Internal Revenue Bulletin

CUMULATIVE BULLETIN 1966-1

JANUARY-JUNE 1966

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Internal Revenue Bulletin

Cumulative Bulletin 1966–1
January–June 1966

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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.R.R.—Committee on Appeals and Review recommendation.
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.
T.I.R.—Technical Information Release.
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 other than those pertaining to alcohol and tobacco taxes.

II. Part II includes rulings and decisions which are based on the application of the Internal Revenue Code of 1939, and other public laws, except those pertaining to the alcohol and tobacco taxes.

III. Part III contains rulings and decisions pertaining to the alcohol and tobacco taxes. This part is subdivided into two subparts according to alcohol tax matters issued under chapter 51 of the Internal Revenue Code of 1954 (Subpart A), and tobacco tax matters issued under chapter 52 of the Internal Revenue Code of 1954 (Subpart B).

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. To the extent practicable, pertinent cross references to these are contained in the other Parts and Subparts. The weekly Internal Revenue Bulletins contained Parts III–E and VI consisting of items of general interest; those items are not reproduced herein, other than the disbarment list, which has been incorporated in Part V of this Bulletin.

INTRODUCTION

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service, and for publishing Treasury Decisions, Executive Orders, tax conventions, legislation, court decisions, and other items considered to be of general interest.

It is the policy of the Service to publish in the Bulletin all substantive and procedural rulings of importance or of general interest, the publication of which is considered necessary to promote a uniform application of the tax laws. 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 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. No unpublished ruling or decision will be cited or relied upon by any officer or employee of the Internal Revenue Service as a precedent in the disposition of other cases.

Since each published ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, Service personnel and others concerned are cautioned against reaching the same conclusions 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, court decisions, rulings, and procedures.

Internal Revenue Cumulative Bulletin 1966–1 contains all rulings, decisions, and procedures pertaining to Internal Revenue matters published in the weekly Internal Revenue Bulletins 1966–1 to 1966–26, inclusive, for the period January 1 to June 30, 1966. 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 contents of this publication are not copyrighted and may be reprinted freely. A citation of the *Cumulative Bulletin* as the source would be appropriate.

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, 1966, TO JUNE 30, 1966, 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 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 shall 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 announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

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Cuckler, Harold W., et ux	87982	39	1107
Davies, Geoffrey C.[2]	642–62	40	525
DeMartini, Edward J., et ux	81980	37	31
Frederick Steel Co.[2]	92949	42	13
Frizzell, James E., estate of[1 4]	6704	9	979
Gajda, Frank P	2239–64	44	783
General Manufacturing Corp	5386–63	44	513
Gerard, Raymon, et ux	86042	37	826
Gidwitz, Jacob, estate of[1 7]	21764	14	1263
Hamrick, James C., et ux.[8]	2479–62	43	21
Heminway, Willard S., et ux	4706–62	44	96
Hitchon, Julie B., deceased, estate of; Milton L. Jacobson, executor, and Herbert M. Hitchon	119–64	45	96
Hitchon, Walter G., estate of, the Union and New Haven Trust Co., conservator, and Lucile B. Hitchon	132–64		
Hughes, Harry A., et ux	81979	37	31
Industrial Research Products, Inc	81970	40	578
Jacobs, Allen C., et ux	83464	36	446
	86381		
Juniata Farmers Cooperative Association	4265–62	43	836
Knapp, Bessie	44348	23	716
Knapp, Edith	44408		
Knapp, F. E	44353		
Knapp, Frederick M	44351		
Knapp, George Parker	44354		
Knapp, Gilson	44352		
Knapp, Ida	44409		
Knapp, John A	44411		
Knapp, Mavis	44407		
Knapp, Olga	44410		
Knowles, Hugh S., et ux	81976	40	578
Lencione, Julius, Sr	94985	43	68
Lowe, Alvin B., et ux.[2]	4745–62	44	363
Makransky, Harry, et ux	83212	36	446
Marks, Laurence M., et ux	59551	27	464
McGuire, Daniel S., et ux[2]	3348–63	44	801
Meneguzzo, Barry	470–63	43	824
Morgan, Edward C	81978	37	31

See footnotes at end of table.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report Volume	Report Page
Morgan Guaranty Trust Co. of New York, formerly Guaranty Trust Co. of New York, executor of estate of Mary Cotton Wood [1 2]	89846	39	919
Morgan, Joseph P., estate of, et ux	81977	37	31
Mortrud, Jerome, et ex	4848–62	44	208
Moss, Emanuel, et ux	83356 86008	36	446
National Mutual Casualty Co	78966 85613	38	1011
Peninsular Metal Products Corp	82074	37	172
Pessin, Arnold G., et ux	4901–63	44	590
Potter, Walter H. and Gladys L. Erickson (formerly Gladys L. Potter)	81795	44	159
Potter, Walter H., et ux	86259		
Pridemark, Inc. (formerly Prefab Homes and Supplies, Inc.)	93303	42	510
Pridemark, Inc., of Connecticut	93304		
Puget Sound Plywood, Inc	3933–62	44	305
Schneider, Hilda B	83357 86007	36	446
Shamrock Oil and Gas Corp., The	49145 61315 68580 77791	35	979
South Philadelphia Terminal, Inc.[9 10]	3234–62	44	349
Southwest Properties, Inc.[3 11]	76036	38	97
Spicer Theatre, Inc	657–62	44	198
Stone, Roy Marilyn, Trust U/A "A" [9 10]	3232–62	44	349
Stone, Roy Clayton, Jr., Trust U/A "B" [9 10]	3233–62		
Theodore, Peter	78341 85610	38	1011
Theodore & Theodore, Inc	78342 85614		
Thiman, Gershan K., et ux	93307	42	510
United Control Corp	77477	38	957
Wood, Mary Cotton, estate of [1 2]	89846	39	919
Woody, Charles L., estate of [1 2]	78817	36	900
Woody, Charles L., Jr., et al., executors, estate of Charles L. Woody, deceased [1 2]			

See footnotes at end of table.

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
DuMais, Natalie D	91756	40	269
Humacid Co., The	95343	42	894
Huntsinger, Fritz, executor of the estate of Mathilde Huntsinger and individually	95344		
Huntsinger, Mathilde, estate of			
Matagorda Shell Co	54950	29	1060
McDonald, Eli [12]	[a] 21042	23	521
Miller, Irwin, et al., co-executors, estate of Nettie S. Miller	1152–63	43	760
Miller, Nettie S., estate of			
Oakland Bank of Commerce, trustee, Sherwood Swan & Co., Ltd., Employees' Benefit Fund	4677–62	42	299
Swan, Sherwood, & Co., Ltd., Employees' Benefit Fund, Oakland Bank of Commerce, trustee			
Sweeney, Elsie I	1153–63	43	760
Wier, Mary Norwood and Tom P. Wier, executors of estate of Robert W. Wier [1] [13]	27538	17	409
Wier, Robert W., estate of [1] [13]			

[a] United States Board of Tax Appeals.

[1] Estate Tax decision.

[2] Acquiescence in result only. Acquiescence "in result only" means acceptance of the decision of the Court but disagreement with some or all of the reasons assigned for the decision.

[3] Acquiescence in the issues relating to the useful life of an office building and whether W. H. Black was liable as transferee.

[4] Nonacquiescence published in C.B. 1949-1, 5, is withdrawn and acquiescence is substituted therefor.

[5] Acquiescence in result only relates to the issue whether petitioner is entitled to deduct as a dividend declared, under sections 204(c)(11) of the 1939 Code and 832(c)(11) of the 1954 Code, that portion of the dividends stated to be "contributions" by its members. Acquiescence "in result only" means acceptance of the decision of the Court but disagreement with some or all of the reasons assigned for the decision.

[6] Acquiescence relates to the issue of an adjustment to the stipulated excess profits credit on Rule 50 computation.

[7] Nonacquiescence published in C.B. 1950-2, 5, is withdrawn and acquiescence is substituted therefor.

[8] Acquiescence in result only. See Rev. Rul. 66-112, page 68, this Bulletin. Acquiescence "in result only" means acceptance of the decision of the Court but disagreement with some or all of the reasons assigned for the decision.

[9] Acquiescence relates to the issue whether amounts paid by a rental company to employees of its customers were ordinary and necessary business expenses or kickback payments.

[10] Acquiescence in result only relates to the issue whether amounts paid by South Philadelphia Terminal, Inc., to an employee of its customer and to the daughter of an employee of its customer were ordinary and necessary business expenses or if such payments were unreasonable compensation for the services performed. Acquiescence "in result only" means acceptance of the decision of the Court but disagreement with some or all the reasons assigned for the decision.

[11] Acquiescence in result only in the issue of whether the taxpayer was a collapsible corporation within the meaning of section 341(b) of the 1954 Code and therefore not entitled to the nonrecognition of gain on liquidation under section 337 of the Code. Acquiescence "in result only" means acceptance of the decision of the Court but disagreement with some or all of the reasons for the decision.

[12] Acquiescence published in C.B. X-2, 46 (1931), relating to the issue whether a bankruptcy adjudication deprives the Court of jurisdiction to hear a deficiency determination covering a year prior to the bankruptcy, is withdrawn and nonacquiescence is substituted therefor.

[13] Acquiescence in the issue as to the inclusion of one-half of the value of homestead property in the decedent's estate, published in C.B. 1952-1, 4, is withdrawn and nonacquiescence is substituted therefor.

PART I

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1954, EXCEPT THOSE PERTAINING TO ALCOHOL AND TOBACCO TAXES

SUBTITLE A.—INCOME TAXES

CHAPTER 1.—NORMAL TAXES AND SURTAXES

SUBCHAPTER A.—DETERMINATION OF TAX LIABILITY

PART IV.—CREDITS AGAINST TAX

Subpart A.—Credits Allowable

SECTION 34.—DIVIDENDS RECEIVED BY INDIVIDUALS

26 CFR 1.34–1: Credit against tax and exclusion from gross income in case of dividends received by individuals.
(Also Section 116; 1.116–1.)

Rev. Rul. 66–70

The Internal Revenue Service explains the computation of the dividend exclusion and the dividends received credit allowable on returns filed by individuals for the calendar year 1964 which include dividends deemed received by them as beneficiaries of estates and trusts which file fiduciary returns on a fiscal year basis, and time of receipt of dividends for purposes of the dividends received credit for 1965 and the dividend exclusion for 1965 and subsequent taxable years in respect of such dividends.

Advice has been requested concerning the computation of the dividend exclusion and the dividends received credit allowable on returns filed by individuals for the calendar year 1964 which include dividends deemed received by them as beneficiaries of estates and trusts which file fiduciary returns on a fiscal year basis.

Section 116(a) of the Internal Revenue Code of 1954 as amended by section 201(c) of the Revenue Act of 1964, Public Law 88–272, C.B. 1964–1 (Part 2), 6, increased the maximum dividend exclusion to $100 with respect to qualifying dividends received by an individual in taxable years beginning after December 31, 1963. If the dividends received in a taxable year exceed $100, the exclusion applies to the dividends first received in that year.

Under section 34(a)(1) of the Code, as amended by section 201(a)(1) of the Revenue Act of 1964, a 4-percent credit is allowable with

respect to dividends received before January 1, 1964, and a 2-percent credit is allowable with respect to dividends received during the calendar year 1964, to the extent that they are included in the individual's income. The credit is determined with reference to the date on which the dividends are received regardless of the taxable year of the individual receiving them.

Section 642(a)(3) of the Code (which despite its repeal by section 201(d)(6)(A) of the Revenue Act of 1964 remains effective under section 201(e) of that Act with respect to dividends received prior to January 1, 1965, in taxable years ending before that date) provides that for purposes of determining the time of receipt of dividends under section 34 and section 116 of the Code, the amount of dividends properly allocable to a beneficiary under section 652 or 662 of the Code shall be deemed to have been received by the beneficiary ratably on the same dates that the dividends were received by the estate or trust. A similar provision, for purposes of section 116(a) of the Code only, is contained in section 116(c)(3) of the Code, as amended by section 201(d)(6)(C) of the Act, effective with respect to dividends received after December 31, 1964, in taxable years ending after such date.

If an individual as a beneficiary of an estate or trust is deemed to have received from the estate or trust dividends, part of which were deemed received in 1963 and part in 1964, the dividend exclusion allowable in 1964 for dividends deemed received in 1963 is limited to $50 (or the amount of dividends deemed to have been received in 1963 if less than $50), plus the dividends deemed to have been received in 1964. However, the total amount of dividends excluded, including both those deemed received in 1963 and deemed received in 1964, shall in no case exceed $100, the maximum exclusion for dividends received in 1964.

The computation of the dividend exclusion allowable for 1964 may be illustrated by the following examples. In each case the individual received no dividends except those deemed received from the trust.

1. A simple trust reporting income on the basis of a fiscal year ending March 31 received quarterly dividends of $25 on June 1, September 1, and December 1, 1963, and March 1, 1964. All of these dividends are allocable to an individual filing returns on a calendar year basis and are reported in his income tax return for 1964. Since he is deemed to have received these dividends when the trust received them, he is allowed a dividend exclusion of $75 for 1964.

2. The facts are the same as in the first example, except that the amount of the quarterly dividends received by the trust was $100. The individual is allowed a dividend exclusion of $100. Of this amount, $50 (the limitation for 1963) is excludable from those deemed received in 1963 and $50 from those deemed received in 1964.

3. An individual is sole beneficiary of a simple trust which is a participant in a common trust fund. The common trust fund's taxable year ends on April 30; the taxable year of the trust ends on September 30; and the beneficiary of the trust computes his income on the basis of a calendar year. Charges are made to the common trust fund for the amount distributable to each participant four times a year, on the last day of July, October, January, and April. The trust is required to distribute its income to the beneficiary during its taxa-

ble year. The trust's proportionate share of the amount of dividends received by the common trust fund during its fiscal year ended April 30, 1964, was $240, one-half of which was received in 1963 and the balance in 1964. The individual beneficiary is deemed to have received $120 in dividends during 1963 and $120 in 1964, when they were received by the common trust, and is allowed a dividend exclusion of $100.

The individual is allowed a dividends received credit of 4 percent for those dividends deemed to have been received by him in 1963 and 2 percent for those deemed to have been received by him in 1964, to the extent that they are included in his income. Accordingly, the dividends received credit allowable in the examples given above is:

1. $1 (4 percent of $25).
2. $11 (4 percent of $250 plus 2 percent of $50).
3. $4.20 (4 percent of $70 plus 2 percent of $70).

However, because of the limitation imposed by section 34(b)(2) of the Code, as amended by section 201(a)(2) of the Revenue Act of 1964, the credit for the calendar year 1964 may not exceed 2 percent of the individual's taxable income for that year, or the tax for the year reduced by any allowable foreign tax credit, whichever is the lesser.

In view of the repeal of section 34 of the Code by section 201(b) of the Revenue Act of 1964, effective with respect to dividends received after December 31, 1964, no dividends received credit is allowable to individuals in respect of dividends received after December 31, 1964. However, that portion of this Revenue Ruling dealing with the dividends received credit is applicable to dividends deemed to have been received in 1964 to the extent that a beneficiary is required to include such dividends in his gross income for 1965. That portion of this Revenue Ruling dealing with the dividends received exclusion, which remains effective with respect to taxable years beginning after December 31, 1963, is equally applicable, for purposes of determining the time of receipt of dividends, to dividends deemed received from an estate or trust in 1965 and subsequent taxable years.

SECTION 38.—INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY

26 CFR 1.38–1: Investment in certain depreciable property. Rev. Rul. 66–89

(Also Section 48; 1.48–1.)

Examples of certain farm improvements are offered as guides in determining farm improvements which may qualify as "section 38 property" for purposes of the investment credit allowed by section 38 of the Internal Revenue Code of 1954.

Advice has been requested concerning the qualification of farm improvements as "section 38 property" for purposes of the investment credit allowed by section 38 of the Internal Revenue Code of 1954.

Section 38 of the Code allows a credit against Federal income tax for qualified investment in "section 38 property." The amount of this

credit is determined in accordance with sections 46 through 48 of the Code.

Section 48(a)(1) of the Code provides, in pertinent part, that the term "section 38 property" means tangible personal property or other tangible property (not including a building or its structural components) but only if such other property is used as an integral part of manufacturing, production, or extraction or is a research or storage facility used in connection with any of the foregoing activities. In order to qualify as "section 38 property" the property must be depreciable property and must have a useful life of 4 years or more.

Section 1.48–1(d) of the Income Tax Regulations provides, in part, that the terms "manufacturing," "production" and "extraction" include the cultivation of the soil and the raising of livestock. That section also provides that property is used as an integral part of the specified activities if it is used directly in the activity and is essential to the completeness of the activity. Fences used to confine livestock are specifically mentioned as property used as an integral part of one of the specified activities. Examples of storage facilities given in section 1.48–1 of the regulations include grain storage bins, and subsection (e) thereof specifically states that the term "building" does not include such structures as grain storage bins and silos.

The following examples are offered as guides in determining which farm improvements qualify as "section 38 property" for purposes of the investment credit allowed by section 38 of the Code:

(1) *Fences.* Fences used in connection with raising livestock qualify as section 38 property. This includes fences used to confine livestock in pastures as well as fences within the pasture used to keep livestock out of hazardous areas. In addition, fences used to keep livestock and other animals out of cultivated areas are essential to the cultivation activity and qualify as section 38 property.

(2) *Drain tiles.* Drain tiles used to irrigate cultivated fields are part of the specified activity performed thereon and qualify as section 38 property. Drain tiles used to improve the drainage of a pasture are an integral part of the livestock-raising activity and thus qualify as section 38 property.

(3) *Paved Barnyards.* Paved barnyards which are used to keep livestock out of mud and to load them onto auto trucks are an integral part of the livestock-raising activity and qualify as section 38 property.

(4) *Water wells.* Water wells which provide water for raising poultry and livestock are an integral part of a specified activity and are, therefore, "other tangible property" within the meaning of section 48(a)(1) of the Code and, as such, qualify as section 38 property.

(5) *Storage facilities.* If property (other than a building and its structural components) is a storage facility used in farming such as the cultivation of the soil or the raising of livestock, and if it cannot be reasonably adapted to other uses, it qualifies as "other tangible property" within the meaning of section 48(a)(1) of the Code, regardless of whether it is a temporary or a permanent facility. Typical storage facilities on farms include grain storage bins, corn cribs and silos. These are all to be distinguished from farm buildings which do not qualify as section 38 property, such as barns, stables, poultry houses and warehouses. All of these contain space within which the farmer

works and carries on his farming activities and are ineligible for the credit because they fall within the definition of the term "building." A storage facility, as above illustrated, provides the farmer only storage space but not working space.

SECTION 39.—CERTAIN USES OF GASOLINE AND LUBRICATING OIL

(Also Sections 6421, 6424.) Rev. Rul. 66–48

Various situations are presented for claiming refund of, or taking credit against income tax for, the tax on gasoline used otherwise than as a fuel in a highway vehicle after June 30, 1965, and the tax on lubricating oil used otherwise than in a highway motor vehicle after December 31, 1965.

Advice has been requested in respect of a number of questions regarding the recovery of excise taxes on gasoline and lubricating oil under sections 39 and 6424 of the Internal Revenue Code of 1954, as added by sections 809(c) and 202(b), respectively, of the Excise Tax Reduction Act of 1965, Public Law 89–44, C.B. 1965–2, 568, and section 6421 of the Code, as amended by section 809(b) of such Act. The questions relate to a taxpayer who reports on the basis of a calendar year. The specific questions and the answers thereto are as follows:

QUESTION 1: Do the transitional rules in section 39(b) of the Code mean that where a taxpayer chooses to take the credit, the credit attributable to the tax determined under section 6421(a) of the Code which is taken in the tax return for 1966 may include such tax covering the period July 1, 1965 to December 31, 1966?

Answer: Yes. The credit for gasoline tax will first be taken on the return for the first full taxable year beginning after June 30, 1965. The credit on the first return will include any tax paid on gasoline used after June 30, 1965, but before the beginning of such taxable year. In the typical case of a calendar year taxpayer, a credit for gasoline tax will first be taken on the income tax return filed for the year 1966 and will cover the period from June 30, 1965, through December 31, 1966.

QUESTION 2: May the taxpayer take a credit for the tax covering the period July 1, 1965, to December 31, 1965, in his 1965 income tax return?

