143

Gross income:
- Exclusions:
  - Cemetery organization, perpetual care funds ... 15
  - Compensation for part-time absences due to injury ... 50
  - Employee death benefits receivable in installments ... 43
  - Fees received by doctors while full-time employees of hospital ... 26
  - Housing allowance, employee of Jewish community center ... 53
  - "Telethon" receipts paid over to charitable organization ... 23
- Inclusions:
  - Amounts received by advertising membership corporation ... 19
  - Award by union for service with one employer ... 41
  - Award with appointment to Civil Service position ... 59
  - Crew members, vessel operated in foreign waters by United States agency ... 268
  - Dues deducted from refundable membership fees ... 11
  - Income from unallotted Indian lands ... 24
  - Lockout benefits ... 14
  - Lump-sum payment for accumulated vacation leave ... 51
  - Payments in lieu of alimony pursuant to agreement ... 32
  - Payments to abandoned wife, state support decree ... 35
  - Payments to retain ship in American registry ... 276
  - Reimbursement for lost wages ... 15
  - Supplemental unemployment benefits ... 89
- To whom:
  - Contest award won by parent made payable to child ... 42
  - Gift of bond back-interest coupons ... 22

INCOME TAX—Continued

	Page
Gross income—Continued	
To whom—Continued	
Minors, dividends from savings accounts	13
Quiz show prize assigned to exempt organization	26
Tax deficiency of wife paid by husband under separation agreement	31
When included:	
Accounting methods, § 1.451–1	215
Amount received by optionor for writing put or call	279
Constructive receipt, § 1.451–2	215
House won in contest	233
Interest collected in advance by insurance company	258
Lump-sum payment in cancellation of employment agreement	23
Obligations issued at discount § 1.454–1	215
Sale of wheat by cash method farmer, payment contractually deferred	234
Husband and wife:	
Alimony, tax deficiency of wife paid by husband	31
Charitable contributions, deductibility, § 1.170–2	127
Common-law marriage, personal exemption	60
Income allocated to prior period, § 1.1306–1	288
Partnership agreement, recognition where Federal and state laws differ	255
Improvements, leased property, deductibility as business expenses, § 1.162–11	63
Income:	
Minors, dividends from savings accounts	13
Net worth method of computation (See: ADMINISTRATIVE: Fraud)	
Sources, annuity payments from foreign employees' trust	37
Indians:	
Income derived directly from allotted lands	12
Income from unalloted lands	24
Per capita payments, judgment funds, Otoe and Missouria Tribes	634
Individuals—Losses (See: Losses: Individuals)	
Installment sales:	
Bond deferring gain, exempt organization	511
Public buildings, financing, construction and sales agreements	235
Insurance:	
Premiums:	
Sickness and disability insurance	88
Vehicles used by Civil Air Patrol volunteers	145
Insurance companies:	
Life:	
Advance collection of interest on loans	258
Formula applicable to taxable years beginning in 1957	632
Interest:	
Exempt:	
Bonds and obligations of District of Columbia Armory Board	626
Foreign corporation operating in United States	262
On deficiencies (See: ADMINISTRATIVE: Interest)	
On overpayments (See: ADMINISTRATIVE: Interest)	
Paid:	
Allocation of partial payment of tax deficiencies	94
Mortgage on personal residence, occupancy prior to settlement	93
Savings and loan associations, investment certificates, nonresident owners	333
Received:	
Insurance companies, advance collection	258
Prepaid, refunded in subsequent year	318
Inventions, allocation of income attributable to several years, § 1.1302–1	288
Inventories:	
Adjustments, mitigation of effect of limitation	316
Costs, amortization of emergency facilities	238
Inventories (LIFO), department stores, January 1958 BLS price indexes	238

INCOME TAX—Continued Page

Involuntary conversions:
Replacement property, unimproved replaced by improved lot with building which was demolished to provide parking space 274
Stock sold under court order in anti-trust action 273
Joint returns (See: Husband and wife, ADMINISTRATIVE: Returns)
Leases, coal property, direct expenses attributable to disposal 520
Liquidations:
Basis, property received from liquidated subsidiary 177
Collapsible corporation 179
Election of nonrecognition of gain or loss, effective date, § 1.392–1 191
Stock or securities "acquired after December 31, 1953" 174
Loans, membership fees, refundable except for delinquent dues 11
Losses:
Casualty or theft, appraisal fee to establish 153
Individuals, deductions not attributable to a trade or business 147
Stock, purchase as contract guarantee or to gain inventory 275
Medical expenses:
"Autoette" or wheel chair 154
Cardiac patient, reclining chair 156
Mentally retarded child, special education and maintenance 157
Special educational aids, progressive blindness 156
Transportation for taxpayer and nurse 155
Military personnel (See: Armed Forces)
Mines and mining, direct expenses attributable to disposal 520
Ministers:
Contributions to pension fund administered by church 144
Employee of Jewish community center 53
Minors, dividends from savings accounts 13
Mitigation of effect of limitation:
Accrued expenses deducted in year paid 317
Inventory adjustments 316
Vacation pay deducted in wrong year 318
Natural resources:
Assignment of oil payment rights 516
Coal, royalties contract, § 1.631–3 159
Indian lands 12
Timber:
Determination of when "cut" 519
Royalties under disposal contract, § 1.631–2 159
Timber cutting, capital gains treatment, § 1.631–1 159
Net operating loss:
Allocation of income attributable to several years, § 1.1301–2 288
Carryover:
Affiliated group, separation of loss member during taxable year 337
Inactive corporation, change in ownership 190
Nonbusiness expenses 147
Nonbusiness expenses (See: Deductions)
Nonresidents:
Australian convention, total distribution from employees' trust 621
Canadian convention, total distribution from employees' trust 623
Departing aliens, layover of five days or less, Certificate of Compliance 497
French convention, purse won in horse race 624
Interest on investment certificates of state-chartered savings and loan association 333
Members of Armed Forces, training period in United States 260
Sale of decedent's assets, administrator in United States 261
Obligations:
Instrumentalities of the United States, District of Columbia stadium bonds 626
States and subdivisions, issued at discount, accounting methods, § 1.454–1 215
United States or possessions, issued at discount, accounting methods, § 1.454–1 215

INCOME TAX—Continued

Page

Oil and gas properties:
- Intangible drilling and development costs, determination of allowable percentage depletion ... 247
- Limitation of surtax on sale, § 1.632–1 ... 159

Options:
- Puts and calls, treatment of premium by optionor or optionee ... 279
- Restricted stock option:
  - Constructive ownership by optionee, trust interests of qualifying relative ... 212
  - Determination of combined voting power of stock of parent ... 211
  - Granted by parent corporation, exercised while employee of subsidiary ... 214

Partnerships:
- Distributions:
  - Compensation received for period of 36 months or more, § 1.1301–2 ... 288
  - Husband and wife, recognition of agreement where Federal and state laws differ ... 255
- General, charitable contributions, deductibility, § 1.170–1 ... 127
- Returns (See: ADMINISTRATIVE: Returns)

Patents:
- Compensatory damages for infringement, § 1.1304–1 ... 288
- Part interest donated by owner to exempt organization ... 126

Penalties (See: ADMINISTRATIVE: Penalties)

Pension trusts (See: Trusts: Employees')

Personal exemption (See: Exemptions)

Personal expenses:
- Contributions by clergymen to pension fund administered by church ... 144
- Services to charitable organization, § 1.170–2 ... 127

Personal holding company:
- Finance company, salaries paid to employees holding stock options ... 245
- Rents, use of corporation property by shareholder ... 628

Railroads, cost of pole-driving in roadbed ... 92

Real estate:
- Accrual of taxes, accounting methods, § 1.461–1 ... 215
- Apportionment of taxes between seller and purchaser, § 1.164–6 ... 114
- Undivided interest, gift to charitable organization ... 143

Records (See: ADMINISTRATIVE: Records)

Recoveries, compensatory damages for patent infringement, allocation of income, § 1.1304–1 ... 288

Redemption of stock and bonds, constructive ownership of estate beneficiary, attribution rule ... 173

Refunds (See: ADMINISTRATIVE: Credits and refunds)