Answer: No. This credit may not be taken on the 1965 income tax return.

QUESTION 3: Assuming that the taxpayer chooses to file claims for refund pursuant to the provisions of sections 6421 and 6424 of the Code, will a claim covering the period July 1, 1965 to December 31, 1965, be allowed under section 6421(c)(3) of the Code if filed not later than the due date of the return for 1965? If such a claim is not allowable, then assuming that $1,000 or more is payable with respect to gasoline used during the third quarter of 1965, will a claim timely filed under section 6421(c)(3)(B) of the Code be allowed and

may the taxpayer take a tax credit under section 39 of the Code for the amount payable with respect to gasoline used during the fourth quarter of 1965?

Answer: There are two methods for obtaining the amount of the refund allowable under section 6421 of the Code. Generally, the amount due must be claimed by the ultimate purchaser as a credit against his income tax for the taxable year. However, if $1,000 or more is payable with respect to gasoline used during any of the first three quarters of his taxable year, a claim for refund may be filed under section 6421(c)(3)(B) of the Code with respect to gasoline used during such quarter. As stated above, a credit in the case of a calendar year taxpayer may not be taken on the 1965 income tax return but will be taken on the 1966 return and will cover the period from June 30, 1965, through December 31, 1966. In the case of a claim for refund under section 6421(c)(3)(B) of the Code, the provisions of subparagraph (B) should be read in context with the provision in subparagraph (A) which provides that, for purposes of this paragraph, a person's first taxable year beginning after June 30, 1965, shall include the period after June 30, 1965, and before the beginning of such first taxable year. When this is done, it is deemed that claims for refund may be filed for all quarters in the taxable year except the last quarter. Thus, a claim for refund timely filed under section 6421(c)(3)(B) of the Code would be acceptable in respect of gasoline used during either the third or fourth quarter of 1965.

QUESTION 4: Will a claim for refund of gasoline tax for the period July 1, 1965, to December 31, 1966, be allowed if filed on or before the due date of the 1966 return?

Answer: No. Unless a refund claim was or is filed on or before the last day of the first quarter following the quarter in which the gasoline was used, the amount due must be claimed as a credit on the 1966 income tax return no later than the time prescribed by law for filing such return.

QUESTION 5: Where taxpayer files quarterly claims pursuant to sections 6421(c)(3)(B) and 6424(b)(2) of the Code, may he take a tax credit under section 39 of the Code with respect to taxes payable to him for any quarter for which a claim was not filed?

Answer: The taxpayer should claim the amount payable to him as a credit on his return with respect to gasoline and lubricating oil used during any quarters in the taxable year for which a claim was not filed under sections 6421(c)(3)(B) and 6424(b)(2) of the Code. In any case, a tax payment for the last quarter may be claimed only as a credit on the income tax return.

QUESTION 6: Will a single claim on Form 843 covering both gasoline and lubricating oil taxes payable to taxpayer be acceptable, or must separate claims be filed?

Answer: Where it is appropriate to file a claim on Form 843, a single Form 843 covering both gasoline and lubricating oil taxes payable to a taxpayer will be acceptable if there is shown on the Form 843 separate computations in respect of each tax and all the supporting information is submitted therewith.

SECTION 48.—DEFINITIONS; SPECIAL RULES

26 CFR 1.48–1: Definition of section 38 property. Rev. Rul. 66–156

Structures in which mushrooms are grown are buildings within the meaning of section 1.48–1(e)(1) of the Income Tax Regulations and do not qualify as "section 38 property" for purposes of the investment credit.

Certain other property contained in or attached to the buildings (other than structural components), including the beds in which the mushrooms grow, is tangible personal property eligible for the investment credit under section 1.48–1(c) of the regulations.

Components which serve a dual purpose of supporting the growing beds and the false ceiling, a structural component, are structural components within the meaning of section 1.48–1(e)(2) of the regulations.

Advice has been requested whether facilities used to grow mushrooms are structures which are essentially items of equipment within the meaning of section 1.48–1(e) of the Income Tax Regulations and hence qualify as "section 38 property" for purposes of the investment credit allowed under section 38 of the Internal Revenue Code of 1954.

The taxpayer is a mushroom grower and packager. The principal facility used in the growing of mushrooms is commonly referred to as a "mushroom house." These structures are specially designed and constructed to meet the particular temperature, humidity, and darkness conditions required for mushroom growing.

The mushroom house is a rectangular shaped enclosure with concrete block walls and aluminum or tar-felt asbestos roofs. There are no windows as mushrooms must grow in darkness. It houses the shelf-like "beds" in which the mushrooms grow and the conveyors which are used to fill the "beds" with compost and soil. These "beds" are supported by heavy closely placed studding, since the beds contain large quantities of mushroom soil and are extremely heavy. The house has a false ceiling equipped with ventilators in order to permit proper ventilation of the "beds." This false ceiling is held in place by the same studding which supports the heavy mushroom beds.

The mushroom house must be well insulated and sealed in order to withstand the high temperature and humidity conditions which are required to be maintained over long periods of time within closely controlled limits.

The sole purpose of the mushroom house is the growing of mushrooms. Substantial expenditures in relation to original cost would be required to make the structure suitable for any other purpose. Persons entering the structure do so only for purposes involved in the mushroom growing process.

The investment credit sections of the Code provide, in part, that the credit is allowable for certain qualified investment in tangible personal property for which depreciation is allowable having a useful life of 4 or more years. Section 1.48–1(c) of the regulations provides that tangible personal property includes all property (other than structural components) which is contained in or attached to a building.

The credit is also allowable for qualified investment in certain other

depreciable tangible property (with a useful life of 4 or more years), but not to a building and its structural components. As defined in section 1.48–1(e)(1) of the regulations, the term "building" generally means any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. However, such term does not include a structure which is essentially an item of machinery or equipment.

The term "structural components," as defined in section 1.48–1(e)(2) of the regulations, includes parts of a building relating to its operation or maintenance. However, the term does not include machinery required only for the purpose of meeting temperature or humidity requirements which are essential for the operation of other machinery or the processing of materials and foodstuffs.

Based on the foregoing, it is concluded that the mushroom house in which mushrooms are grown is a building within the meaning of section 1.48–1(e) of the regulations and is ineligible for the investment credit. Thus, the roof, walls, false ceiling, and concrete floor do not qualify as "section 38 property."

However, certain other property contained in or attached to the building (other than structural components) qualifies as "section 38 property" under section 1.48–1(c) of the regulations and is therefore subject to the investment credit provided the other provisions of the investment credit sections of the Code are met. The beds in which the mushrooms grow and the conveyors used to fill the beds are items of tangible personal property and qualify for the credit. The machinery and pipes of the heating system are tangible personal property since the sole justification for their installation is that the heating system is required to meet critical temperature and humidity requirements essential to the growing of mushrooms.

However, the vertical studs which support the conveyor and shelf-like "beds" also serve to hold the false ceiling in place. These studs do not qualify for the investment credit. They serve a dual purpose and, therefore, are structural components within the meaning of section 1.48–1(e)(2) of the regulations. That section does not authorize fragmentation of costs in order to allow the investment credit on a pro rata basis.

Qualification of farm improvements as section 38 property. See Rev. Rul. 66–89, page 7.

SUBCHAPTER B.—COMPUTATION OF TAXABLE INCOME

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

SECTION 61.—GROSS INCOME DEFINED

26 CFR 1.61–1: Gross income.
(Also Section 72; 1.72–16.)

Rev. Rul. 66–110

Policyholder dividends paid to an employee on life insurance policies purchased under a so-called "split dollar" arrangement of

the type considered in Revenue Ruling 64–328, C.B. 1964–2, 11, are to be aggregated with the other benefits received by the employee under the arrangement for purposes of determining the amount includible in the employee's gross income.

The current published premium rates charged by an insurer for individual 1-year term life insurance available to all standard risks may be used for determining the cost of insurance in connection with individual policies issued by the same insurer and used for "split dollar" arrangements or held by trusts qualified under section 401(a) of the Internal Revenue Code of 1954, where those rates are lower than the rates set forth in Revenue Ruling 55–747, C.B. 1955–2, 228.

The table of premiums set forth in Revenue Ruling 55–747 is extended to age 81.

Revenue Rulings 64–328 and 55–747 are amplified.

Advice has been requested regarding the proper income tax treatment of policyholder dividends paid on life insurance policies purchased under so-called "split dollar" arrangements of the types considered in Revenue Ruling 64–328, C.B. 1964–2, 11.

Revenue Ruling 64–328 holds that the typical "split dollar" arrangement confers an economic benefit on the employee, the value of which must be included in the gross income of the employee. In that ruling, current insurance protection is the only benefit which the employee receives and consequently only the value of that benefit is referred to as being includible in the employee's income. However, the employee may receive other benefits, such as cash dividends or additional life insurance, the value of which would likewise be includible in the employee's gross income. The amount includible in the employee's gross income each year is equal to the excess of the total value of all the benefits received under the arrangement for such year, over the amount, if any, provided by the employee for that year.

Revenue Ruling 64–328 considers two major types of "split dollar" arrangements, the endorsement system and the collateral assignment system. That ruling indicates that while the two systems differ in form, in substance they result in the same economic benefit to the employee. Accordingly, the treatment to be accorded the additional benefits received by the employee on account of policyholder dividends under a "split dollar" arrangement would be the same whether the endorsement system or the collateral assignment system is used.

If the policyholder dividend is distributed to the employee, the amount of the dividend must be aggregated with the other benefits received by the employee under the arrangement for purposes of determining the amount includible in the employee's gross income. Similarly, if the dividend is used to purchase for the employee additional 1-year term insurance, or paid-up life insurance (in which the employee has a nonforfeitable interest) for a period of more than 1 year, the employee receives an additional economic benefit, the value of which is equal to the amount of the dividend. If, in the case where the dividend is used to purchase additional paid-up life insurance for a period of more than 1 year, the employer retains the right to the cash surrender value of such additional insurance, the annual value of the additional insurance coverage is includible in the employee's gross income in the same manner as set forth in Revenue Ruling 64–328; the value of the benefit to be so included each year may be determined in the manner set forth in that ruling.

Revenue Ruling 64–328 states further that the cost of life insurance protection per $1,000, as shown in the table contained in Revenue Ruling 55–747, C.B. 1955-2, 228, may be used to compute the 1-year term cost of the insurance protection to which an employee is entitled from year to year under a "split dollar" arrangement with his employer. Revenue Ruling 55–747 states that the rates set forth therein may be used to determine the cost of current life insurance protection required to be included in the income of an employee who is furnished insurance protection under a trust qualified under section 401(a) of the Code. Such cost is includible in the employee's gross income in accordance with section 72(m)(3) of the Code. In any case where the current published premium rates per $1,000 of insurance protection charged by an insurer for individual 1-year term life insurance available to all standard risks are lower than those set forth in Revenue Ruling 55–747, such published rates may be used in place of the rates set forth in that Revenue Ruling for determining the cost of insurance in connection with individual policies issued by the same insurer and used for "split dollar" arrangements or held by trusts qualified under section 401(a) of the Code.

Advice has also been requested as to the 1-year term premiums to be used at ages 76 through 81 in cases similar to those where the rates set forth in Revenue Ruling 55–747 are applicable. The 1-year term premiums for $1,000 of life insurance protection for these ages, computed on the same basis as the premiums shown in Revenue Ruling 55–747, are as follows:

Age:	*Premium*
76	$79.63
77	86.57
78	94.09
79	102.23
80	111.04
81	120.57

Revenue Rulings 55–747 and 64–328 are hereby amplified.

(Also Section 6049; 1.6049–1.) Rev. Rul. 66–120

Guidelines are set forth in the form of examples illustrating the application of Revenue Ruling 65–199, C.B. 1965–2, 20, relating to the reporting of increments earned on advance or prepaid premiums on individual insurance or annuity policies under various arrangements that allow an interest discount from the respective contract premiums.

Revenue Ruling 65–199, C.B. 1965–2, 20, amplified.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to provide guidelines for the reporting of increments earned on advance or prepaid premiums under various arrangements that allow an interest discount to be deducted from the respective contract premiums.

SEC. 2. BACKGROUND.

Prior to the issuance of Revenue Ruling 65–199, C.B. 1965–2, 20, I.T. 3513, C.B. 1941–2, 75, embodied the Service's position with respect to the increments in value on advance premiums on an annuity policy. I.T. 3513 held that the increments represented by the excess of the

stated policy premiums over the discounted premiums should not be included in the gross income of the premium payor in the years in which the premiums fall due. Revenue Ruling 65–24, C.B. 1965–1, 31, made the holding in I.T. 3513 equally applicable to advance premiums on a life insurance policy. Revenue Ruling 65–199 was issued to establish the new position of the Service and to revoke I.T. 3513 and Revenue Ruling 65–24.

Revenue Ruling 65–199 holds, in part, that any increment in value of so-called "advance premiums", "prepaid premiums", or "premium deposit funds" which is applied to the payment of premiums due on annuity and life insurance policies, or made available for withdrawal by the policyholder, will result in taxable income to the policyholder at that time.

SEC. 3. TRANSITIONAL RULE.

In order to make the transition as orderly as possible and to minimize hardship to taxpayers affected where advance premiums had been deposited on or before July 8, 1965, Revenue Ruling 65–199 states that with respect to such deposits the new position will be applied only to increments credited or made available for withdrawal subsequent to the first premium due date falling after July 31, 1965. Consequently, any increments on advance premium deposits made on or before July 8, 1965, which are made available for withdrawal, but not withdrawn or applied to premium payments due, on or before the first premium due date falling after July 31, 1965, need not be reported in gross income. Furthermore, any increments on advance premium deposits made on or before July 8, 1965, which are not made available for withdrawal or applied to premium payments due but which are accrued on or before the first premium due date falling after July 31, 1965, and are not withdrawn, need not be reported in gross income. The total of the increments which, for purposes of the preceding sentence, are deemed to be so accrued is the amount of interest included in the sum that would be withdrawable immediately before the application of the premium due on the first premium date falling due after July 31, 1965, determined on the assumption that full withdrawal is permitted without penalty against principal or interest. See section 6, below.

SEC. 4. LIMITED APPLICABILITY.

The terms "advance premiums", "prepaid premiums", and "premium deposit funds" as used in Revenue Ruling 65–199 mean the discounted value of the corresponding contract premiums not yet due under a specific individual insurance or annuity policy. Those terms do not include deposits to an interest-bearing fund, under an agreement to pay policy premiums from the fund whenever such premiums are not paid from some other source. Deposits made under this latter type of arrangement are not advance or prepaid premiums within the meaning of those terms as used in Revenue Ruling 65–199, but are amounts held under an agreement to pay interest. Such interest has always been reportable in gross income when received, credited, made available for withdrawal, or accrued. Revenue Ruling 65–199 and this Revenue Ruling are limited in application to an advance premium arrangement with respect to an individual life or annuity

policy but do not relate to individual single premium policies.[1] The transitional period provided in Revenue Ruling 65–199 does not apply to increments actually withdrawn. Such increments have always been taxable.

SEC. 5. AVAILABILITY FOR WITHDRAWAL.

For purposes of this Revenue Ruling an amount is considered to be available for withdrawal if the taxpayer's control of its receipt is not subject to substantial limitations or restrictions within the meaning of section 1.451–2 of the Income Tax Regulations, relating to constructive receipt of income. For example, a requirement that increments may be withdrawn only upon a withdrawal of all of the unapplied advance premiums is not a substantial limitation, but a requirement that increments may be withdrawn only upon surrender of the policy, or upon the death of the insured, is a substantial limitation.

Increments which were never available for withdrawal but which are applied to the payment of a premium should be reported in gross income when so applied, except to the extent that they are subject to the provisions of section 3.

SEC. 6. EXAMPLES.

The examples set forth below illustrate the application of Revenue Ruling 65–199 in determining the reportable gross income attributable to increments earned on amounts deposited with insurance companies as advance premiums under various advance or prepaid premium arrangements.

The general facts in each of the examples are as follows: *D*, a calendar year taxpayer, is the insured under a whole-life insurance policy issued by *L* life insurance company which provides for a premium of $1,000 to be paid by *D* on November 14 of each year the policy is in force. On November 14, 1964, in addition to the $1,000 premium then due, *D* deposited a total of $2,775.10 with *L* as an advance premium deposit to be used together with increments earned on the deposit for the payment of three successive annual $1,000 premiums commencing with the one due on November 14, 1965. If no withdrawal from the deposit fund is made, a portion of the initial deposit together with the increment earned on such portion will be used to pay the premium then due. Increments are computed at a 4-percent rate compounded annually from the date of deposit. Thus, 1 year after the deposit, $961.54 of the deposit fund ("deposit 1") together with an increment of $38.46 (the amount earned on $961.54 for 1 year ending November 14, 1965) will be applied against the $1,000 premium then due. Similarly, 2 years hence, $924.56 of the deposit ("deposit 2") together with an increment of $75.44 (the amount earned on

[1] The distinction between a single premium policy and an annual premium policy on which advance premiums have been deposited may be illustrated by the following example: *A* takes out a $10,000 single premium whole-life policy on his life, for which he pays a single premium of $5,050. At the same time he takes out a $10,000 20-payment-life policy on his life and pays the insurer $5,724.25, which represents the first annual premium of $405 plus the discounted value ($5,319.25) of the remaining 19 premiums of $405 each. *A* dies 10 months later. The insurer of the single premium policy pays $10,000 to the beneficiary. The insurer of the 20-payment-life policy pays $10,000 to the beneficiary and $5,319.25 plus interest thereon to the date of death to the estate of *A* (or to the beneficiary of the policy, depending on the terms of the advance premium agreement).

$924.56 for 2 years ending November 14, 1966) will be applied, and 3 years hence, $889 of the deposit ("deposit 3") together with an increment of $111 (the amount earned on $889 for 3 years ending November 14, 1967) will be applied.

D may withdraw at any time the unapplied advance premiums together with interest on such amounts computed at a rate of 4 percent per annum compounded annually for the period from the date of deposit to the date of withdrawal (measured in completed months) provided the entire account is withdrawn.

The chart set forth below should be considered with the examples. It shows the increments earned on each portion of the deposit fund for each calendar year involved (assuming a 4-percent rate compounded annually from the date of deposit) and the amount of and date when each increment is applied to the payment of a $1,000 premium.

Where applicable, the transitional rule operates so that the taxpayer in the examples set forth below need not report that portion of each increment earned from the date of deposit through November 14, 1965.

Deposit number	$1,000 premium due on	Initial deposit (11–14–64)	Calendar year increments				Total increment
			1964	1965	1966	1967	
1	11–14–65	$961. 54	$3. 21	$35. 25	-------	-------	$38. 46
2	11–14–66	924. 56	3. 08	37. 11	$35. 25	-------	75. 44
3	11–14–67	889. 00	2. 96	35. 68	37. 11	$35. 25	111. 00
Total	----------	2, 775. 10	9. 25	108. 04	72. 36	35. 25	224. 90

Example 1.—The facts are the same as in the general facts. Assume *D* makes no withdrawal.

The increments earned for each year on the unapplied deposits are $9.25 in 1964, $108.04 in 1965, $72.36 in 1966, and $35.25 in 1967. Since there is no substantial limitation on *D*'s right to withdraw the increments earned, all the increments (but for the prospective application of Revenue Ruling 65–199) should be reported in his gross income in the year they are available for withdrawal. Because of the transitional rule, however, none of the 1964 increment and only $6.29 of the 1965 increment (the amount earned on the unapplied deposits for 1 complete month in calendar year 1965) should be reported in *D*'s gross income. The 1966 increment of $72.36 and the 1967 increment of $35.25 should be included in gross income for those years.

Example 2.—The facts are the same as in the general facts except that on December 15, 1965, *D* withdraws his total unapplied advance premium deposits together with interest. This would include deposit 2 of $924.56 plus total increment of $40.19 (the amount earned in 1 year and 1 month) and deposit 3 of $889 plus total increment of $38.64 (the amount earned in 1 year and 1 month). Since the transitional rule does not apply to increments withdrawn, the total increments so withdrawn, $78.83, are taxable in 1965.

Example 3.—The facts are the same as in the general facts except that no interest is paid on unapplied deposits withdrawn while the policy remains in force, and on December 15, 1966, after deposits 1 and 2 (together with their respective increments) have been applied to pay premiums, *D* withdraws his total unapplied advance premium of $889.