Regulated investment companies, Form 2439, reproduction ... 684

Regulations:
- 26 CFR 1.164–6, 1.6655–2 amended, apportionment of real property taxes between seller and purchaser, failure by a corporation to pay estimated tax ... 114
- 26 CFR 1.170–1, 1.170–3, deduction for charitable contributions by individuals and corporations ... 127
- 26 CFR 1.272–1, 1.631–1 through 1.632–1, expenditures connected with coal royalty contracts, gain or loss in the case of timber and coal, and sale of oil and gas properties ... 159
- 26 CFR 1.392–1, amended, corporate liquidations, effective date for election of nonrecognition of gain or loss for certain sales or exchanges ... 191
- 26 CFR 1.446—1.451–4, 1.454–1—1.461–1, methods of accounting, taxable year for including gross income, obligations issued at discount, and taxable year for taking deductions ... 215
- 26 CFR 1.1301 through 1.1306–1, except 1.1305–1, income attributable to several taxable years ... 288

Rent paid:
- Bookmakers ... 506
- Business expenses, general rules, § 1.162–11 ... 63

INCOME TAX—Continued Page

Rent received:
Crop shares, participation in production by lessor, retirement income 9
Indian lands 12
Personal holding company property used by shareholder 628
Reorganizations:
Conversion of insurance underwriters association into stock corporation 185
Corporate merger after exchange of assets for stock of controlled corporation 188
Spin-off:
Cancellation of indebtedness in connection with merger 183
Division of single business 181
Research expenses:
Deduction in year incurred, accrual basis taxpayer 148
Patent costs 148
Retirement income:
Armed Forces, eligibility as sick pay exclusion 45
Rentals paid in crop shares, participation in production by lessor 9
Returns (See: ADMINISTRATIVE: Returns)
Royalties:
Indian lands 12
Received under coal disposal contract, capital gains treatment, § 1.631–3 159
Rulings (See: ADMINISTRATIVE: Rulings)
Salary (See: Compensation received)
Sales or exchanges:
Capital assets, deceased nonresident 261
Corporate merger after exchange of assets for stock of controlled corporation 188
Income derived directly from Indian lands 12
Liquidation, election of nonrecognition of gain or loss, effective date, § 1.392–1 191
Liquidation of collapsible corporation 179
Proceeds from disposal of timber under royalties contract, § 1.631–2 159
Proceeds under royalties contract for disposal of coal, § 1.631–3 159
Stock sold under court order in anti-trust action 273
Timber cutting, election, § 1.631–1 159
Wheat, cash method farmer, payment contractually deferred 234
Scholarships:
Amounts received for research, professor on sabbatical leave 54
Award with appointment to Civil Service position 59
Contest award made payable to child of contestant 42
Medical research grant, National Institutes of Health 57
Research fellowship, American Heart Association 56
Securities transactions:
Purchase of stock as contract guarantee or to gain inventory 86
Puts and calls, treatment of premium by optionor or optionee 279
Substantially identical bonds, wash sales 523
Servicemen (See: Armed Forces)
Short sales, puts and calls, treatment of optioner's premium 279
Soil conservation expenditures (See: Farmers and farming)
Spouse (See: Exemptions)
Stock:
Distributions (See: Distributions, Reorganizations)
Dividends (See: Dividends: Stock)
Exchanges (See: Exchanges of property)
Options:
Finance company employees, deductibility of salaries paid, personal holding company tax 245
Restricted:
Constructive ownership by optionee, trust interests of qualifying relation 212
Determination of combining voting power of stock of parent 211
Exercise by estate 628
Granted by parent corporation, exercised while employee of subsidiary 214

INCOME TAX—Continued Page

Surtax, $25,000 exemption, corporations filing consolidated return 339
Tax conventions (See: TAX CONVENTIONS)
Tax Court of the United States (See: ADMINISTRATIVE: Tax Court of the United States)
Taxable income:
- Accounting method, computation, § 1.446–1 215
- Australian convention, total distribution from employees' trust 621
- Computation, allowance of deductions, § 1.161–1 63