Since none of the increments earned were available for withdrawal, *D* is taxable only as the increments are actually applied to the payment of his premiums. However, because of the transitional rule, none of the increments applied to pay the premium due on November 14, 1965, is to be reported in 1965, and only $38.46 (the amount earned between November 15, 1965, and November 14, 1966) of the total increments applied ($75.44) to pay the premium due on November 14, 1966, is to be reported in 1966.

These results would be the same in any case where there is a substantial limitation on the right to withdraw increments on unapplied advance premium deposits.

Example 4.—The facts are the same as in the general facts except that if unapplied deposits are withdrawn only three-fourths of the increment accrued will be paid. Assume *D* makes no withdrawal.

Since *D* has no right to receive one-quarter of the increment earned on unapplied advance premium deposits, that portion will be taxable only when actually applied to the payment of premiums. Because of the transitional rule, in 1964 *D* should report zero in his gross income. In 1965 *D* should report $4.72; this amount represents three-fourths of the increment earned for the period November 14, 1965, to December 14, 1965, on deposit 2 (three-fourths of $961.54 × 4% × 1/12 = $2.41) and on deposit 3 (three-fourths of $924.56 × 4% × 1/12 = $2.31). In 1966 *D* should report $63.88; this amount represents all of the increment earned on deposit 2 in 1966 and applied in 1966 ($35.25), one-fourth of the increment earned for 1 complete month in the calendar year 1965 on deposit 2 and applied in 1966 ($3.21 × 1/4 = $0.80), and three-fourths of the increment earned on deposit 3 in 1966 ($37.11 × 3/4 = $27.83). In 1967 *D* should report $45.30; this amount represents all of the increment earned on deposit 3 in 1967 and applied in 1967 ($35.25), one-fourth of the increment earned on deposit 3 in 1966 and applied in 1967 ($37.11 × 1/4 = $9.28), and one-fourth of the increment earned for 1 complete month in the calendar year 1965 on deposit 3 and applied in 1967 ($3.08 × 1/4 = $0.77). In absence of the transitional rule, the following amounts would have been reportable in *D*'s gross income: $6.94 in 1964, $90.64 in 1965, $73.13 in 1966, and $54.19 in 1967.

SEC. 7. EFFECT ON OTHER DOCUMENTS.

Revenue Ruling 65–199, C.B. 1965–2, 20, is hereby amplified.

An amount equal to an employment agency fee previously paid by an employee which is reimbursed by the employer to the employee after he has completed a specified period of satisfactory service. See Rev. Rul. 66–41, page 233.

26 CFR 1.61–2: Compensation for services, including fees, commissions, and similar items. Rev. Rul. 66–3

Amounts received as subsistence allowances, under the provisions of the Reserve Officers' Training Corps Vitalization Act of 1964, Public Law 88–647, as amended by Public Law 89–51, by members of the ROTC selected for advanced training under section 2104 of title 10 of the United States Code and members appointed under section 2107 of title 10, are not includible in the gross income of the recipients for Federal income tax purposes.

Advice has been requested whether amounts received by certain students participating in the ROTC program under the provisions of the Reserve Officers' Training Corps Vitalization Act of 1964, Public Law 88–647, as amended by Public Law 89–51, are subject to Federal income tax.

Section 202(2) of title II of the Reserve Officers' Training Corps Vitalization Act of 1964, amended section 209 of title 37 of the United States Code, and provided that, except when on active duty, members of the ROTC selected for advanced training under the provisions of section 2104 of title 10 U.S.C. and members appointed under the provisions of section 2107 of title 10 U.S.C. are entitled to receive *retainer pay* during certain periods of training. Sections 2104(b)(3) and 2107(b)(3) of title 10 U.S.C. require that the ROTC member enlist in a reserve component of the Armed Forces for the period prescribed by the Secretary of the military department concerned.

However, section 3 of Public Law 89–51, amended section 209 of title 37 U.S.C. by striking out the words "*retainer pay*," wherever they appeared in that section, and inserting the words "*subsistence allowance*" in place thereof. In connection with this change in terminology, see H.R. Report 348, 89th Congress and S. Report 315, 89th Congress. Section 4 of that public law provides that the effective date of the amendment is October 13, 1964.

Under section 61 of the Internal Revenue Code of 1954, gross income includes, among other items, all compensation for services, including fees, commissions, and similar items.

Section 1.61–2(a)(1) of the Income Tax Regulations in part provides, that pay of persons in the military or naval forces of the United States is income to the recipients. Under the provisions of section 1.61–2(b) of the regulations, subsistence allowances granted to various members of the Armed Forces of the United States are excludable from gross income.

ROTC *retainer pay* is pay of persons in the military or naval forces of the United States and is includible in the gross income of the recipients. However, *subsistence allowances* received by members of the ROTC are subsistence allowances granted to members of the Armed Forces of the United States and are excludable from the gross income of the recipients.

By virtue of the change made by Public Law 89–51, the allowances received by members participating in the ROTC program are subsistence allowances, as contemplated by section 1.61–2(b) of the regulations, rather than retainer pay. Therefore, the amounts representing allowances for subsistence are not subject to Federal income tax.

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Accordingly, amounts received as subsistence allowances, under the provisions of Public Law 88–647, as amended by Public Law 89–51, by members of the ROTC selected for advanced training under the provisions of section 2104 of title 10 U.S.C. and members appointed under the provisions of section 2107 of title 10 U.S.C. are not includible in the gross income of the recipients.

Rev. Rul. 66–157

A State statute provides that fees of inheritance tax appraisers be paid according to a schedule set out in the statute which is based upon the value of the assets of an estate. The state controller, in considering the circumstances involved in a particular estate, requested that the appraisers under his authority who were eligible for appointment accept a fee substantially less than the statutory fee for appraising such estate. The taxpayer, who was a party to the agreement, was thereafter selected as the inheritance tax appraiser of the estate and appraised the estate. The agreement was a valid and binding contract. *Held*, the amount the appraiser was entitled to receive under the contract, rather than the higher amount provided for by statute, is includible in income under section 61 of the Internal Revenue Code of 1954.

(Also Section 2501; 25.2501–1.) Rev. Rul. 66–167

Statutory fees or commissions are not includible in the gross income of the executor of an estate, where he effectively waives his right to receive such fees or commissions within a reasonable time after commencing to serve as the executor and all his other actions with respect to the estate are consistent with an intention to render gratuitous service. The act of waiving said fees or commissions under these conditions will likewise effect no gift thereof.

Revenue Ruling 56–472. C.B. 1956–2, 21, clarified and Revenue Ruling 64–225, C.B. 1964–2, 15, distinguished.

The Internal Revenue Service has given further consideration to Revenue Ruling 56–472, C.B. 1956–2, 21, and Revenue Ruling 64–225, C.B. 1964–2, 15, which relate to the waiver of commissions by executors and similar fiduciaries.

In the instant case, the taxpayer served as the sole executor of his deceased wife's estate pursuant to the terms of a will under which he and his adult son were each given a half interest in the net proceeds thereof. The laws of the state in which the will was executed and probated impose no limitation on the use of either principal or income for the payment of compensation to an executor and do not purport to deal with whether a failure to withdraw any particular fee or commission may properly be considered as a waiver thereof.

The taxpayer's administration of his wife's estate continued for a period of approximately three full years during which time he filed two annual accountings as well as the usual final accounting with the probate court, all of which reported the collection and disposition of a substantial amount of estate assets.

At some point within a reasonable time after first entering upon the performance of his duties as executor, the taxpayer decided to make

no charge for serving in such capacity, and each of the aforesaid accountings accordingly omitted any claim for statutory commissions and was so filed with the intention to waive the same. The taxpayer-executor likewise took no other action which was inconsistent with a fixed and continuing intention to serve on a gratuitous basis.

The specific questions presented are whether the amounts which the taxpayer-executor could have received as fees or commissions are includible in his gross income for Federal income tax purposes and whether his waiver of the right to receive these amounts results in a gift for Federal gift tax purposes.

In Revenue Ruling 56–472, the executor of an estate entered into an agreement to serve in such capacity for substantially less than all of the statutory commissions otherwise allowable to him and also formally waived his right to receive the remaining portion thereof. The basic agreement with respect to his acceptance of a reduced amount of compensation antedated the performance of any services and the related waiver of the disclaimed commissions was signed before he would otherwise have become entitled to receive them. Under these circumstances, the ruling held that the difference between the commissions which such executor could have otherwise acquired an unrestricted right to obtain and the lesser amount which he actually received was not includible in his income and that his disclaimer did not effect any gift thereof.

In Revenue Ruling 64–225, the trustees of a testamentary trust in the State of New York waived their rights to receive one particular class of statutory commissions. This waiver was effected by means of certain formal instruments that were not executed until long after the close of most of the years to which such commissions related. This circumstance, along with all the other facts described therein, indicated that such trustees had not intended to render their services on a gratuitous basis. The Revenue Ruling accordingly held that such commissions were includible in the trustees' gross income for the taxable year when so waived and that their execution of the waivers also effected a taxable gift of these commissions.

The crucial test of whether the executor of an estate or any other fiduciary in a similar situation may waive his right to receive statutory commissions without thereby incurring any income or gift tax liability is whether the waiver involved will at least primarily constitute evidence of an intent to render a gratuitous service. If the timing, purpose, and effect of the waiver make it serve any other important objective, it may then be proper to conclude that the fiduciary has thereby enjoyed a realization of income by means of controlling the disposition thereof, and at the same time, has also effected a taxable gift by means of any resulting transfer to a third party of his contingent beneficial interest in a part of the assets under his fiduciary control. See the above cited Revenue Rulings and the authorities therein cited, as well as section 25.2511–1(c) of the Gift Tax Regulations.

The requisite intention to serve on a gratuitous basis will ordinarily be deemed to have been adequately manifested if the executor or administrator of an estate supplies one or more of the decedent's principal legatees or devisees, or of those principally entitled to distribution of

decedent's intestate estate, within six months after his initial appointment as such fiduciary, with a formal waiver of any right to compensation for his services. Such an intention to serve on a gratuitous basis may also be adequately manifested through an implied waiver, if the fiduciary fails to claim fees or commissions at the time of filing the usual accountings and if all the other attendant facts and circumstances are consistent with a fixed and continuing intention to serve gratuitously. If the executor or administrator of an estate claims his statutory fees or commissions as a deduction on one or more of the estate, inheritance, or income tax returns which are filed on behalf of the estate, such action will ordinarily be considered inconsistent with any fixed or definite intention to serve on a gratuitous basis. No such claim was made in the instant case.

Accordingly, the amounts which the present taxpayer-executor would have otherwise become entitled to receive as fees or commissions are not includible in his gross income for Federal income tax purposes, and are not gifts for Federal gift tax purposes.

Revenue Ruling 56–472 is clarified to remove any implication that, although an executor effectively waives his right to receive commissions, such commissions are includible in his gross income unless the waiver is executed prior to performance of any service.

Revenue Ruling 64–225 is distinguished.

Stipends received by an intern in the field of community organization and intergroup relations at a social service agency. See Rev. Rul. 66–83, page 30.

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26 CFR 1.61–11: Pensions. Rev. Rul. 66–34
(Also Sections 72, 7805; 1.72–1, 301.7805–1.)

The payments received under the social security system of the Federal Republic of Germany by a taxpayer who is a citizen of the United States or has been admitted to the United States for permanent residence are includible in his gross income under section 61 of the Internal Revenue Code of 1954, unless excluded by law.

A basic similarity between the benefits paid under the social security system of the Federal Republic of Germany and the sundry insurance benefits paid under the social security system of the United States is not a valid basis for excluding the German payments from gross income.

Revenue Ruling 56–135, C.B. 1956–1, 56, revoked.

Advice has been requested whether the payments a taxpayer receives under the social security system of the Federal Republic of Germany are includible in his gross income under section 61 of the Internal Revenue Code of 1954.

The taxpayer, in the instant case, is an individual who has been admitted to the United States for permanent residence. He is receiving benefit payments under the old age insurance program of the social security system of the Federal Republic of Germany.

Section 61(a) of the Code provides that, except as otherwise provided, gross income means all income from whatever source derived.

Section 1.61–11(a) of the Income Tax Regulations provides, in part, as follows:

(a) *In general.*—Pensions and retirement allowances paid either by the Government or by private persons constitute gross income unless excluded by law. Usually, where the taxpayer did not contribute to the cost of a pension and was not taxable on his employer's contributions, the full amount of the pension is to be included in his gross income. But see sections 72, 402, and 403 and the regulations thereunder. * * *

Paragraph (b) of the same regulation includes the statement that "Amounts received as pensions or annuities under the Social Security Act * * * are excluded from gross income," and refers to "section 37 and the regulations thereunder" with respect to the "inclusion of pensions in income for the purpose of the retirement income credit."

Section 37(d)(1) of the Code relates to retirement income and prescribes a maximum dollar amount, to be reduced by, "in the case of any individual, any amount received by the individual, as a pension or annuity," "under Title II of the Social Security Act," or "otherwise excluded from gross income." Section 37(e) of the Code states that subsection (d)(1) shall not apply, among other things, "to any amount excluded from gross income under section 72 (relating to annuities)." This is explained in section 1.37–3(b)(2) of the regulations in the following manner:

(2) *Amounts not includible in gross income.*—Retirement income may not include any amount not includible in the gross income of the individual for the taxable year. For example, if a portion of an annuity is excluded from gross income under section 72, relating to annuities, that portion of the annuity is not retirement income. * * *

The purpose of the retirement income credit of section 37 of the Code was explained in Senate Report No. 1622, Eighty-third Congress, at page 8, as follows:

Under existing law, benefits payable under the social security program and certain other retirement programs of the Federal Government are exempt from income tax. No similar exemption is accorded to persons receiving retirement pensions under other publicly administered programs * * *. In order to adjust this differential tax treatment, the House bill grants an individual * * * a credit against his tax liability * * *.

It is evident, therefore, that in enacting the Internal Revenue Code of 1954 Congress intended the benefit of the retirement income credit to be available with respect to payments like those in the instant case, but not to payments under the U.S. social security system, Congress recognizing that such payments had been specifically held "not subject to the Federal income tax in the hands of the recipients" by the Internal Revenue Service in I.T. 3447, C.B. 1941–1, 191, 192. Accordingly, no basis is known for attributing to Congress a belief that payments under the social security system of the Federal Republic of Germany or any other foreign social security system were not subject to the Federal income tax. Compare Revenue Ruling 62–179, C.B. 1962–2, 20.

The Service has given consideration to the provisions of the *Convention between the United States of America and the Federal Republic of Germany*, July 22, 1954, 5 UST 2768, C.B. 1955–1, 635. The Convention relates to double taxation and Article XI provides, in part, as follows:

* * * * * * *

(b) Wages, salaries and similar compensation and pensions paid by the Federal Republic, Laender or municipalities, or by a public pension fund, to an individual (other than a citizen of the United States and other than an individual

who has been admitted to the United States for permanent residence therein) shall be exempt from tax by the United States.

(c) For the purpose of this paragraph the term "pensions" shall be deemed to include annuities paid to a retired civilian government employee.

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(3) The term "pensions", as used in this Article, means periodic payments made in consideration for services rendered or by way of compensation for injuries received.

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Since the payments in question in the instant case are to be made by the Federal Republic of Germany or from a public pension fund thereof, to an individual specifically excluded from the benefits of Article XI, they are not excludable from gross income of the taxpayer by reason of the treaty provision quoted.

Furthermore, section 2 of Article IV of the *Treaty of Friendship, Commerce, and Navigation* with the Federal Republic of Germany, October 29, 1954, 7 UST 1839, has no pertinence to the instant case although it provides that nationals of either country are to be accorded national treatment in the application of laws and regulations within the other country which establish compensation or other benefits on account of disease or injury from the course or nature of employment or with regard to social security laws or regulations relating to sickness, disability, maternity, old age, death of breadwinner, or unemployment, since the treaty deals with the availability of such payments rather than their taxability.

In view of these circumstances and in the light of the opinion of the Supreme Court of the United States in *Commissioner* v. *Glenshaw Glass Company*, 348 U.S. 426 (1954), Ct. D. 1783, C.B. 1955–1, 207, which recognized "a clear legislative attempt to bring the taxing power to bear upon all recipients constitutionally taxable" on the part of Congress, the payments received under the social security system of the Federal Republic of Germany by individuals who are citizens of the United States or have been admitted to the United States for permanent residence are includible in their gross income for Federal income tax purposes, unless excluded by law. Such taxpayers are entitled to recover their cost, if any, in the payments under the rules of section 72 of the Code. They may also be eligible for the retirement income credit provided by section 37 of the Code.

Revenue Ruling 56–135, C.B. 1956–1, 56, held that the Panamanian social security benefit payments received by United States citizens were excludable from their gross income because the benefits were basically similar to the excludable sundry insurance benefit payments made to individuals under the U.S. social security system.

It is now the position of the Service that any similarity between the benefits provided by the social security system of the United States and those provided by the social security system of a foreign nation is not a valid basis for excluding from the gross income of the recipient, under the Federal income tax laws, the benefits paid by a foreign nation.

Pursuant to the authority of section 7805(b) of the Code, and effective with respect to Panamanian social security benefit payments received in taxable years commencing after December 31, 1965, Revenue Ruling 56–135, C.B. 1956–1, 56, is hereby revoked.

Treatment of "interest" portion of amounts repaid into the United States Civil Service Retirement and Disability Fund by reinstated employees. See Rev. Rul. 66–168, below.

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26 CFR 1.61–12: Income from discharge of indebtedness.

Effect of amortizable premiums and discounts on outstanding bonds on earnings and profits of a corporation. See Rev. Rul. 66–35, page 63.

PART II.—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

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

26 CFR 1.72–1: Introduction. Rev. Rul. 66–168
(Also Sections 61, 163; 1.61–11, 1.163–1.)

Federal Civil Service employees who resign sometimes withdraw amounts they have deposited in the United States Civil Service Retirement and Disability Fund (hereinafter referred to as the Fund). Should such an employee later re-enter Civil Service employment, he may elect to repay to the Fund the amount previously withdrawn. If he exercises this election, he is required, in addition, to pay a sum designated as "interest" on the redeposited amounts.

I.T. 3545, C.B. 1942–1, 49, holds that payments of the so-called "interest" described above are not deductible under section 23(b) of the Internal Revenue Code of 1939, predecessor of section 163 of the Internal Revenue Code of 1954, since they are not compensation for the use of borrowed money or for the forbearance of money legally due.

However, repaid deposits, and amounts paid as "interest", become a part of the employee's total retirement account. The total of these amounts combined with the employee's other deposits represent the consideration for his annuity. As part of the consideration for the annuity, the "interest" in question is excluded from the gross income of the annuitant in the manner and to the extent provided by section 72(b) or section 72(d) of the Code, whichever may be applicable.

Includibility in gross income of the social security benefit payments received under the social security system of the Federal Republic of Germany by individuals who are citizens of the United States or have been admitted to the United States for permanent residence. See Rev. Rul. 66–34, page 22.

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26 CFR 1.72–16: Life insurance contracts purchased under qualified employee plans. Rev. Rul. 66–138

Employee participants in a qualified employees' trust are not currently taxable on the amount of premiums paid for a group assurance indemnity policy purchased by the trustee to indemnify the trust against excessive payouts due to the deaths of participants.

The question has been raised as to whether premiums paid for a group assurance indemnity policy, under a qualified employees' retirement trust to indemnify the trust against excessive payouts due to deaths of participants, are taxable currently to the employees participating in the trust.

A corporation established a self-insured trusteed pension plan on behalf of its employees. Under the provisions of the plan the beneficiary of an employee with at least 5 years of service who dies while in the service is entitled to a death benefit equal to 100 times the monthly normal retirement benefit the deceased employee expected to receive at the normal retirement age. The death benefit is computed in accordance with a formula provided in the plan for this purpose.

A favorable determination was made by the District Director with respect to the qualification of the trust under section 401(a) of the Internal Revenue Code of 1954 and as to its exemption under section 501(a) of the Code.

Although the funds in the trust were calculated to be adequate to meet the death benefits under the plan, the trustee as a protective measure during the early years of the trust, purchased a group life insurance policy on the lives of the participants. Under the terms of the policy, if the trustees, during any policy year, are required to pay death benefits under the plan in excess of the amount of the trust assets at the commencement of that policy year the insurer will pay the amount of such excess to the trustees. No amount is payable on account of the death of an insured person under the policy unless and until aggregate death benefits under the plan in any policy year exceed the trust assets at the beginning of such policy year. Any amount payable under the policy is to be paid into the trust with no obligation on the part of the trustees to pay such amounts over to a specific or identifiable beneficiary or to any beneficiary.

Section 72(m) of the Code provides, in part, that where a life insurance contract is purchased by a trust described in section 401(a) which is exempt from tax under section 501(a), if the proceeds of such contract are payable directly or indirectly to a participant in such trust or to a beneficiary of such participant, the amount of any contribution to the trust, which is allowed as a deduction under section 404 of the Code, and any income of the trust which has been determined to have been applied to purchase the life insurance protection, is includible in the gross income of the participant for the taxable year when so applied.

Section 1.72–16 (a) and (b) of the Income Tax Regulations provides, in substance, that if a trust described in section 401(a) and exempt under section 501(a) of the Code purchases under the plan a contract providing life insurance protection payable upon the death of the employee participants and either the proceeds of the life insurance are payable to a beneficiary of the employee participant other than the trust, or if the proceeds are payable to the trust and the terms of the plan require the trustee to pay over all the proceeds to a beneficiary of the employee, then the portion of the premiums paid for life insurance protection provided under such contracts by employer contributions, or from trust earnings, will constitute currently taxable income to the participants in the year so paid to the extent provided

therein. However, as provided for under section 1.72–16(b)(6) of the regulations, the foregoing does not apply if the trust has a right under any circumstances to retain any part of the proceeds of the life insurance contract.

The insurance protection here considered, although based on the lives of the participants in the plan, does not offer life insurance protection, as such, for each member, individually. This is so because the proceeds under the policy are payable only when certain conditions are met, namely, when death benefits paid or payable under the trust exceed the trust funds at the beginning of the policy year. There may be individual cases of death where there would be no proceeds payable under the policy.

Further, under the contract of assurance the owner of the policy is the trust. Any and all proceeds payable at any time under the policy are payable only to and receivable by the trust. Neither title to nor interest in any such contract or policy of assurance can vest in any beneficiary or member under the plan or trust. Since all proceeds are commingled with other assets of the trust no beneficiary can be considered as having received any portion of the proceeds under the assurance policy.

In view of all of the foregoing, the premiums paid for the group assurance indemnity policy do not constitute taxable income to the employee participants in the plan and trust.

Bases upon which one-year term permiums may be computed for use in determining the amount required to be included in the income of an employee on account of current life insurance protection provided under qualified employee plans. See Rev. Rul. 66–110, page 12.

PART III.—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

SECTION 107.—RENTAL VALUE OF PARSONAGES

26 CFR 1.107–1: Rental value of parsonages. Rev. Rul. 66–90

Individuals holding executive positions in a religious denomination which has no formal ordination, commissioning, or licensing procedure, do not qualify as ministers of the gospel for purposes of section 107 of the Internal Revenue Code of 1954 even though they are employed to carry out functions normally performed by ministers of the gospel in other denominations. However, those individuals who have been recorded and invested with authority as ministers by their employing meeting do qualify for this exclusion.

Advice has been requested whether certain individuals holding executive positions in the religious denomination described below qualify as ministers of the gospel for purposes of section 107 of the Internal Revenue Code of 1954.

The religious denomination under consideration is organized on a congregational basis with authority for the most part residing in the local unit designated as the "monthly meeting." Several of these

units are linked together to form a "quarterly meeting," and the quarterly meetings in a region are organized into "yearly meetings." This denomination has no rituals, rubrics or programed religious service, its central act of worship consisting chiefly in communal prayer and meditation with any member being free to speak to those assembled if he is moved to do so. The customary role of the minister, therefore, does not exist insofar as the worship service is concerned. Some of the larger monthly meetings, however, do employ a full time "secretary" who is an executive performing functions similar to those performed by the minister in other denominations. For example, he assists in the operation of the Sunday School, visits the sick, advises the meeting's various committees, represents the meeting on the local council of churches, prepares a newsletter for the members of the meeting and speaks at interchurch gatherings explaining the beliefs of his particular denomination. The employment of the secretary is approved at a business session of the meeting and is recorded in its minutes. There is no ordination or other formal ceremony in connection with his employment and the secretary's tenure of office is on a year-to-year basis terminable at the will of either party.

At the level of the yearly meeting, there are offices providing a variety of services to the local monthly meetings. These offices publish educational materials, coordinate the operations of church schools and promote a variety of programs in the advancement of world peace, social service, and race relations. Administrators are employed at this level to perform functions similar to those carried out by administrators of other religious organizations and their integral agencies.

The denomination historically does not employ ordained ministers to perform these duties. However, certain local meetings do employ professional ministers for this purpose. These individuals, who have fulfilled all scholastic prerequisites for becoming professional ministers, are not officially ordained by any superior but are recorded as ministers in the minutes of the competent meeting. This recording is regarded by the denomination as being the equivalent of the ordination of a minister by other denominations and confers upon the individuals so recorded the right to exercise ministerial duties, such as performing marriages, if required to do so.

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.

Section 1.107–1(a) of the Income Tax Regulations provides, in part, that in order to qualify for the exclusion, the home or rental allowance must be provided as remuneration for services which are ordinarily the duties of a minister of the gospel and that, in general, the rules provided in section 1.1402(c)–5 of the regulations will be applicable to such determination.

Section 1.1402(c)–5(b)(2)(i) of the regulations states that whether services performed by a minister constitute the conduct of religious worship or the ministration of sacerdotal functions depends on the tenets and practices of the particular religious body constituting his church or church denomination.

The term "minister of the gospel" as used in section 107 of the Code

means an individual who is duly ordained, commissioned, or licensed to the pastoral ministry by action of a religious body constituting a church or church denomination and invested with the authority to conduct religious worship, to perform sacerdotal functions, and to administer ordinances or sacraments in accordance with the prescribed tenets and practices of such church or church denomination. In cases where a church or church denomination ordains some ministers of the gospel and licenses or commissions other ministers, in every respect the licensing or commissioning of an individual as a minister of the gospel must establish a status that is equivalent of ordination and is so recognized by the church. That is, the individual, upon being licensed or commissioned, must be invested with the status and authority of an ordained minister, fully qualified to exercise all of the ecclesiastical duties of such a minister in his denomination. See Rev. Rul. 65–124, C.B. 1965–1, 60. See also Revenue Ruling 59–270, C.B. 1959–2, 44, which holds that neither a "minister of music" nor a "minister of education" is entitled to the exclusion provided in section 107 of the Code. In each case, neither was an ordained minister of the gospel, although both performed services relating to the office and function of a minister of the gospel.

That holding may be contrasted with the position taken in Revenue Ruling 58–221, C.B. 1958–1, 53, where an exclusion under section 107 of the Code was permitted to an individual who was employed at a Jewish Community Center and Temple and whose duties constituted the conduct of religious worship or the ministration of sacerdotal functions according to the tenets and practices of the Jewish faith. The individual concerned, however, had been ordained by a theological seminary.

Many of the individuals holding executive positions in this denomination have been recorded as secretaries by the various meetings of that denomination for the period of their employment only, to serve primarily in a secular capacity. On the other hand, some of the individuals have been recorded as ministers by a meeting and invested with the authority to exercise ministerial duties. This latter recording is regarded by the denomination as the equivalent of ordination by other Protestant denominations.

Accordingly, individuals holding executive positions in a religious denomination which has no formal ordination, commissioning, or licensing procedure, do not qualify as ministers of the gospel for purposes of section 107 of the Code even though they are employed to carry out functions normally performed by ministers of the gospel in other denominations. However, those individuals who have been recorded and invested with authority as ministers by their employing meeting do qualify for this exclusion.

SECTION 116.—PARTIAL EXCLUSION OF DIVIDENDS RECEIVED BY INDIVIDUALS

26 CFR 1.116–1: Partial exclusion of dividends.

Dividends received by individuals as beneficiaries of estates and trusts. See Rev. Rul. 66–70, page 5.

SECTION 117.—SCHOLARSHIPS AND FELLOWSHIP GRANTS

26 CFR 1.117–4: Items not considered as scholarships or fellowship grants. (Also Section 61; 1.61–2.) Rev. Rul. 66–83

Stipends paid to an intern performing services for a social service agency, out of funds received by the agency from a foundation to finance an intern training program, are compensation for services rendered even though he is acquiring training and experience in the field of social work. Therefore, such stipends are includible in the gross income of the recipient under section 61 of the Internal Revenue Code of 1954 and not excludable as fellowship grants under section 117 of the Code.

Advice has been requested whether, under the circumstances described below, the stipends received by an intern of a social service agency are taxable to the recipient, or whether such amounts are excludable from gross income as fellowship grants.

A social service agency has received a grant from a foundation to provide funds for a training program for an intern in the field of community organization and intergroup relations. One purpose of the internship program is to provide the agency with additional staff members at no additional cost to the agency.

The taxpayer in the instant case was selected to serve a 1-year internship. He spends at least one-half of each day in "work experience" under the supervision of the regular staff of the agency, which work experience consists of normal work of the agency. The remainder of the day is spent in study, conferences, and report writing. With the exception of the salary scale, the taxpayer is subject to all the provisions of the rules regulating the agency's professional staff.

Section 117(a)(1)(B) of the Internal Revenue Code of 1954 excludes from gross income amounts received as fellowship grants. A fellowship grant as defined by section 1.117–3(c) of the Income Tax Regulations generally means an amount paid or allowed to, or for the benefit of, an individual to aid him in the pursuit of study or research. Section 1.117–4(c) of the regulations provides, in part, that amounts paid to an individual as compensation for past, present, or future employment services are not considered as fellowship grants for the purpose of section 117 of the Code.

Section 61(a) of the Code requires inclusion in gross income of all amounts received as compensation for services, including fees, commissions, and similar items.

Under the circumstances described above the intern is primarily performing services for the social service agency even though in the process he is acquiring training and experience in the field of community organization and intergroup relations. See Rev. Rul. 64–212, C.B. 1964–2, 39, and Rev. Rul. 64–213, C.B. 1964–2, 40. Therefore, stipends received by the taxpayer represent compensation for services rendered to the agency and are not amounts received as fellowship grants within the meaning of section 117 of the Code.

Accordingly, the stipends received by the taxpayer during the period of internship are includible in his gross income under section 61(a) of the Code and are not excludable as fellowship grants under section 117 of the Code.

PART V.—DEDUCTIONS FOR PERSONAL EXEMPTIONS

SECTION 151.—ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS

26 CFR 1.151–1: Deductions for personal exemptions.

Dependency exemption for an unrelated person who is temporarily absent from her principal place of abode because of illness. See Rev. Rul. 66–28, below.

SECTION 152.—DEPENDENT DEFINED

26 CFR 1.152–1: General definition of a dependent. Rev. Rul. 66–28

(Also Section 151; 1.151–1.)

An elderly woman who, because of illness requiring constant medical care, is indefinitely confined to a nursing home is considered to be temporarily absent from her principal place of abode during confinement, for the purpose of determining whether she qualifies as the taxpayer's dependent under section 152(a)(9) of the Internal Revenue Code of 1954.

Advice has been requested whether an individual who, because of illness requiring constant medical care, is indefinitely confined to a nursing home is considered to be temporarily absent from her principal place of abode during such confinement, for the purpose of determining whether she qualifies as the taxpayer's dependent under section 152(a)(9) of the Internal Revenue Code of 1954.

The individual concerned is an elderly woman, unrelated to the taxpayer, who had received her chief support from the taxpayer and had been a member of the taxpayer's household before becoming so ill that she required constant medical care and had to be placed in a nursing home. The woman was continuously confined to the nursing home for several years including the entire tax year under consideration and the nature of her illness was such that it appeared she might never return. The taxpayer paid all her expenses in the nursing home because she had no relatives or other source of support.

To qualify as a dependent under section 152(a)(9) of the Code, an individual must, for the taxable year of the taxpayer have as his or her principal place of abode the home of the taxpayer and be a member of the taxpayer's household.

According to section 1.152–1(b) of the Income Tax Regulations, subject to an exception which is not here pertinent, section 152(a)(9) of the Code applies to any individual who lives with the taxpayer and is a member of the taxpayer's household during the entire taxable year of the taxpayer. It is not necessary under section 152(a)(9) of the Code that the dependent be related to the taxpayer. It is necessary, however, that the taxpayer both maintain and occupy the household. The taxpayer and dependent will be considered as occupying the household for such entire taxable year notwithstanding temporary absences from the household due to special circumstances. Section 1.152–1(b)

of the regulations further provides that a nonpermanent failure to occupy the common abode by reason of illness, education, business, vacation, military service, or a custody agreement under which the dependent is absent for less than 6 months in the taxable year of the taxpayer, shall be considered temporary absence due to special circumstances.

An identical provision with respect to temporary absence due to special circumstances is contained in section 1.1-2(c)(1) of the regulations under the 1954 Code, relating to rates of tax on heads of households. Section 39.12-4(c) of Regulations 118 under the Internal Revenue Code of 1939, which also contains this same temporary absence provision, has been interpreted by the court in the case of *Walter J. Hein* v. *Commissioner*, 28 T.C. 826 (1957) Acquiescence, C.B. 1958-2, 6, to mean that the dependent's stay in a nursing home was a temporary absence due to special circumstances even though it appeared that the elderly lady would be unlikely to return to the taxpayer's household.

In view of the decision in the *Hein* case, a period of time during which a dependent is confined to a nursing home because of illness will likewise be considered a temporary absence due to special circumstances for the purpose of section 152(a)(9) of the Code, even though such absence is for an extended period of time. There must, of course, be an absence of an intent on the part of the taxpayer and the dependent to change the dependent's principal place of abode. The possibility or probability that death might intervene before the dependent returns to the taxpayer's household is not sufficient to make such absence permanent.

Accordingly, an elderly woman, who is indefinitely confined to a nursing home because of illness requiring constant medical care, is, during such confinement, considered to be temporarily absent from her principal place of abode, for the purpose of determining whether she qualifies as a dependent under section 152(a)(9) of the Code.

PART VI.—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

SECTION 162.—TRADE OR BUSINESS EXPENSES

26 CFR 1.162-1; Business expenses. Ct. D. 1907

INCOME TAX—INTERNAL REVENUE CODE OF 1954—DECISION OF SUPREME COURT OF THE UNITED STATES

1. LEGAL EXPENSES—CRIMINAL PROSECUTION—PUBLIC POLICY.

Legal expenses incurred by a taxpayer in the unsuccessful defense of a business-related criminal prosecution for violations of the Securities Act of 1933 and the mail fraud statute are deductible as ordinary and necessary business expenses under section 162(a) of the Internal Revenue Code of 1954.

2. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Second Circuit, 342 Fed. (2d) 690, affirmed.

SUPREME COURT OF THE UNITED STATES

No. 351—OCTOBER TERM, 1965

Commissioner of Internal Revenue, petitioner v. *Walter F. Tellier et ux.*

[383 U.S. 687]

On writ of certiorari to the United States Court of Appeals for the Second Circuit.

[March 24, 1966]

OPINION

MR. JUSTICE STEWART delivered the opinion of the Court.

The question presented in this case is whether expenses incurred by a taxpayer in the unsuccessful defense of a criminal prosecution may qualify for deduction from taxable income under section 162(a) of the Internal Revenue Code of 1954, which allows a deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *."[1] The respondent, Walter F. Tellier, was engaged in the business of underwriting the public sale of stock offerings and purchasing securities for resale to customers. In 1956 he was brought to trial upon a 36-count indictment that charged him with violating the fraud section of the Securities Act of 1933[2] and the mail fraud statute,[3] and with conspiring to violate those statutes.[4] He was found guilty on all counts and was sentenced to pay an $18,000 fine and to serve four and a half years in prison. The judgment of conviction was affirmed on appeal.[5] In his unsuccessful defense of this criminal prosecution, the respondent incurred and paid $22,964.20 in legal expenses in 1956. He claimed a deduction for that amount on his federal income tax return for that year. The Commissioner disallowed the deduction and was sustained by the Tax Court. T.C. Memo. 1963–212, 22 CCH Tax Ct. Memo. 1062. The Court of Appeals for the Second Circuit reversed in a unanimous *en banc* decision, 342 F. 2d 690, and we granted certiorari. 382 U.S. 808. We affirm the judgment of the Court of Appeals.

There can be no serious question that the payments deducted by the respondent were expenses of his securities business under the decisions of this Court, and the Commissioner does not contend otherwise. In *United States* v. *Gilmore*, 372 U.S. 39 [Ct. D. 1878, C.B. 1963–1, 355], we held that "the origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense was 'business' or 'personal' " within the meaning of section 162(a). 372 U.S., at 49. Cf. *Kornhauser* v. *United States*, 276 U.S. 145, 153 [T.D. 4222, C.B. VII–2, 267]; *Deputy* v. *duPont*, 308 U.S. 488, 494, 496 [Ct. D. 1435, C.B. 1940–1, 118]. The criminal charges against the respondent found their source in his business activities as a securities dealer. The respondent's legal fees, paid in defense against those charges, therefore clearly qualify under *Gilmore* as "expenses paid or incurred * * * in carrying on any trade or business" within the meaning of section 162(a).

The Commissioner also concedes that the respondent's legal expenses were "ordinary" and "necessary" expenses within the meaning of section 162(a). Our decisions have consistently construed the term "necessary" as imposing only the minimal requirement that the expense be "appropriate and helpful" for "the development of the [taxpayer's] business." *Welch* v. *Helvering*, 290 U.S. 111, 113 [Ct. D. 755, C.B. XII–2, 112]. Cf. *Kornhauser* v. *United States*, *supra*, at 152; *Lilly* v. *Commissioner*, 343 U.S. 90, 93–94 [Ct. D. 1741, C.B. 1952–1, 16]; *Commissioner* v. *Heininger*, 320 U.S. 467, 471 [Ct. D. 1596, C.B. 1944, 484]; *McCullough* v. *Maryland*, 4 Wheat. 316, 413–415. The principal function of the term "ordinary" in section 162(a) is to clarify the distinction, often difficult, between those expenses that are currently deductible and those that are in the nature of capital expenditures, which, if deductible at all, must be amortized over

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[1] "(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 * * *." 26 U.S.C. § 162.

[2] 48 Stat. 84, as amended, 15 U.S.C. § 77q(a).

[3] 18 U.S.C. § 1341.

[4] 18 U.S.C. § 371.

[5] *United States* v. *Tellier*, 255 F. 2d 441 (C.A. 2d Cir.).

the useful life of the asset. *Welch* v. *Helvering, supra,* at 113–116.[6] The legal expenses deducted by the respondent were not capital expenditures. They were incurred in his defense against charges of past criminal conduct, not in the acquisition of a capital asset. Our decisions establish that counsel fees comparable to those here involved are ordinary business expenses, even though a "lawsuit affecting the safety of a business may happen once in a lifetime." *Welch* v. *Helvering, supra,* at 114. *Kornhauser* v. *United States, supra,* at 152–153; cf. *Trust of Bingham* v. *Commissioner,* 325 U.S. 365, 376 [Ct. D. 1643, C.B. 1945, 103].[7]

It is therefore clear that the respondent's legal fees were deductible under section 162(a) if the provisions of that section are to be given their normal effect in this case. The Commissioner and the Tax Court determined, however, that even though the expenditures meet the literal requirements of section 162(a), their deduction must nevertheless be disallowed on the ground of public policy. That view finds considerable support in other administrative and judicial decisions.[8] It finds no support, however, in any regulation or statute or in any decision of this Court, and we believe no such "public policy" exception to the plain provisions of section 162(a) is warranted in the circumstances presented by this case.

We start with the proposition that the federal income tax is a tax on net income, not a sanction against wrongdoing. That principle has been firmly imbedded in the tax statute from the beginning. One familiar facet of the principle is the truism that the statute does not concern itself with the lawfulness of the income that it taxes. Income from a criminal enterprise is taxed at a rate no higher and no lower than income from more conventional sources. "[T]he fact that a business is unlawful [does not] exempt it from paying the taxes that if lawful it would have to pay." *United States* v. *Sullivan,* 274 U.S. 259, 263 [T.D. 4028, C.B. VI–2, 177]. See *James* v. *United States,* 366 U.S. 213 [Ct. D. 1863, C.B. 1961–2, 9].