Taxes:
- Deductions:
  - Cincinnati earned income tax 95
  - Employee contributions to Iowa retirement system 101
  - Foreign corporation operating in United States 262
  - Lessor's taxes paid by lessee, deductibility as business expense by lessee, § 1.162–11 63
  - Mexican Mercantile Revenue Law 263
  - Michigan cigarette tax 104
  - Michigan liquor tax 110
  - Nebraska cigarette tax 99
  - Nebraska motor vehicle fuel taxes 98
  - North Carolina sales and use taxes 106
  - Real estate, apportionment between seller and purchaser, § 1.164–6 114
  - Real property not subject to estate administration 254
  - Real property taxes, accounting methods, § 1.461–1 215
  - Washington state liquor tax 103
  - West Virginia cigarette, sales and use taxes 111
- Foreign countries (See: Foreign tax credit)

Tax-free exchanges (See: Exchanges of property)
Training, deductibility of cost as business expense, § 1.162–5 63
Traveling expenses:
- Professor engaged in research 54
- Services to charitable organizations, § 1.170–2 127
- Trade or business, general rules, § 1.162–2 63

Trusts:
- Employees':
  - Australian convention, total distribution, nonresidents 621
  - Canadian convention, total distribution, nonresidents 623
  - Carryover to estate of contirbutions by deceased employer 208
  - Contributions, previous service with subsidiary 209
  - Death benefits receivable in installments 43
  - Donations by third party to municipal system 125
  - Lump sum distribution:
    - Corporate dissolution 202
    - Corporate liquidation 200
    - Corporate reorganization 194
    - One division of corporation sold 201
    - Subsidiary liquidated 197
    - Subsidiary separated from parent 202
  - Optional early retirement benefits 192
  - Relinquishment of trust rights, employer contributions 206
  - Supplemental unemployment benefits 89
  - Withdrawal rights of participants restricted 204
- Estates and trusts:
  - Administration of perpetual care cemetery funds 15
  - Beneficiary's constructive ownership of stock, attribution rule 173
  - Deceased nonresident, administrator in United States 261
  - Real estate taxes paid by executor 254
  - Soil and water conservation expenditures, carryover to beneficiary 149
  - Unrelated business income, distributions from limited partnership interests 633
- Income for benefit of grantor, reversionary trust, capital gains added to corpus, ordinary income distributable to beneficiaries 251

INCOME TAX—Continued Page

Trusts—Continued
Miscellaneous:
Charitable contributions, deductibility, § 1.170–2 127
Definition, "related and subordinate party" 251
Personal, interest on Series E bonds included in corpus 236
Revocable:
Contributions to charitable organization, § 1.170–2 127
Prepaid expenses, allocation to exempt income 152
Unrelated income, trusts, distributions from limited partnership interests 633
Vacation pay:
Accrual and deduction 237
Deducted in wrong year 318
Lump-sum, accumulated prior to retirement due to disability 51
Wage continuation plans:
Lump-sum payment for accumulated vacation leave, retirement due to disability 51
Part-time absences due to injury 50
Retirement pay of military personnel 45
Supplemental unemployment benefits 89
Teacher on sabbatical leave for restoration of health 49
Wages (See: Compensation received)
Wash sales, substantially identical securities 523, 529
Water conservation expenditures (See: Farmers and farming).
Western Hemisphere corporations, special deduction, consolidated returns 335
Withholding:
Income tax at source:
Award with appointment to Civil Service position 59
Dental hygienist 353
Gratuities accounted for to employer for compensation determination 343
Industrial debit insurance agents 349
Lockout benefits 14
Supplemental unemployment benefits 89
Liability for tax, surety completing school construction 354
Nonresidents:
Interest on investment certificates of state-chartered savings and loan association 333
Total distribution from employees' trust 621
Wages (See: EMPLOYMENT TAXES: Wages)

SELF EMPLOYMENT TAX:

Community income, religious organization, members' distributive share 327
Earnings:
Business carried on by guardian of incompetent 327
Commission on isolated stock sale 323
Fiduciaries of decedents' estates 322
Indians:
Income from allotted lands 12
Income from unallotted lands 24
Interest on loans, sideline activity 329
Mineral lease coowner 324
Religious organization, members' distributive share 327
Elections (See: ADMINISTRATIVE: Elections)
Fiduciaries, decedents' estates, guides for determining net earnings from self-employment 322
Income (See: Earnings)
Interest, loans made and serviced as sideline activity 329
Ministers:
Religious or apostolic organization, distributive share of income 327
Voluntary self-employment coverage, release from poverty oath 331
Partners and partnerships, mineral lease coowner 324
Religious order members (See: Ministers)
Returns (See: ADMINISTRATIVE: RETURNS)
Tax (See: ADMINISTRATIVE: Tax)