With respect to deductions, the basic rule, with only a few limited and well-defined exceptions, is the same. During the Senate debate in 1913 on the bill that became the first modern income tax law, amendments were rejected that would have limited deductions for losses to those incurred in a "legitimate" or "lawful" trade or business. Senator Williams, who was in charge of the bill, stated on the floor of the Senate that

> "[T]he object of this bill is to tax a man's net income; that is to say, what he has at the end of the year after deducting from his receipts his expenditures or losses. It is not to reform men's moral characters; that is not the object of the bill at all. The tax is not levied for the purpose of restraining people from betting on horse races or upon 'futures,' but the tax is framed for the purpose of making a man pay upon his net income, his actual profit during the year. The law does not care where he got it from, so far as the tax is concerned, although the law may very properly care in another way." 50 Cong. Rec. 3849.[9]

The application of this principle is reflected in several decisions of this Court. As recently as *Commissioner* v. *Sullivan,* 356 U.S. 27 [Ct. D. 1821, C.B. 1958–1,506], we sustained the allowance of a deduction for rent and wages paid by the operators of a gambling enterprise, even though both the business itself and the specific rent and wage payments there in question were illegal under state

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[6] See Griswold, An Argument Against the Doctrine that Deductions Should Be Narrowly Construed as a Matter of Legislative Grace, 56 Harv. L. Rev. 1142, 1145; Wolfman, Professors and the "Ordinary and Necessary" Business Expense, 112 U. Pa. L. Rev. 1089, 1111–1112.

[7] See Brookes, Litigation Expenses and the Income Tax, 12 Tax L. Rev. 241.

[8] See *Sarah Backer,* 1 B.T.A. 214; *Norvin R. Lindheim,* 2 B.T.A. 229; *Thomas A. Joseph,* 26 T.C. 562; *Burroughs Bldg. Material Co.* v. *Commissioner,* 47 F. 2d 178 (C.A. 2d Cir.); *Commissioner* v. *Schwartz,* 232 F. 2d 94 (C.A. 5th Cir.); *Acker* v. *Commissioner,* 258 F. 2d 568 (C.A. 6th Cir.); *Bell* v. *Commissioner,* 320 F. 2d 953 (C.A. 8th Cir.); *Peckham* v. *Commissioner,* 327 F. 2d 855, 856 (C.A. 4th Cir.); *Port* v. *United States,* 163 F. Supp. 645 (Ct. Cl.). See also Note, Business Expenses, Disallowance, and Public Policy: Some Problems of Sanctioning with the Internal Revenue Code, 72 Yale L.J. 108; 4 Mertens, Law of Federal Income Taxation, sec. 25.49 ff. Compare *Longhorn Portland Cement Co.,* 3 T.C. 310; G.C.M. 24377, 1944 C.B. 93; Lamont, Controversial Aspects of Ordinary and Necessary Business Expense, 42 Taxes 808, 833–834.

[9] In challenging the amendments, Senator Williams also stated:

"In other words, you are going to count the man as having money which he has not got, because he has lost it in a way that you do not approve of." 50 Cong. Rec. 3850.

law. In rejecting the Commissioner's contention that the illegality of the enterprise required disallowance of the deduction, we held that, were we to "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." *Id.*, at 29. In *Lilly* v. *Commissioner*, 343 U.S. 90, the Court upheld deductions claimed by opticians for amounts paid to doctors who prescribed the eyeglasses that the opticians sold, although the Court was careful to disavow "approval of the business ethics or public policy involved in the payments * * *." 343 U.S., at 97. And in *Commissioner* v. *Heininger*, 320 U.S. 467, a case akin to the one before us, the Court upheld deductions claimed by a dentist for lawyer's fees and other expenses incurred in unsuccesfully defending against an administrative fraud order issued by the Postmaster General.

Deduction of expenses falling within the general definition of section 162(a) may, to be sure, be disallowed by specific legislation, since deductions "are a matter of grace and Congress can, of course, disallow them as it chooses." *Commissioner* v. *Sullivan*, 356 U.S., at 28.[10] The Court has also given effect to a precise and longstanding Treasury Regulation prohibiting the deduction of a specified category of expenditures; an example is lobbying expenses, whose nondeductibility was supported by considerations not here present. *Textile Mills Corp.* v. *Commissioner*, 314 U.S. 326 [Ct. D. 1532, C.B. 1941–2,200]; *Cammarano* v. *United States*, 358 U.S. 498 [Ct. D. 1835, C.B. 1959–1,666]. But where Congress has been wholly silent, it is only in extremely limited circumstances that the Court has countenanced exceptions to the general principle reflected in the *Sullivan*, *Lilly* and *Heininger* decisions. Only where the allowance of a deduction would "frustrate sharply defined national or state policies proscribing particular forms of conduct" have we upheld its disallowance. *Commissioner* v. *Heininger*, 320 U.S., at 473. Further, the "policies frustrated must be national or state policies evidenced by some *governmental* declaration of them." *Lilly* v. *Commissioner*, 343 U.S., at 97. (Emphasis added.) Finally, the "test of nondeductibility always is the severity and immediacy of the frustration resulting from allowance of the deduction." *Tank Truck Rentals* v. *Commissioner*, 356 U.S. 30, 35 [Ct. D. 1819, C.B. 1958–1,502]. In that case, as in *Hoover Express Co.* v. *United States*, 356 U.S. 38 [Ct. D. 1820, C.B. 1958–1,505], we upheld the disallowance of deductions claimed by taxpayers for fines and penalties imposed upon them for violating state penal statutes; to allow a deduction in those circumstances would have directly and substantially diluted the actual punishment imposed.

The present case falls far outside that sharply limited and carefully defined category. No public policy is offended when a man faced with serious criminal charges employs a lawyer to help in his defense. That is not "proscribed conduct." It is his constitutional right. *Chandler* v. *Fretag*, 348 U.S. 3. See *Gideon* v. *Wainwright*, 372 U.S. 335. In an adversary system of criminal justice, it is a basic of our public policy that a defendant in a criminal case have counsel to represent him.

Congress has authorized the imposition of severe punishment upon those found guilty of the serious criminal offenses with which the respondent was charged and of which he was convicted. But we can find no warrant for attaching to that punishment an additional financial burden that Congress has neither

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[10] Specific legislation denying deductions for payments that violate public policy is not unknown. *E.g.*, Internal Revenue Code of 1954, sec. 162(c) (disallowance of deduction for payments to officials and employees of foreign countries in circumstances where the payments would be illegal if federal laws were applicable; cf. Treas. Reg. sec. 1.162–18); sec. 165(d) (deduction for wagering losses limited to extent of wagering gains). See also Stabilization Act of 1942, § 5(a), 56 Stat. 767, 50 U.S.C.A. Appendix sec. 965(a), Defense Production Act of 1950, sec. 405(a), as amended, c. 275, sec. 104(i), 65 Stat. 136 (1951), 50 U.S.C.A. Appendix sec. 2105(a), and Defense Production Act of 1950, sec. 405(b), 64 Stat. 807, 50 U.S.C.A. Appendix sec. 2105(b) (general authority in President to prescribe extent to which payments violating price and wage regulations should be disregarded by government agencies, including the Internal Revenue Service; see Rev. Rul. 56–180, 1956–1 C.B. 94). Cf. Treas. Reg. sec. 1.162–1(a), which provides that "Penalty payments with respect to Federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income"; Joint Committee on Internal Revenue Taxation, Staff Study of Income Tax Treatment of Treble Damage Payments under the Antitrust Laws, Nov. 1, 1965, p. 16 (proposal that sec. 162 be amended to deny deductions for certain fines, penalties, treble damage payments, bribes, and kickbacks).

expressly nor implicitly directed.[11] To deny a deduction for expenses incurred in the unsuccessful defense of a criminal prosecution would impose such a burden in a measure dependent not on the seriousness of the offense or the actual sentence imposed by the court, but on the cost of the defense and the defendant's particular tax bracket. We decline to distort the income tax laws to serve a purpose for which they were neither intended nor designed by Congress.

The judgment is

Affirmed.

Ordinary and necessary expenses incurred for silvicultural practices in the cultivation, as a trade or business, of Christmas trees for sale when more than 6 years old. See Rev. Rul. 66–18, page 59.

Deduction of a guaranteed payment as defined in section 707(c) of the Code as a business expense. See Rev. Rul. 66–95, page 169.

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26 CFR 1.162–12: Expenses of farmers.

Deductibility of cost of upland cotton acreage allotment. See Rev. Rul. 66–58, page 186.

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26 CFR 1.162–13: Depositors' guaranty fund. Rev. Rul. 66–49

(Also Sections 451, 461; 1.451–2, 1.461–2.)

> The additional premium prepayments which an insured savings and loan institution is required to pay to the Federal Savings and Loan Insurance Corporation under the provisions of section 404 of the National Housing Act, as amended, are not deductible when paid and may be deducted only when any possibility of their return is precluded. With respect to an accrual basis institution, earnings on such premiums are not includible in the gross income of that institution until such time as the earnings are no longer available for losses of the FSLIC. With respect to a cash basis institution, earnings on such premiums are includible in the gross income of the institution credited therewith only when such earnings are used to pay its obligations or become available to that institution without substantial restriction or limitation.

Advice has been requested concerning (1) the deductibility, for Federal income tax purposes, of the additional insurance premiums paid by savings and loan institutions under section 404 of the National Housing Act, as amended by Public Law 87–210 (75 Stat. 482), 12 U.S.C. 1727, and (2) the time earnings on such premiums are includible in the gross incomes of such institutions.

Under section 404 of the National Housing Act, as amended, all institutions insured with the Federal Savings and Loan Insurance Corporation (FSLIC) are required to pay regular premium charges

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[11] Cf. Paul, The Use of Public Policy by the Commissioner in Disallowing Deductions, Proc. Tax Inst. Univ. S. Calif. School of Law 715, 730–731: "* * * Section 23(a)(1)(A) [the predecessor of sec. 162(a)] is not an essay in morality designed to encourage virtue and discourage sin. It 'was not contrived as an arm of the law to enforce State criminal statutes. * * *' Nor was it contrived to implement the various regulatory statutes which Congress has from time to time enacted. The provision is more modestly concerned with 'commercial net income'—a businessman's net accretion in wealth during the taxable year after due allowance for the operating costs of the business. * * * There is no evidence in the Section of an attempt to punish taxpayers * * * when the Commissioner feels that a state or federal statute has been flouted. The statute hardly operates 'in a vacuum,' if it serves its own vital function and leaves other problems to other statutes."

for such insurance (12 U.S.C. 1727(b)). They are also required to pay certain additional annual premiums, referred to as premium prepayments (12 U.S.C. 1727(d)) which may be suspended under certain circumstances (12 U.S.C. 1727(g)). These additional premiums, which are treated as assets of each institution by the Federal Home Loan Bank Board and the FSLIC, are recorded in a separate, or "secondary", reserve account and are available for the losses of the FSLIC only to the extent that the regular, or "primary", reserve is insufficient. Each institution's balance in the secondary reserve account is credited each year with a return, representing investment earnings on the prepayments, at a rate which is equal to the average annual rate of return on the FSLIC's investments (12 U.S.C. 1727(e)).

When the sum of the secondary and primary reserves of the FSLIC reaches a specified level, the requirement for additional premiums will be suspended (until the reserves drop to a lower specified level) and each institution's balance in the secondary reserve will be used to pay its regular annual premiums. When the primary reserve alone reaches a specified level, the requirement for payment of additional premiums will terminate and the balance, if any, of the secondary reserve will be distributed, in cash, to the insured institutions (12 U.S.C. 1727(g)). If an institution ceases to be insured for any reason, its balance in the secondary reserve of the FSLIC will be refunded to it (12 U.S.C. 1727(f)).

Under section 1.162–13 of the Income Tax Regulations a banking corporation is permitted to deduct from its gross income amounts, such as depositors' guaranty funds, which it is required by state law to set apart each year, provided that under the state law, no portion of the amounts thus set aside is returnable to the assets of the banking corporation.

It is the position of the Internal Revenue Service that prerequisites to deductibility similar to those set forth in section 1.162–13 of the regulations apply to contributions to this reserve fund.

The facts indicate that a savings and loan institution retains at all times an interest in the secondary reserve fund equal to the unexpended portion of its contributions thereto the amount of which is readily determinable and which is returnable to it, under specified circumstances. Accordingly, these additional payments are not deductible until they are used to pay regular premiums or losses, or the possibility of their return to the institutions is otherwise precluded.

Section 1.451–1 of the regulations sets forth the general rule dealing with the taxable year of inclusion. With respect to taxpayers operating under an accrual method of accounting, income is includible in gross income when all events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy, regardless of any limitations or restrictions on the actual receipt of such amounts.

With respect to accrual basis taxpayers, the facts indicate that all events which fix the right to receive an amount of income earned on an individual institution's balance in the secondary reserve do not occur when the amounts are credited because of their availability for losses of the FSLIC. Accordingly, earnings credited to such an institution's secondary reserve account are not includible in the gross

income of that institution until such time as the earnings are no longer available for losses of the FSLIC.

Section 1.451–2 of the regulations deals with the constructive receipt of income and is applicable in those situations where inclusion in gross income under the taxpayer's method of accounting is normally dependent upon actual receipt. This section provides, in general, that income credited to a taxpayer's account or set aside for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given, is income even though it is not actually reduced to possession. However, where there is a substantial restriction or limitation upon actual receipt of such amounts, they do not constitute income until their actual receipt or the removal of such restrictions or limitations.

With respect to cash basis taxpayers, the facts indicate that there exists a substantial restriction or limitation on withdrawal of amounts credited to an individual institution's secondary reserve account. Accordingly, earnings credited to such an institution's balance in the secondary reserve account are not includible in the gross income of that institution until they are used to pay its obligations, such as regular premiums of the institution due to the FSLIC, or until they become available to that institution without substantial restriction or limitation.

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26 CFR 1.162–17: Reporting and substantiation of certain business expenses of employees. (Also Section 274; 1.274–5.) — Rev. Rul. 66–78

Where an employer makes a payment to one employee to cover actual ordinary and necessary transportation and travel expenses to be incurred by several employees in respect of a particular business trip, such individuals need not report their allocable portion of the direct or indirect payment in their income tax returns provided (1) the employee receiving the money properly accounts to the employer, within the meaning of sections 1.162–17 and 1.274–5 of the Income Tax Regulations, by submitting the same detailed information that would have been required of each individual in the group had each submitted his own separate accounting to the employer, and (2) the total of such amount received directly or indirectly equals the total of the business transportation and travel expenses.

Simplified method for computing deductions for the costs of operating passenger automobiles for business purposes. See Rev. Proc. 66–10, page 622.

SECTION 163.—INTEREST

26 CFR 1.163–1: Interest deduction in general.

Treatment of "interest" portion of amounts repaid into the United States Civil Service Retirement and Disability Fund by reinstated employees. See Rev. Rul. 66–168, page 25.

SECTION 164.—TAXES

26 CFR 1.164–1 : Deduction for taxes. Rev. Rul. 66–29

The margin fee authorized under Republic Act No. 2609 of the Congress of the Philippines approved July 16, 1959, and charged by the Central Bank of the Philippines and its agent banks on the purchase of foreign currency is not a tax which is deductible under section 164 of the Internal Revenue Code of 1954.

Automobile used in trade or business by employees or self-employed individuals. See Rev. Proc. 66–10, page 622.

SECTION 165.—LOSSES

26 CFR 1.165–1: Losses.

Prepayment made for the purchase of natural gas under a "take-or-pay" contract which gas is not ultimately taken nor a refund made with respect thereto. See Rev. Rul. 66–64, page 97.

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26 CFR 1.165–7: Casualty losses. Rev. Rul. 66–9

The amount allowable as a deduction for a casualty loss due to destruction of timber by hurricane may not exceed the adjusted basis for determining loss from the sale or other disposition of the quantity of timber which by fair and reasonable estimates is found to be unfit for use because of the hurricane.

Advice has been requested concerning the amount allowable for a casualty loss due to destruction of timber by a hurricane.

A taxpayer owns several tracts of timberland which he holds for investment. Some of the tracts were acquired by gift or inheritance. The taxpayer acquired other tracts by occasional purchases and exchanges over a period of years. The timberland was not acquired for resale in the course of any business.

A hurricane destroyed or damaged some of the timber on five different tracts of the taxpayer's land. The damage included breakage and uprooting of standing timber varying in severity from tract to tract. Some of the damaged timber was salvaged and some of it was unfit for salvage.

Section 165(a) of the Internal Revenue Code of 1954 provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Under section 165(c)(2) of the Code in the case of an individual a deduction is allowed for losses incurred in any transaction entered into for profit.

Section 1.165–7 of the Income Tax Regulations outlines the manner of determining the amount of a casualty loss allowable as a deduction. Section 1.165-7(b) of the regulations provides:

(b) AMOUNT DEDUCTIBLE.—(1) GENERAL RULE.—In the case of any casualty loss whether or not incurred in a trade or business or in any transaction entered into for profit, the amount of loss to be taken into account for purposes of section 165(a) shall be the lesser of either—

(i) The amount which is equal to the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty; or

(ii) The amount of the adjusted basis prescribed in § 1.1011–1 for determining the loss from the sale or other disposition of the property involved.

However, if property used in a trade or business or held for the production of income is totally destroyed by casualty, and if the fair market value of such property immediately before the casualty is less than the adjusted basis of such property, the amount of the adjusted basis of such property shall be treated as the amount of the loss for purposes of section 165(a).

(2) AGGREGATION OF PROPERTY FOR COMPUTING LOSS.—(i) A loss incurred in a trade or business or in any transaction entered into for profit shall be determined under subparagraph (1) of this paragraph by reference to the single, identifiable property damaged or destroyed. * * *

In the case of a casualty loss to timber, the "property involved" and the "single, identifiable property" destroyed is the quantity of timber which is rendered unfit for use by reason of the casualty. The amount of the casualty loss allowable is limited to the adjusted basis prescribed in section 1.1011–1 of the regulations for determining the loss from the sale or other disposition of that quantity of timber. The adjusted basis of the quantity of timber destroyed is determined by multiplying the unit adjusted basis by the quantity of timber destroyed.

In *Oregon Mesabi Corporation* v. *Commissioner*, 39 B.T.A. 1033 (1939), acquiescence, C.B. 1944, 22, the United States Board of Tax Appeals (now the Tax Court of the United States) held that timber killed by a fire was not thereby made worthless. Deduction for loss was allowed for the quantity of timber found by fair and reasonable estimates to have been destroyed. The court pointed out that timber which may be salvaged is not destroyed, but will present the usual problems of depletion when it is salvaged.

Gain or loss from the sale or other disposition of the timber which was not destroyed by the hurricane should be determined by deducting at the time of sale or other disposition the adjusted basis of the quantity of timber involved from the amount received for that timber. The adjusted basis of the quantity of timber rendered worthless for practical purposes is allowable as a deduction for casualty loss by hurricane if the loss is not compensated for by insurance or otherwise.

Accordingly, the amount allowable as a deduction for casualty loss due to destruction of timber by hurricane may not exceed the adjusted basis for determining loss from the sale or other disposition of the quantity of timber which by fair and reasonable estimates is found to be unfit for use by reason of the hurricane. Such adjusted basis does not include any portion of the basis (or adjusted basis) attributable to the land, other improvements, or to any timber not rendered worthless by the hurricane.

Rev. Rul. 66–50

The question has been raised as to the proper method of computing the deductible casualty loss, under section 165(c)(3) of the Internal Revenue Code of 1954, where more than one item of nonbusiness personal property was lost or damaged in the casualty.

In the case of each casualty, the amount of loss to be taken into account is the lesser of either (1) an amount equal to the fair market

value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty or (2) the amount of the adjusted basis prescribed in section 1.1011–1 of the Income Tax Regulations for determining the loss from the sale or other disposition of the property involved.

Held, for purposes of determining a casualty loss with respect to nonbusiness personal property, the decrease in fair market value and the adjusted basis must be determined separately for each item claimed to have been lost or damaged in order to establish a separate loss for each item. These separate losses must then be combined to determine the amount of the deduction under section 165(c)(3) of the Code.

SECTION 166.—BAD DEBTS

26 CFR 1.166–4: Reserve for bad debts. Rev. Rul. 66–26 [1]

Guidelines for computing annual additions to reserves for bad debts by banks for taxable years ending after December 31, 1964. Revenue Ruling 65–92, C.B. 1965–1, 112, supplemented.

The purpose of this Revenue Ruling is to assist banks in computing their bad debt reserves under the provisions of Revenue Ruling 65–92, C.B. 1965–1, 112. There follows a series of guidelines which supplement Revenue Ruling 65–92, and which clarify many of the questions which have been raised concerning the application of the formula provided in that Ruling.

(1) With respect to the establishing of the bad debt reserve on the books, the reserve should be shown on the bank's books or records on a basis consistent with its income tax returns. However, it is not required that the reserve be actually placed on the books by the close of the year. Ordinarily the amounts deducted and the reserve shown in the returns should be shown on the books as soon as practicable after the close of the taxable year.

When an addition to the bad debt reserve as originally set up is adjusted or corrected upon audit in a later year, the revenue agent's adjustments should not be reflected for the year in which the audit is made, but should be reflected in the computation of the annual addition for the year to which such adjustments relate.

(2) Bad debts and recoveries on bad debts must be recorded in the reserve account except as hereinafter provided. Bad debts should be charged to the reserve for the year in which they occur, and recoveries on bad debts which have been previously charged against the reserve should be credited to the reserve for the taxable year of recovery.

Recoveries on bad debts which were charged off prior to the time that the bank adopted the reserve method should not be credited to the reserve, but should be treated as taxable income subject to the provisions of section 111 of the Internal Revenue Code of 1954.

(3) The term "net bad debts" as used in section 4 of Revenue Ruling 65–92 means all bad debts charged to the reserve account for the current taxable year less any recoveries realized during the current taxable year on bad debts charged to the reserve account in prior years.

(4) If, as a result of net recoveries during the taxable year, the

[1] Also released as Technical Information Release 794, dated Jan. 12, 1966.

reserve balance exceeds the prescribed limitations, a bank is not required to report the excess as taxable income. Any recoveries on bad debts previously charged to the reserve account must be credited to the reserve even though the limitations relating to the permissible amount of the reserve are exceeded. In such a case the excess over the otherwise permissible balance in the reserve account precludes current deductible additions to the reserve, and may affect future deductible additions.

Where a bank subject to section 4 of Revenue Ruling 65–92 (i.e., a bank with a reserve less than the 2.4-percent uniform ratio) has recoveries for the year which exceed bad debts for that year, the bank is not required to reduce its otherwise permissible current annual additions by the amount of the net recovery. The amount of the addition to the reserve is, however, subject to the applicable limitations prescribed in sections 4, 5, and 6 of the Ruling.

(5) Circumstances under which an addition in excess of 0.8 percent of eligible loans might be made to the reserve would exist if net bad debts charged to the reserve during the taxable year exceed the reserve balance as of the beginning of the taxable year. In such a case, an amount could be added which would result in a final balance of 0.8 percent of eligible loans, provided, however, that the limitations of section 4 of Revenue Ruling 65–92 are not exceeded.

(6) Concerning the meaning and application in section 4 of Revenue Ruling 65–92 of the term "end of the year preceding the year of change" as that term relates to increases in yearend outstanding loans, the term represents the base yearend date for determining any increases in yearend loan balances in future years. For example, a bank whose taxable year is the calendar year would have a base yearend of either:

1. December 31, 1964, in a situation where the bank was on the reserve method as of that date; or,

2. December 31, of the year preceding the year of change in method for a bank which changed from the specific chargeoff method to the reserve method of treating bad debts after December 31, 1964.

In the case of a newly organized bank, there would be no outstanding loan balance as of the end of the year preceding its first taxable year, and the loan balance base to be used for determining future increases in yearend outstanding loans would, therefore, be zero. Thus, in the case of a new bank whose first taxable year ends after December 31, 1964, there would be no reserve deficiency (as that term is used in Revenue Ruling 65–92) and the new bank would compute its annual reserve addition by including in such addition the amount of its net bad debts for the taxable year, plus 2.4 percent of the increase in its loans outstanding at the end of the year over the amount of its loans outstanding (zero) at the end of the year preceding its first taxable year. The foregoing amounts would represent the bank's tentative reserve addition subject to the limitations of section 4 (other than the one-tenth limitation) and the maximum limitations of section 6 of Revenue Ruling 65–92. (The term "newly organized bank" as used here does not include a bank organized as a result of a transaction to which section 381(a) of the Internal Revenue Code of 1954 applied.)

With respect to the application of the provisions of section 4 of Revenue Ruling 65–92 to a bank which changes from the specific chargeoff method to the reserve method of treating bad debts, the only factor which would distinguish that bank from one which was on the reserve method at December 31, 1964, would be the amount of the reserve deficiency which, in the case of the changing bank, would be a full 2.4 percent of its outstanding loans at the end of the year preceding the year of change.

(7) In order that a bank may add to its reserve an amount attributable to loan balance increases, the loan balance at the end of the year of the proposed reserve addition must exceed the total of (a) the amount of loans which were outstanding at the end of the year preceding the year of change, and (b) the amount of any outstanding loans with respect to which reserve additions for loan increases were taken in years prior to the year of the proposed addition. This limitation is illustrated as follows:

> Assume that a bank with a reserve less than the 2.4 percent ceiling had outstanding loans of $1,000,000 on December 31, 1964, had outstanding loans of $2,000,000 on December 31, 1965, and has outstanding loans of $1,750,000 on December 31, 1966. For 1965 the bank elected not to add to its reserve the full amount based upon the $1,000,000 increase in loans, but in making its reserve addition it took into account only 50 percent of the $1,000,000 increase ($500,000). In computing its reserve addition for 1966, the bank would be entitled to a reserve addition attributable only to outstanding loan increases of $250,000, since a reserve addition with respect to $500,000 of the $750,000 outstanding loan increase was taken in the year 1965.

(8) The order in which the factors which make up the annual reserve addition should be claimed is:

1. Net bad debts charged to the reserve;
2. An amount equal to one-tenth of the reserve deficiency; and,
3. An amount attributable to any increase in outstanding loans.

A bank is not required to take as a tax deduction its maximum permissible annual reserve addition for each taxable year, and unused portions of the above factors may be used in a subsequent year. The use of such portions in a later year would, however, be subject to the applicable limitations of Revenue Ruling 65–92 governing the amount of the reserve addition in such later year.

There is no requirement that the reserve deficiency be used up within a 10-year period. The one-tenth additions relating to the deficiency may be taken over a period in excess of 10 years.

(9) The maximum limitations in section 6 of Revenue Ruling 65–92 are overall limitations not to be exceeded under any circumstances. Section 6 would apply only in a situation where the proposed reserve addition as computed under either section 4 or 5 of Revenue Ruling 65–92 is greater than 0.8 percent of outstanding loans. If the reserve addition as determined under either section 4 or 5 of the Ruling is not greater than 0.8 percent of outstanding loans, section 6 of the Ruling is not applicable and the lesser amount must be used.

(10) Losses on worthless securities are not to be charged against the bad debt reserve for loans established under Revenue Ruling 65–92.

See G.C.M. 25605, C.B. 1948–1, 38, as modified by Revenue Ruling 65–92. Deductions for losses on securities may be taken either as specific bad debt losses or may be taken through the creation of a separate loss reserve on such securities established without respect to Revenue Ruling 65–92.

(11) Application for permission to change the method of treating bad debts must be made within 90 days after the beginning of the taxable year in which the taxpayer desires to make the change. (Section 1.446(e)(3) of the Income Tax Regulations.)

A bank is not required to adopt the reserve method of accounting for bad debts because of the permission granted it to do so; however, if it does not change, it would be necessary to again obtain permission if a change is desired in a subsequent year.

Revenue Ruling 65–92, C.B. 1965–1, 112, supplemented.

SECTION 167.—DEPRECIATION

26 CFR 1.167(a)–1: Depreciation in general.

Depreciation classification of floating or self-propelled drilling vessels and barges, platforms, and support vessels. See Rev. Proc. 66–18, page 646.

26 CFR 1.167(a)–2: Tangible property.

Depreciation of returnable glass bottles. See Rev. Proc. 66–7, page 617.

26 CFR 1.167(a)–3: Intangibles. Rev. Rul. 66–71

Expenditures for dredging to deepen that portion of a harbor alongside the taxpayer's pier leading to a navigable channel which are for improvements to land rights are expenditures for an intangible asset, not depreciable under section 167 of the Internal Revenue Code of 1954 when the useful life of such assets is not reasonably susceptible of measurement.

Advice has been requested whether the cost of work done to deepen a portion of a harbor alongside the taxpayer's pier leading to a navigable channel, for the purpose of making the pier more accessible to shipping vessels, creates an asset which may be depreciated under section 167 of the Internal Revenue Code of 1954. The taxpayer did not own the underlying land, the subject of the dredging operation, but was operating under permits issued by various governmental agencies for an indefinite period of time. The experience of the taxpayer indicated that silting was not a problem in this case.

Section 167 of the Code provides as follows:

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

Section 1.167(a)–2 of the Income Tax Regulations provides in part as follows:

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 stock in trade, or to land apart from improvements or physical development added to it. * * *

Section 1.167(a)–3 of the regulations, relating to depreciation allowances on intangible assets, provides in part as follows:

Intangibles.—If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. * * * An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. * * *

For Federal income tax purposes, no depreciation allowance may be made for exhaustion of assets, tangible or intangible, where no exhaustion susceptible of measurement is actually taking place. *General Equipment Co.* v. *Commissioner*, 2 B.T.A. 804 (1925).

In those instances where particular conditions, such as silting, require regular repeated dredging there may be, based on the particular facts and conditions as in the case of *Commodore's Point Terminal Co.* v. *Commissioner*, 18 B.T.A. 385 (1929), acquiescence, C.B. IX–2, 13 (1929), grounds for depreciating dredging costs. In the instant case, however, neither silting nor other factual conditions were present to demonstrate a wasting or exhausting of the asset.

In cases where land rights are in the form of easements or permits allowing the use of the land by the taxpayer for an indefinite period of time, improvements such as the dredging of harbors and channels are intangible assets of a capital nature the costs of which are not depreciable under section 167 of the Code and section 1.167(a)–3 of the regulations, unless the useful lives of such assets are reasonably susceptible of measurement.

The mere fact that the dredged harbor or channel is associated with a depreciable pier or wharf does not establish the useful life of the dredged channel since the dredging costs are normally independent of the pier in that the dredging costs will not ordinarly be reincurred with each replacement or reconstruction of the pier itself.

Accordingly, expenditures for dredging to deepen that portion of the harbor alongside the taxpayer's pier leading to a navigable channel which are for the improvements to land rights are expenditures for an intangible asset, not depreciable under section 167 of the Code when the useful life of the asset is not reasonably susceptible of measurement.

Rev. Rul. 66–140

A taxpayer purchased a franchise which entitled him to the exclusive right to sell the product of the *M* company in the State of *X* for a period of five years. Under the terms of the franchise, the taxpayer must complete at least two sales per year; failure to do so results in a

breach of the franchise contract. The franchise is automatically renewed without further cost on an annual basis provided a breach of the franchise contract does not occur.

Held, since the franchise contract provides for an indefinite succession of automatic renewals, subject to a possible breach, it is for an indefinite and unlimited period and its cost is not depreciable for Federal income tax purposes. *Westinghouse Broadcasting Company, Inc.* v. *Commissioner*, 309 Fed. (2d) 279 (1962). *Commissioner* v. *Indiana Broadcasting Corporation*, 350 Fed. (2d) 580 (1965).

Depreciation or amortization of cost of upland cotton acreage allotment. See Rev. Rul. 66–58, page 186.

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26 CFR 1.167(a)–7: Accounting for depreciable property. Rev. Rul. 66–111

> The basis of used real property such as a building ordinarily cannot be allocated into separate component accounts for the purpose of determining a composite life in computing depreciation allowances, but an overall useful life for the building must be determined on the basis of the building as a whole.

Advice has been requested whether the cost of used real property, mainly buildings, may be allocated to separate component units for the purpose of accounting for depreciable property under section 1.167(a)–7 of the Income Tax Regulations.

In the instant case, the taxpayer acquired an existing apartment building and land for a lump sum consideration. That part of the purchase price representing land value was allocated on the basis of recent sales of similar lands located in the general vicinity of the subject property. The taxpayer allocated that part of the purchase price representing investment in the apartment building to various component units, some of which would normally have a shorter useful life than the building as a whole. The allocation of the taxpayer's basis in the building was made in proportion to the relative construction costs of the components as determined by the original owner.

In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and nondepreciable property for a lump sum, as for example, buildings and land, the basis for depreciation cannot exceed an amount which bears the same proportion to the lump sum as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time. Section 1.167(a)–5 of the regulations.

Depreciable property may be accounted for by treating each individual item as an account, or by combining two or more assets in a single account. Assets may be grouped in an account in a variety of ways. Section 1.167(a)–7 of the regulations.

In the case of new property where the taxpayer is the first user, the actual costs of the separate components are generally known and where such costs have been allocated to component groups by personnel competent in design, construction and auditing procedures, and complete and accurate property ledgers are maintained, properly allocated costs

may be used by the original owner as a basis for depreciating the components separately, using an appropriate rate of depreciation for each of the separate components.

In the case of *Herbert Shainberg, et ux.* v. *Commissioner*, 33 T.C. 241 (1959), acquiescence, C.B. 1960–1, 5, the Tax Court of the United States permitted the taxpayer to allocate the actual costs of construction of new buildings in his shopping center into separate component group accounts, such as "structures," "wiring," "plumbing," "roof," "ceiling," and "flooring," for depreciation purposes.

When a used building is acquired for a lump sum consideration, separate components are not bought; a unified structure is purchased. The individual components of a used building are not sold separately and hence are not ordinarily subject to fair market value determinations for allocation of basis or for depreciation purposes. The value of components (ceilings, floors, electrical systems, etc.) of a used building cannot be separated from the value of the building as a whole since their values exist only in connection with the building as a whole. The original components in a new building bear a direct and known relationship to one another and to the total building cost; however, differing rates of depreciation for the components tend to distort this relationship with time. As a consequence, the new owners of a used building would not normally place the same relative values on components as the original known construction costs. Realistically, this difference in values is academic since the buyer and seller must only agree on an overall price for the unified structure.

In the case of *Louis Lesser and Jeanne Lesser, et al.*, v. *Commissioner*, 352 F. (2d) 789 (1965), the U.S. Court of Appeals for the Ninth Circuit, affirming the Tax Court, 42 T.C. 688 (1964), refused to accept as valid a composite rate for the useful life of a used building based on useful lives of its various components. The Court of Appeals stated: "The Tax Court found: 'The matter * * * is not susceptible of any precise mathematical solution.' We agree."

Accordingly, the basis of used real property, such as a building, ordinarily cannot be allocated into separate component accounts for the purpose of determining a composite life in computing depreciation allowances but an overall useful life for the building must be determined on the basis of the building as a whole.

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26 CFR 1.167(b)–0: Methods of computing depreciation.

Adoption of straight-line or other methods of depreciation for purposes of basis of depreciable assets held by a foreign corporation on the first day of its first taxable year beginning after December 31, 1962. See Rev. Rul. 66–19, page 178.

SECTION 170.—CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS

26 CFR 1.170–1: Charitable, etc., contributions and gifts; allowance of deduction. Rev. Rul. 66–10

Actual unreimbursed expenses incurred by an individual directly connected with and solely attributable to providing necessities such as lodging, food, and clothing to hurricane evacuees, referred to him by an organization described in section 170 of the Internal Revenue Code of 1954, are contributions within the meaning of section 170 of the Code and are deductible in computing taxable income.

Advice has been requested regarding the deductibility, for Federal income tax purposes, of expenses incurred by individuals, under the circumstances presented, in maintaining temporarily in their homes refugees made homeless by a hurricane.

The officials of a State which had suffered a hurricane disaster appealed to householders to open their homes to the thousands of people made homeless by the hurricane. The evacuees were advised to check at Centers set up by the Red Cross, Civil Defense, Salvation Army and the United States Office of Emergency Planning. Churches were urged to assist in the effort of finding temporary shelter for the displaced.

It is well established that contributions made directly to individuals, no matter how deserving, are not deductible as charitable contributions under section 170 of the Internal Revenue Code of 1954, and that contributions or gifts made to organizations qualifying under section 170 of the Code are not deductible if they are made for the benefit of designated beneficiaries.

In the instant situation, certain organizations assumed the responsibility of caring for evacuees during the emergency caused by the hurricane. Where taxpayers opened their homes for the use of the evacuees referred to them by organizations qualifying under section 170(c) of the Code, such householders are aiding the organizations in carrying out their charitable activities during the emergency.

Accordingly, actual unreimbursed out-of-pocket expenses incurred by a taxpayer which are directly connected with and solely attributable to providing necessities such as lodging, food, and clothing to hurricane evacuees referred to him by an organization described in section 170(c) of the Code during the emergency, are contributions or gifts for the use of such organization within the meaning of section 170 of the Code, and are deductible in the manner and to the extent provided by such section in computing his taxable income.

Qualifying organizations include those mentioned above, and persons or organizations acting on behalf of organizations described in section 170(c) of the Code. The term "actual unreimbursed out-of-pocket expenses" does not include allocation of the usual household costs such as rent, utilities, and similar items. The taxpayer should keep as detailed a record of expenditures as is reasonably possible under the circumstances in order to support the deductions claimed. See section 1.170–1(a)(3) of the Income Tax Regulations.

Rev. Rul. 66–79

Contributions to a domestic charity described in section 170(c)(2) of the Internal Revenue Code of 1954 which are solicited for a specific project of a foreign charitable organization are deductible under section 170 of the Code where the domestic charity has reviewed and approved the project as being in furtherance of its

own exempt purposes and has control and discretion as to the use of the contributions.

Revenue Ruling 63–252, C.B. 1963–2, 101, amplified.

The Internal Revenue Service has been requested to clarify Revenue Ruling 63–252, C.B. 1963–2, 101, with respect to the deductibility of contributions to a domestic charitable corporation which may solicit contributions for a specific project of a foreign charity in the manner presented below.

X corporation is a domestic charitable organization formed under the nonprofit laws of the state of *Y*. It is exempt from Federal income tax as being organized and operated exclusively for charitable, educational, and scientific purposes described in section 501(c)(3) of the Internal Revenue Code of 1954. Contributions to it are deductible since it is an organization described in section 170(c)(2) of the Code.

The corporation's charter provides, in part, that in furtherance of its educational, scientific, and charitable purposes it shall have the power to receive and allocate contributions, within the discretion of the board of directors, to any organization organized and operated exclusively for charitable or educational purposes within the meaning of section 501(c)(3) of the Code.

In contrast to the broad generality of the purposes stated in its charter, the name *X* corporation suggests a purpose to assist a named foreign organization. The individuals who organized *X* corporation had become interested in furthering the work of the named foreign organization, a corporation organized and operated in a foreign country exclusively for charitable, scientific, and educational purposes. The individuals concerned, who are United States citizens not acting on behalf of the foreign organization, did not wish *X* corporation to function simply as a fund raising medium for the foreign organization. Instead, they were interested in raising funds for specific projects, such as scientific research projects, to be carried out by the foreign organization, or individuals connected with the foreign organization, pursuant to grants previously reviewed and approved by the board of directors of *X* corporation.

The bylaws of *X* corporation provide, in part, that: (1) The making of grants and contributions and otherwise rendering financial assistance for the purposes expressed in the charter of the organization shall be within the exclusive power of the board of directors; (2) in furtherance of the organization's purposes, the board of directors shall have power to make grants to any organization organized and operated exclusively for charitable, scientific or educational purposes within the meaning of section 501(c)(3) of the Code; (3) the board of directors shall review all requests for funds from other organizations, shall require that such requests specify the use to which the funds will be put, and if the board of directors approves the request, shall authorize payment of such funds to the approved grantee; (4) the board of directors shall require that the grantees furnish a periodic accounting to show that the funds were expended for the purposes which were approved by the board of directors; and (5) the board of directors may, in its absolute discretion, refuse to make any grants or contributions or otherwise render financial assistance to or for any or all the purposes for which funds are requested.