SELF EMPLOYMENT TAX—Continued Page

Trade or business:
- Farming, cattle raised on allotted Indian lands — 12
- Fiduciaries of decedents' estates — 322
- Guardian in control of business — 327
- Making and servicing loans as sideline activity — 329

TAX CONVENTIONS:

Australia:
- Income tax:
  - Capital gains and losses:
    - Nonresidents, total distribution from employees' trust — 621
  - Nonresidents, total distribution from employees' trust — 621
  - Taxable income, total distribution from employees' trust — 621
  - Trusts:
    - Employees', total distributions, nonresidents — 621
  - Withholding:
    - Nonresidents, total distribution from employees' trust — 621

Canada:
- Income tax:
  - Capital gains and losses:
    - Nonresidents, total distribution from employees' trust — 623
  - Exempt income, total distribution from employees' trust — 623
  - Nonresidents, total distribution from employees' trust — 623
  - Trusts:
    - Employees', total distributions, nonresidents — 623

France:
- Income tax, nonresidents, purse won in horse race — 624

TOBACCO TAX:

Applications, permit, approval, § 601.311(b)(8) — 664
Bonds, removals from customs manufacturing bonded warehouse, § 601.312(b) — 664
Cigarette papers and tubes, offers in compromise, delegated authority — 683
Cigars:
- Claims, allowance of tax, § 601.316(e) — 664
- Method of taxpayment, § 601.313(a) — 664
- Removals from customs manufacturing bonded warehouse, § 601.312(b) — 664

Claims:
- Allowance of tax, cigars, § 601.316(e) — 664
- Credit or refund, filing after April 30, 1958 — 630
- Drawback, bond requirements, § 601.312(c) — 664
- Refund, cigar taxes, establishment of date of taxpayment — 692
- Requirements, § 601.316(f) — 664

Credits, conditions to allowance, rightful claimant — 630
Customs, manufacturing bonded warehouse bond, § 601.312(b) — 664
Foreign-trade zones, removals to, § 601.311(b)(7) — 664
Forms, 2130 or 2131, discontinuance, annual inventory of tobacco materials, etc — 689
Inventories, annual, discontinuance for tobacco materials, products, stamps — 689
Limitation period, filing refund claim for cigar taxes — 692
Losses, cigars, allowance claims, § 601.316(e) — 664
Offers in compromise, delegated authority — 683
Packages, cigars, marking to indicate, date of taxpayment — 692
Permits, approval, suspension, revocation, § 601.311(b)(8) — 664
Records, statistical, tobacco materials used for tobacco products — 689
Refunds, conditions to allowance, rightful claimant — 630
Returns, taxpayment of cigars, timely filing of refund claim — 692
Stamps:
- Cigarette tax, new Class A, denomination 10 — 683
- Tax, annual inventories, discontinuance — 689

TOBACCO TAX—Continued

	Page
Taxes:	
Cigarette, new Class A, denomination 10 stamp	683
Cigars, refund claim, establishment of timely filing	692
Cigars lost or removed, claims, § 601.316(e)	664
Credit or refund allowances, rightful claimant	630
Liabilities, offers in compromise, delegated authority	683
Methods of payment, § 601.313(a)	664
Tobacco materials, annual inventories, discontinuance	689
Tobacco products:	
Annual inventories, discontinuance	689
Cigarettes, new Class A, denomination 10, tax stamp	683
Cigars, etc., offers in compromise, delegated authority	683
Cigars, packages marked with date of taxpayment	692
Removals to foreign-trade zone, § 601.311(b)(7)	664
Tax payment, § 601.313(a)	664

U. S. GOVERNMENT PRINTING OFFICE: 1958

Cop. 1

U.S. TREASURY LIBRARY
1 0069024