The bylaws also provide that after the board of directors has approved a grant to another organization for a specific project or purpose, the corporation may solicit funds for the grant to the specifically approved project or purpose of the other organization. However, the board of directors shall at all times have the right to withdraw approval of the grant and use the funds for other charitable, scientific or educational purposes.

In accordance with the provisions of its charter and bylaws, *X* corporation at times solicits contributions which are to be used to provide grants to the foreign organization mentioned above, or to individuals connected with such foreign organization, for specific purposes approved by *X* corporation's board of directors in accordance with its bylaws. At all times all of the pertinent facts, including the fact that the board of directors may withdraw its approval of a particular grant even after it has been made, are available to any contributor not previously informed of such facts should the contributor so request either before or after a contribution has been made. The corporation refuses to accept contributions so earmarked that they must in any event go to the foreign organization.

Section 170(a) of the Code provides, in part, 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) of the Code defines a charitable contribution as meaning, in part, a contribution or gift to or for the use of a corporation, trust, or 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. However, the organization must be 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.

Revenue Ruling 63–252, C.B. 1963–2, 101, discusses the deductibility of contributions by individuals to a charity organized in the United States which thereafter transmits some or all of its funds to a foreign charitable organization. Example (4) of that ruling concerns a domestic organization described in section 170(c) of the Code which makes grants to a foreign organization for purposes which the domestic organization has reviewed and approved as in furtherance of its purposes. Contributions to the domestic organization are not earmarked in any manner for a foreign organization and the use of such contributions is subject to control by the domestic organization. For these reasons, the domestic organization is considered to be the recipient of such contributions within the meaning of section 170(c)(2) of the Code.

Under the provisions of its charter and bylaws, *X* corporation may make grants to any organization organized and operated exclusively for charitable, scientific, or educational purposes within the meaning of section 501(c)(3) of the Code. An organization described in that section can be either a domestic or a foreign organization. The operations of *X* corporation bring it within the purview of example (4) of Revenue Ruling 63–252 except for the manner in which it may solicit contributions for its foreign grants. This raises a question as to

whether the contributions are earmarked for the foreign organization so as to prohibit a deduction under section 170 of the Code.

Revenue Ruling 62–113, C.B. 1962–2, 10, holds that where gifts to an organization described in section 170(c) of the Code are not earmarked by the donor for a particular individual, the deduction will be allowable where it is established that a gift is intended by the donor for the use of the organization and not as a gift to an individual for whose benefit the amount given may be used by the donee organization. The test in each case is whether the organization has full control of the donated funds, and discretion as to their use, so as to insure that they will be used to carry out its functions and purposes.

In the instant case the domestic corporation may only solicit for specific grants when it has reviewed and approved them as being in furtherance of its purposes. Furthermore, under the terms of its bylaws the domestic corporation may make such solicitations only on the condition that it shall have control and discretion as to the use of the contributions received by it. Therefore, contributions received by the domestic organization from such solicitations are regarded as for the use of the domestic corporation and not for the organization receiving the grant from the domestic organization.

Accordingly, contributions paid to the domestic organization under the circumstances described above are deductible, for Federal income tax purposes, in the manner and to the extent provided by section 170 of the Code.

Revenue Ruling 63–252 is hereby amplified.

(Also Section 1.170–2.) Rev. Rul. 66–100 [1]

The Internal Revenue Service discusses the rules which may be relied upon in determining whether a contribution made by an individual will qualify as a gift to a "publicly supported" organization for purposes of section 170 of the Internal Revenue Code of 1954.

Proposed Income Tax Regulations, relating, among other things, to the determination of whether an organization is "publicly supported" for purposes of the additional deduction not to exceed 10 percent of adjusted gross income for charitable contributions of an individual, were published in the Federal Register for November 10, 1965 (30 F.R. 14158). The rules set forth in these proposed regulations differ in certain respects from the provisions set forth in the following paragraphs.

Until such time as the final regulations have been adopted, taxpayers may rely upon either the provisions of the proposed regulations or the provisions set forth in this Revenue Ruling (previously announced in Technical Information Release No. 667, Announcement 65–9, I.R.B. 1965–4, 49) in determining whether a contribution made by an individual will qualify as a gift to a "publicly supported" organization for purposes of section 170 of the Internal Revenue Code of 1954.

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[1] Based on Technical Information Release 667, dated Dec. 21, 1964, published as Announcement 65–9, I.R.B. 1965–4, page 49; and on Technical Information Release 782, dated Dec. 1, 1965.

Under the provisions of the Revenue Act of 1964, Public Law 88–272, C.B. 1964–1 (Part 2), 6, "publicly supported" organizations qualify as "30 percent organizations." Charitable contributions by an individual to a "publicly supported" organization, as is the case with respect to gifts to other types of "30 percent organizations," generally may be deducted to the extent that such contributions do not exceed 30 percent of the donor's adjusted gross income. Contributions to privately supported organizations are normally subject to a 20 percent limitation.

Gifts to "30 percent organizations" by an individual which exceed 30 percent of his adjusted gross income generally may be carried over and deducted in later years under the "carryover" provision in section 170(b)(5) of the Code as added by the Revenue Act of 1964.

Section 170 of the Code contains a limitation which allows individual taxpayers a charitable deduction of up to 20 percent of their adjusted gross income (computed without regard to any net operating loss carryback) for contributions made to or for the use of certain organizations, known as "20 percent organizations," including, among others, organizations organized and operated exclusively for religious, charitable, educational, etc., purposes, and to the United States, a State, or a local governmental unit if the contribution is made for exclusively public purposes.

Prior to the Revenue Act of 1964, a deduction limited to an additional 10 percent of adjusted gross income (computed without regard to any net operating loss carryback) was also allowable in the case of contributions made to certain other organizations, known as "30 percent organizations," including churches, or conventions or associations of churches, certain educational organizations, hospitals, certain medical research organizations, and certain organizations affiliated with State colleges or universities. The Revenue Act of 1964 continued this provision and expanded the group of "30 percent organizations" to include organizations which normally receive a substantial part of their support from a governmental unit or from direct or indirect contributions from the general public. See section 170(b)(1)(A)(vi) of the Code.

Contributions to "30 percent organizations" by individuals generally are deductible to the extent that such contributions, when added to deductible contributions to "20 percent organizations," do not exceed 30 percent of the donor's adjusted gross income. For example, if a taxpayer makes a contribution which equals 18 percent of his adjusted gross income to an organization in the 20 percent group and makes an additional contribution which equals 12 percent of his adjusted gross income to an organization in the 30 percent group, both contributions are fully deductible.

In addition, contributions to organizations in the 30 percent group in excess of 30 percent of the donor's adjusted gross income generally may be carried over and deducted in a later year under section 170(b)(5) of the Code. However, such carryover is available only if the contributions to organizations in the 30 percent group alone exceed 30 percent of the taxpayer's adjusted gross income without considering contributions to organizations in the 20 percent group. Furthermore, contributions to organizations in the 30 percent group are "quali-

fied contributions" under the new provisions dealing with the unlimited charitable contribution deduction which also were added by the Revenue Act of 1964.

In determining whether an organization is "publicly supported," the term "support" not only includes contributions received by the organization, but also includes investment income, such as interest, rents, royalties, dividends, and capital gains, and net income from related and unrelated business activities. However, in determining the amount of any capital gain to be included in support, the organization should use as its basis the fair market value of any contributed property at the time of its contribution. "Support" does not include any income from the exercise or performance by an organization of its charitable, educational, or other purpose or function constituting the basis of its exemption under section 501(a) of the Code, such as fees charged for admission to a museum.

Whether or not an organization receives a "substantial" part of its support from the sources required by the statute depends upon the facts and circumstances in each case. The term "substantial" is used in many places in the tax law and its meaning in one section is not necessarily applicable in other sections. However, an organization will be considered to be one which normally receives a substantial part of its support from donations by a governmental unit, from donations made directly or indirectly by the general public, or from donations from a combination of these sources, if such organization received one-third or more of its support for each of three out of its last four taxable years ending prior to July 1, 1964, from such sources. Indirect contributions from the general public includes contributions from other "publicly supported" organizations, such as a United Givers Fund.

The requirement that the support be received from the general public means that such support must be received from a wide segment of the public, and not solely from a few individuals or families. Therefore, contributions by any individual, trust, or corporation shall be taken into account in determining whether the one-third of support test is met only to the extent that such contributions do not exceed 1 percent of the organization's total support. In applying this 1 percent limitation, all contributions made by a donor and a related person within the meaning of section 267(b) of the Code shall be treated as made by one person. The 1 percent limitation does not apply to contributions from governmental units or from other "publicly supported" organizations.

The application of these rules may be illustrated by the following example:

In 1963, *X*, an organization referred to in section 170(c)(2) of the Code received total support of $50,000 from the following sources:

Investment income		$30,000
Contributions:		
100 gifts, each of less than $500	$15,000	
4 gifts of $750 each	3,000	
1 gift of $2,000	2,000	
Total contributions		20,000
Total support of *X*		50,000

The amount of support which X received from the general public may be computed by adding the following: (1) Since none of the 100 gifts exceeds 1 percent of total support, the full amount of such gifts ($15,000); (2) the portion of each $750 gift which does not exceed 1 percent of total support ($50,000 x 1%=$500; $500 x 4=$2,000); and (3) the portion of the $2,000 gift which does not exceed 1 percent of total support ($500). The total contribution from the general public would be $17,500 ($15,000 plus $2,000 plus $500). Since this amount exceeds one-third of X's total support, X will be considered to have received a substantial part of its support from the general public for 1963.

The guides set forth above are not exclusive, and a donor may be able to establish, on the basis of all the facts and circumstances, that an organization to which he has contributed is a "publicly supported" organization.

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26 CFR 1.170–2: Charitable deductions by individuals; limitations.

For guides in determining whether a contribution made by an individual will qualify as a gift to a "publicly supported" organization for purposes of section 170 of the Code. See Rev. Rul. 66–100, page 51.

SECTION 172.—NET OPERATING LOSS DEDUCTION

26 CFR 1.172–1: Net operating loss deduction. (Also Section 1502; 1.1502–31.) Rev. Rul. 66–91

S corporation was a wholly-owned subsidiary of P corporation until December 31, 1961. In 1961 S corporation had taxable income which was included in a consolidated return filed for the calendar year by P corporation. This return showed a consolidated net operating loss. On January 1, 1962, S corporation severed its affiliation with P corporation and for the calendar years 1962 and 1963 S corporation filed separate income tax returns showing taxable income. For the calendar year 1964, S corporation sustained a net operating loss which was reflected on the separate tax return which it filed for that year. No adjustments were required under section 172(d) of the Internal Revenue Code of 1954. *Held*, that in determining the net operating loss deduction for the years 1962 and 1963, no portion of the net operating loss sustained by S corporation in 1964 is required to be carried back to 1961 since there was no consolidated taxable income for 1961.

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26 CFR 1.172–11: Election with respect to portion of net operating loss attributable to foreign expropriation loss. Rev. Rul. 66–169

Y corporation, in a taxable year ending after December 31, 1958, and before January 1, 1964, sustained a foreign expropriation loss (as defined in section 172(k) of the Internal Revenue Code of 1954). Subsequently, all of Y's assets were distributed to X corporation in a

complete liquidation qualifying under section 332(a) of the Code. On or before December 31, 1965, *X* filed an election to carry over for 10-years the net operating loss sustained by *Y* pursuant to section 172(b)(3)(C)(iii) of the Code and section 1.172–11(c)(2) of the Income Tax Regulations.

Held, for purposes of section 172(b)(3)(C)(iii) of the Code as amended by section 210 of the Revenue Act of 1964, Public Law 88–272, C.B. 1964–1 (Part 2), 6, *X* was entitled to make the election for the 10-year carryover of the foreign expropriation loss, provided for in section 172(b)(1)(D) of the Code. The provisions of section 172(b)(3)(D) of the Code apply to the distributor corporation.

SECTION 174.—RESEARCH AND EXPERIMENTAL EXPENDITURES

26 CFR 1.174–2: Definition of research and experimental expenditures. Rev. Rul. 66–30

Expenses paid or incurred by a taxpayer in obtaining foreign patents on inventions covered by United States patents and patent applications developed and owned by other persons are not deductible under section 174(a) of the Internal Revenue Code of 1954 as research or experimental expenditures.

Advice has been requested whether a taxpayer may deduct, under section 174(a) of the Internal Revenue Code of 1954, relating to research and experimental expenditures, amounts spent in obtaining foreign patents on inventions covered by United States patents and patent applications owned and developed by persons other than the taxpayer.

The taxpayer in this case enters into agreements with holders of United States patents and patent applications giving to the taxpayer the right to obtain and exploit the foreign rights in the inventions owned by the other parties to the agreements. The taxpayer and the owner of the United States patent share equally in any funds collected from licensees in foreign countries or otherwise derived from the exploitation of the foreign patents.

The taxpayer applies for and obtains foreign patents and rights in its own name and not in the name of or as licensee of the owner of the United States patents. The patents are acquired for the purpose of commercializing the inventions in foreign countries through licensees and not for purpose of resale.

All expenses in connection with the foreign patents are paid for by the taxpayer. These expenses include costs of preparing foreign translations of specifications and claims, costs of formal drawings and certified copies of United States patents and patent applications, legal fees, filing fees, and taxes.

Section 174(a) of the Code allows a deduction for research and experimental expenditures paid or incurred by a taxpayer in connection with his trade or business. The issue in this case is whether the expenditures of the taxpayer are research or experimental expenditures.

Section 1.174–2 of the Income Tax Regulations provides, in part, as follows:

(a) IN GENERAL.—(1) The term "research or experimental expenditures", as used in section 174, means expenditures incurred in connection with the taxpayer's trade or business which represent research and development costs in the experimental or laboratory sense. The term includes generally all such costs incident to the development of an experimental or pilot model, a plant process, a product, a formula, an invention, or similar property, and the improvement of already existing property of the type mentioned. The term does not include expenditures such as those for the ordinary testing or inspection of materials or products for quality control or those for efficiency surveys, management studies, consumer surveys, advertising, or promotion. However, the term includes the cost of obtaining a patent, such as attorneys' fees expended in making and perfecting a patent application. On the other hand, the term does not include the costs of acquiring another's patent, model, production or process.

While this definition includes the costs of obtaining a patent, such costs are included only in connection with inventions or improvements from research and development in the experimental or laboratory sense undertaken directly by the taxpayer or carried on in his behalf by another person or organization. The expenses incurred in this case do not differ for purposes of the question presented from the costs of acquiring the patents of others.

Accordingly, expenditures paid or incurred by a taxpayer in obtaining foreign patents on inventions covered by United States patents and patent applications owned by other persons may not be deducted as research or experimental expenditures under section 174(a) of the Code.

SECTION 182.—EXPENDITURES BY FARMERS FOR CLEARING LAND

26 CFR 1.182–6: Election to deduct land clearing expenditures. Rev. Rul. 66–141

(Also Sections 702, 703; 1.702–1, 1.703–1.)

In the case of a partnership engaged in the business of farming, the election to deduct expenditures for clearing land provided by section 182 of the Internal Revenue Code of 1954 must be made by the partnership in the manner provided in section 1.182–6 of the Income Tax Regulations. See section 703(b) of the Code.

In accordance with the election made by the partnership each partner must take into account separately his distributive share of the partnership's expenditures for clearing land and his distributive share of each item of income, gain, loss or deduction required in computing "taxable income derived from farming" as defined in section 182(b) of the Code.

In applying the limitation imposed by section 182(b) of the Code, a partner who has also elected to deduct his own separate expenditures for clearing land which he farms as a sole proprietor must aggregate: (1) the amount of his separate "taxable income derived from farming" and his share of the partnership's "taxable income derived from farming"; and (2) his separate expenditures for clearing land and his distributive share of the partnership's expenditures for clearing land.

PART VII.—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

SECTION 213.—MEDICAL, DENTAL, ETC., EXPENSES

26 CFR 1.213–1: Medical, dental, etc., expenses. Rev. Rul. 66–80

The cost of hand controls and other equipment specially adapted to permit the operation or use of an automobile by a physically handicapped individual, and the cost of a mechanical device used to lift and place such a handicapped individual in an automobile, are medical expenses under section 213 of the Internal Revenue Code of 1954.

The costs of operating the automobile by such an individual, as a means of transportation that is not primarily for and essential to medical care, are not medical expenses for purposes of section 213 of the Code.

Advice has been requested whether the cost of certain equipment especially adapted for use in connection with automobile transportation by physically handicapped individuals and the cost of operating the automobile are deductible as medical expenses for Federal income tax purposes.

Section 213 of the Internal Revenue Code of 1954 provides, in part, that there shall be allowed as a deduction in computing taxable income, 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 within the limitations prescribed by that section. For the purposes of section 213 of the Code, the term "medical care" to the extent pertinent here 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, or for transportation primarily for and essential to medical care.

Section 1.213–1(e)(1)(ii) of the Income Tax Regulations provides, in part, that deductions for expenditures for medical care allowable under section 213 of the Code will be confined strictly to expenses incurred primarily for the prevention or alleviation of a physical or mental defect or illness.

Section 1.213–1(e)(1)(iii) of the regulations provides that a capital expenditure which is related only to the sick person, and is not related to permanent improvement or betterment of property, if it otherwise qualifies as an expenditure for medical care, shall be deductible. For example, an expenditure for crutches, or an inclinator which is detachable from the property and purchased only for the use of a sick person, is deductible. Such items and others named in section 1.213–1(e)(1)(iii) of the regulations are not, however, intended to be all inclusive. Revenue Ruling 58–8, C.B. 1958–1, 154, holds that the cost of an "autoette" or a wheelchair, used primarily for the alleviation of the individual's sickness or disability, is a medical expense and deductible under section 213 of the Code.

Hand controls and other equipment specially adapted to permit the operation or use of an automobile by a physically handicapped individual and a mechanical device used to lift and place such a

handicapped individual in an automobile are devices of the type described in section 1.213–1(e)(1)(iii) of the regulations.

Accordingly, the costs thereof are medical expenses within the meaning of section 213 of the Code and are deductible in computing taxable income within the limitations of that section.

However, irrespective of the physical condition of the individual, the costs of operating the automobile, as a means of transportation that is not primarily for and essential to medical care, are not allowable medical expense deductions within the limitations of section 213 of the Code. For example, costs of commuting to or from the individual's place of business or employment are nondeductible personal expenses. See item 3 of Revenue Ruling 55–261, C.B. 1955–1, 307, at page 309.

PART VIII.—SPECIAL DEDUCTIONS FOR CORPORATIONS

SECTION 243.—DIVIDENDS RECEIVED BY CORPORATIONS

26 CFR 1.243–1: Deduction for dividends received by corporations. Rev. Rul. 66–72

(Also Sections 671, 676; 1.671–4, 1.676(a)–1.)

> Where a trust empowers the corporate grantor to revest title to stock in the grantor, dividends received on such stock are considered as received by the corporate grantor and such grantor is eligible for the dividends received deduction provided in section 243 of the Internal Revenue Code of 1954.

Advice has been requested whether a corporation is eligible for the dividends received deduction, in accordance with section 243 of the Internal Revenue Code of 1954, under the circumstances described below.

Three directors or officers of *X* corporation, using assets of *X*, acquired on its behalf all of the stock of *Y* corporation. The same three individuals then executed a trust indenture declaring themselves trustees of *Y* corporation stock. Under the trust indenture the trustees vote the stock and hold the stock on the condition that all dividends received are payable directly to *X* to be used in *X*'s business as its own funds or to be distributed as dividends by *X* to its stockholders.

The trust is to last for a period of 30 years after the death of the last trustee at which time the stock of *Y* is to be distributed ratably to the then stockholders of *X*. However, at any time before the end of such period, the board of directors of *X* may require the trustees to sell the stock of *Y* and distribute the proceeds as directed by such board of directors.

Section 676(a) of the Code provides the general rule that the grantor of a trust shall be treated as the owner of any portion of the trust if at any time the power to revest in the grantor title to such portion is exercisable by the grantor.

In the instant case *X* corporation has retained power to retake the trust principal at any time. The income of the trust belongs to *X*. It

is concluded, therefore, that the trust is a revocable trust within the meaning of section 676(a) of the Code. *X*, in substance, is the grantor.

Items of income, deductions and credits attributable to any portion of the trust which are treated as owned by the grantor are taken into account for income tax purposes on the income tax return of the grantor. Such items should not be reported by the trust on Form 1041, U.S. Fiduciary Income Tax Return (for Estates and Trusts), but should be shown on a separate statement to be attached to that Form (section 1.671–4 of the Income Tax Regulations).

Accordingly, dividends received from stock held by the trust are considered as received by *X* and are, therefore, eligible for the dividends received deduction provided in section 243 of the Code.

PART IX.—ITEMS NOT DEDUCTIBLE

SECTION 263.—CAPITAL EXPENDITURES

26 CFR 1.263(a)–1: Capital expenditures; in general. Rev. Rul. 66–18

(Also Sections 162, 611; 1.162–1, 1.611–3.)

> In connection with the cultivation, as a trade or business, of Christmas trees for purposes of sale when they are more than six years old, the expenditures incurred for planting, basal pruning, stump culture and shearing must be capitalized. Expenditures incurred for silvicultural practices, such as weeding, or cleaning, and noncommercial thinning are deductible as ordinary and necessary trade or business expenses. The cost of land improvements is capitalized in the land account or depreciated, depending on whether the useful life of such improvements is determinable. The cost of equipment purchased and other depreciable assets, such as culverts and fences, should be capitalized and recovered through the allowance for depreciation.

Advice has been requested relative to the Federal income tax treatment of certain expenditures incurred in connection with the cultivation of Christmas trees as a trade or business.

The taxpayer grows and sells Christmas trees. In some areas he plants the trees, in other areas he cultivates and cuts trees that have been naturally seeded. The taxpayer in all instances sells only those trees more than six years old, whether planted or naturally seeded trees. In planting seedlings, the taxpayer usually prepares the land prior to the actual planting. However, there are instances when the seedlings may be planted in one year and competing hardwood brush removed a year or two later to prevent suppression of seedlings.

In connection with the cultivation of both planted and naturally seeded trees, the taxpayer incurs certain expenditures before the cutting of such trees; for example, expenditures for basal pruning, stump culture, shearing and silvicultural practices, such as weeding, or cleaning, and noncommercial thinning. Basal pruning involves the removal of the lower limbs to stimulate heavier growth on the remainder of the top portion of the tree. It is more commonly applied in natural stands and in many cases makes a marketable tree of one which otherwise would be too thin at the top. Stump culture involves careful

pruning of the stump to promote the growth of additional trees from the same stump. Hormones are sometimes used on the stump to stimulate sprouting. The pruning operation may be repeated each time a tree is cut from the stump. Shearing is a practice in which the terminal leader and the side branches are pruned to shape the tree. It is done primarily in planted stands and is usually done more than once to improve the shape and proportions of the tree.

Weeding, or cleaning, is a silvicultural operation employed in young established stands to free small trees from weeds, vines, etc., and to provide better growing conditions by liberating crop trees from other trees of a similar age but of less desirable species. It is sometimes done, especially in plantations, by cultivating between the rows or sometimes by spraying with selective herbicides. Noncommercial thinning is the removal of excess trees in immature stands to give the remaining trees room to grow.

In addition to the above, the taxpayer incurs other expenditures for road grading, ditching, fire breaks, culverts and fences.

The general rules regarding capital expenditures, as set forth in section 1.446–1(a)(4) (ii) and (iii) of the Income Tax Regulations, provide (1) that expenditures shall be properly classified as between capital and expense and (2) that in any case in which there is allowable with respect to an asset a deduction for depreciation, amortization, or depletion, any expenditure (other than ordinary repairs) made to restore the asset or to prolong its useful life shall be added to the asset account.

Section 1.263(a)–1 (a) and (b) of the regulations provides, in part, that no deduction shall be allowed for amounts paid or incurred to add to the value, or substantially prolong the useful life, of property owned by the taxpayer, or to adapt property to a new or different use.

Therefore, in general, it may be said that expenditures, paid or incurred in the business of growing Christmas trees for purposes of sale when they are more than six years old, must be capitalized when they (1) are for the acquisition of property having a useful life of more than one year; (2) add to the value of property owned by the taxpayer; (3) prolong the useful life of property owned by the taxpayer; or (4) adapt property to a new or different use.

Such capital expenditures are to be treated in one of the following ways: (1) As an increase in the basis of the trees, recoverable through allowance for depletion as the trees are cut or as adjusted basis if the standing trees are sold; or (2) as part of the cost of depreciable property, recoverable through allowance for depreciation as provided in section 167 of the Internal Revenue Code of 1954; or (3) as not subject to depletion or depreciation.

Section 1.162–1(a) of the regulations provides that the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or credit under provisions of the law other than section 162 of the Code, may be deducted from gross income as business expenses.

Section 1.611–3(a) of the regulations provides that amounts paid or incurred in connection with the planting of timber (including planting

for Christmas tree purposes) shall be capitalized and recoverable through depletion allowances.

Revenue Ruling 55–252, C.B. 1955–1, 319, holds that direct costs incurred in connection with reforestation by planting are capital expenditures. The ruling enumerates the following planting costs: (a) Preparation of the site, including any girdling or brush removal work to afford good growing conditions; (b) cost of seedlings; and (c) labor and tool expense, including depreciation of equipment used in planting, such as trucks, tree planters, etc.

Brush removal work performed a year or two after planting is considered to be proximately related to the establishment of the seedlings. Such work is essentially a part of the planting operation, and its cost should be capitalized. The cost of seedlings includes the amount expended for those purchased and those planted and raised by the taxpayer. The labor and tool expense includes all costs involved in planting the seedlings, including all amounts expended for transportation, supervision and labor, equipment rental and depreciation of owned equipment and tools used in connection with the planting. The portion of the depreciated cost of equipment thus added to the basis of the seedlings should be proportionate to the use of the equipment or tools in planting as compared with the use of such equipment or tools in other activities of the taxpayer.

Other expenditures that are capital in character include expenditures for basal pruning, stump culture and shearing. Capitalized costs, such as the aforementioned, attributable to the planting and cultivation of Christmas trees, are recoverable (1) as adjusted basis when the standing trees are sold or (2) through allowances for depletion as the trees are cut.

The cost of land improvements which have a useful life substantially beyond the taxable year, such as road grading, ditching and fire breaks, should be capitalized. If such improvements do not have a determinable useful life, then the cost should be added to the basis of the land, to be recovered when the land is disposed of, as in a sale. If they do have a determinable useful life, then the cost should be recovered through annual depreciation. In no case should their cost be added to the basis of the trees.

The cost of equipment purchased and other assets having a limited and determinable life such as culverts and fences, should be capitalized and recovered through annual allowances for depreciation. But compare Revenue Ruling 55–252 for the rule concerning the treatment of depreciation of equipment used in planting as a planting cost and therefore a capital expenditure to be added to the basis of the seedlings.

The expenditures for silvicultural practices such as weeding and noncommercial thinning are incurred after the trees become established and before they are ready to be cut. Such expenditures are in the nature of maintenance charges and are deductible as ordinary and necessary trade or business expenses. In the case of a thinning operation which produces marketable trees, any amount received from the sale of the trees so removed is includible in gross income.

Accordingly, in the planting and cultivation of Christmas trees as a trade or business the expenditures incurred for planting, basal prun-

ing, stump culture, and shearing must be capitalized and added to the basis of the standing trees. These expenditures are recoverable as adjusted basis when the standing trees are sold or through depletion allowances as the trees are cut. Expenditures incurred for silvicultural practices, such as weeding, or cleaning, and noncommercial thinning are deductible expenses. The cost of land improvements is capitalized in the land account or depreciated, depending on whether the useful life of such improvements is determinable. The cost of equipment purchased and other depreciable assets (to the extent not used in connection with the planting of Christmas trees) such as culverts and fences, should be capitalized and recovered through allowances for depreciation.

SECTION 274.—DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES

26 CFR 1.274–5: Substantiation requirements.

Simplified method for computing deductions for the costs of operating passenger automobiles for business purposes. See Rev. Proc. 66–10, page 622.

Reporting of reimbursements for business transportation and travel expenses where one employee properly accounts to the employer for a group of employees. See Rev. Rul. 66–78, page 38.

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.

Whether the receipt of cash by a common parent corporation from its subsidiary during a consolidated return period, in redemption by the subsidiary of all of its preferred stock all of which is held by the parent corporation, constitutes an intercompany dividend to be eliminated in computing the consolidated taxable income. See Rev. Rul. 66–37, page 209.

SECTION 302.—DISTRIBUTIONS IN REDEMPTION OF STOCK

26 CFR 1.302–2: Redemptions not taxable as dividends.

Whether the receipt of cash by a common parent corporation from its subsidiary, during a consolidated return period, in redemption by

the subsidiary of all of its preferred stock, all of which is held by the parent corporation, constitutes an intercompany dividend to be eliminated in computing the consolidated taxable income. See Rev. Rul. 66–37, page 209.

Subpart B.—Effects on Corporation

SECTION 312.—EFFECT ON EARNINGS AND PROFITS

26 CFR 1.312–6: Earnings and profits. Rev. Rul. 66–35
(Also Section 61; 1.61–12.)

A corporation has several issues of bonds outstanding, some of which were issued at a premium, and others at a discount. Such premium and discount are amortizable over the life of the bonds and are reflected in taxable income in accordance with section 1.61–12(c) of the Income Tax Regulations.

Held, amortizable premium and discount with respect to bonds issued by the corporation are reflected in its earnings and profits available for the payment of dividends in the same amount and in the same taxable year that they are properly includible or deductible in computing taxable income. *Held* further, there is no adjustment to earnings and profits available for the payment of dividends for the amount of unamortized bond premium or discount in respect of bonds outstanding at the end of any taxable year.

Subpart C.—Definitions; Constructive Ownership of Stock

SECTION 316.—DIVIDEND DEFINED

26 CFR 1.316–1: Dividends.

Whether the receipt of cash by a common parent corporation from its subsidiary, during a consolidated return period, in redemption by the subsidiary of all of its preferred stock, all of which is held by the parent corporation, constitutes an intercompany dividend to be eliminated in computing the consolidated taxable income. See Rev. Rul. 66–37, page 209.

SECTION 317.—OTHER DEFINITIONS

26 CFR 1.317–1: Property defined.

Whether the receipt of cash by a common parent corporation from its subsidiary, during a consolidated return period, in redemption by the subsidiary of all of its preferred stock, all of which is held by the parent corporation, constitutes an intercompany dividend to be eliminated in computing the consolidated taxable income. See Rev. Rul. 66–37, page 209.

PART II.—CORPORATE LIQUIDATIONS

Subpart A.—Effects on Recipients

SECTION 331.—GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS

26 CFR 1.331–1: Corporate liquidations.

Transfer of the assets of a "section 1361 corporation" to a new legal corporation. See Rev. Rul. 66–25, page 195.

SECTION 333.—ELECTION AS TO RECOGNITION OF GAIN IN CERTAIN LIQUIDATIONS

26 CFR 1.333–1: Corporate liquidation in some one calendar month. (Also Section 334; 1.334–2.) Rev. Rul. 66–81

Where a corporation is liquidated under section 333 of the Internal Revenue Code of 1954 and the goodwill of the corporation has value in the hands of its shareholders, a portion of the basis of the shareholders' stock must be allocated to the goodwill.

Advice has been requested whether the goodwill of a corporation, liquidated under section 333 of the Internal Revenue Code of 1954, is property to which a portion of the shareholders' basis in their stock must be allocated where the shareholders continue the business of the corporation as a partnership under the circumstances described below.

A corporation using the accrual method of accounting operated a catering service for many years. Its four shareholders, who were also its directors and employees, elected to liquidate the corporation under section 333 of the Code. The liquidation was thereupon effected in conformance with the provisions of section 333 of the Code. Each shareholder made and filed timely elections under subsections (c) and (d) of section 333 of the Code. Immediately thereafter the shareholders formed a partnership which continued the business of the corporation without interruption, in the same location, with substantially the same name and with the same customers.

Section 1.333–1(b) of the Income Tax Regulations requires the transfer of all the property, both tangible and intangible, of the liquidating corporation to its shareholders. Goodwill is an intangible asset and where the shareholders continue the business of the liquidated corporation, its goodwill may have value in the hands of its shareholders. See *North American Service Co., Inc.*, 33 T.C. 677 (1960), acquiescence C.B. 1960–2, 6.

Section 334(c) of the Code provides that the basis of property received in liquidation under section 333 of the Code shall be the same as the basis of such stock canceled or redeemed in the liquidation, decreased in the amount of any money received by the shareholder, and increased in the amount of gain recognized to him.

Section 1.334–2 of the regulations provides that the basis of such stock, as adjusted thereunder, should be allocated to the various assets received on the basis of their net fair market values. In *Ralph R. Garrow*, 43 T.C. 890 (1965) the Tax Court held that this manner of allocation is mandatory.

Where in a liquidation under section 333 of the Code the goodwill of a corporation has value in the hands of its shareholders, a portion of the basis of the shareholders' stock must be allocated to it.

Since the partnership formed by the shareholders was operated so that its customers recognized it as a continuation of the business of the corporation, the goodwill of the corporation had value in the hands of the shareholders.

Accordingly, where a corporation is liquidated under section 333 of the Code and the goodwill of the corporation has value in the hands of its shareholders, a portion of the basis of the shareholders' stock must be allocated to the goodwill.

SECTION 334.—BASIS OF PROPERTY RECEIVED IN LIQUIDATIONS

26 CFR 1.334–2: Property received in liquidation under section 333.

Whether, in a liquidation qualifying under section 333 of the Code, a portion of the basis of the shareholders' stock must be allocated to the goodwill of the corporation when the shareholders of the corporation continue its business as a partnership, without interruption, in the same location, with substantially the same name and with the same customers. See Rev. Rul. 66–81, page 64.

PART III.—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

Subpart A.—Corporate Organizations

SECTION 351.—TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR

26 CFR 1.351–1: Transfer to corporation controlled by transferor.

A transfer of the assets of a "section 1361 corporation" to a new legal corporation. See Rev. Rul. 66–25, page 195.

Treatment of receipt by a transferor of the right to receive additional stock of the transferee. See Rev. Rul. 66–112, page 68.

26 CFR 1.351–2: Receipt of property.

Applicability of the provisions of section 357(c) of the Code to transferors in an exchange under section 351 of the Code. See Rev. Rul. 66–142, below.

Subpart B.—Effects on Shareholders and Security Holders

SECTION 354.—EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS

26 CFR 1.354–1: Exchanges of stock and securities in certain reorganizations.

Whether the exchange of stock in a corporation, a party to a reorganization, for a right to receive additional stock in a corporation, a party to the reorganization, qualifies as an exchange of stock for stock. See Rev. Rul. 66–112, page 68.

Nonrecognition of gain on an exchange of stock for stock merely to reflect a change in name in a foreign corporation. See Rev. Rul. 66–171, page 181.

SECTION 356.—RECEIPT OF ADDITIONAL CONSIDERATION

26 CFR 1.356–1: Receipt of additional consideration in connection with an exchange.

Whether the receipt of a right to receive additional stock of a corporation, a party to a reorganization, is additional consideration. See Rev. Rul. 66–112, page 68.

SECTION 357.—ASSUMPTION OF LIABILITY

26 CFR 1.357–2: Liabilities in excess of basis. Rev. Rul. 66–142
(Also Section 351; 1.351–2.)

In an exchange to which section 351 of the Internal Revenue Code of 1954 is applicable, the provisions of section 357(c) of the Code apply separately to each transferor so that the gain to each transferor is the excess of the sum of the amount of his liabilities assumed over the adjusted basis of all property transferred by him pursuant to the exchange determined without regard to the adjusted basis and liabilities of any other transferors.

Subpart D.—Special Rule; Definitions

SECTION 367.—FOREIGN CORPORATIONS

26 CFR 1.367–1: Foreign corporations.

Nonrecognition of gain on an exchange of stock for stock merely

to reflect a change in name in a foreign corporation. See Rev. Rul. 66-171, page 181.

SECTION 368.—DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges. Rev. Rul. 66-23

> Where, under a plan of reorganization, a shareholder of the transferor corporation receives stock in the transferee corporation subject to a court order to dispose of all of the stock received within 7 years, the continuity of interest requirements of the reorganization provisions are satisfied if the shareholder at the time of the reorganization has no preconceived plan or arrangement for disposing of the stock received.

Advice has been requested whether a statutory merger pursuant to applicable State law constitutes a reorganization as defined in section 368(a)(1)(A) of the Internal Revenue Code of 1954 when a shareholder who owns 60 percent of the outstanding stock of the transferor corporation is subject to a court order to divest itself within 7 years of all of the stock of the transferee corporation received in the merger.

X corporation owned 60 percent of the outstanding shares of *Y* corporation. The remaining 40 percent of the outstanding *Y* stock was publicly owned. In 1961, the United States brought suit against *X* and *Y* alleging that *X*'s ownership of *Y* stock was in violation of the antitrust laws. In 1965, a consent decree was entered ordering *Y* to merge with unrelated *Z* corporation. In the merger *X* received 18 percent of the outstanding stock of *Z*. The former stockholders of *Y*, other than *X*, received 12 percent of the outstanding stock of *Z*. The consent decree ordered *X* within 7 years to divest itself of all the *Z* stock which it received in the merger. Under the decree *X* had the choice of holding the shares of *Z* or disposing of them in any manner it wished during the 7-year period. At the time of the merger *X* had no preconceived plan or arrangement for disposing of any of the *Z* shares it received although it knew that it had to dispose of all the shares within 7 years.

Section 368(a)(1)(A) of the Code provides in part that, for the purposes of parts I, II, and III of subchapter C of chapter 1 of subtitle A of the Code, the term "reorganization" means—"a statutory merger or consolidation." Among the requisites to a reorganization under the Code is that of a continuity of interest on the part of those persons who, directly or indirectly, were the owners of the enterprise prior to the reorganization. See section 1.368-1(b) of the Income Tax Regulations. The interest continued must be definite and material and must represent a substantial part of the value of the property transferred. See *Helvering* v. *Minnesota Tea Co.*, 296 U.S. 378 (1935), Ct. D. 1060, C.B. XV-1, 189 (1936).

In the instant case, *X*, the indirect owner of the enterprise prior to the reorganization, received only a stock interest in *Z*, the corporation which continued the enterprise. But, *X* received the *Z* stock subject to the court's order to divest itself of the *Z* stock within 7 years.

Under these circumstances, *X* received as a result of the merger an interest in *Z*, the corporation which continued the enterprise. More-

over, that interest was stock representing an ownership interest and in the absence of any plan or arrangement for disposition of such stock no other person at the time of the merger had any interest in the stock. For a period of 7 years after the merger *X* had complete discretion to retain the stock or to dispose of it without restriction as to the manner of disposition. Hence at the time of the reorganization and for such period up to 7 years as *X* sees fit in its complete discretion, *X* will possess all the benefits and will be subject to all the risks of ownership.

It is the position of the Internal Revenue Service that the continuity of interest requirements of a reorganization can be satisfied where the shareholder of the transferor corporation receives stock of the transferee corporation without any preconceived plan or arrangement for disposing of any of the stock and with unrestricted rights of ownership for a period of time sufficient to warrant the conclusion that such ownership is definite and substantial, notwithstanding that at the time of the reorganization the shareholder is required by a court decree to dispose of the stock before the end of such period. Ordinarily, the Service will treat 5 years of unrestricted rights of ownership as a sufficient period for the purpose of satisfying the continuity of interest requirements of a reorganization.

Further, if in fact *X* does sell some or all of the *Z* shares within 5 years of the date of the reorganization, the status of the reorganization will not be affected, since at the time of the reorganization *X* had no preconceived plan or arrangement for such sales.

Accordingly, since *X* has 7 years of complete discretion as to whether it will retain or dispose of the *Z* shares received in the reorganization, the shares received by *X* are held to represent a continuing interest in the enterprise.

(Also Sections 351, 354, 356; 1.351–1, 1.354–1, 1.356–1.) Rev. Rul. 66–112

For purposes of determining whether a transaction qualifies as a reorganization under section 368(a)(1)(B) of the Internal Revenue Code of 1954, the provision for a nonassignable contingent contractual right to receive only additional voting stock provided for in a plan of reorganization does not violate the "solely for voting stock" requirement of section 368(a)(1)(B) of the Code.

Revenue Ruling 57–586, C.B. 1957–2, 249, distinguished.

Advice has been requested whether the transaction described below satisfies the "solely for voting stock" requirement of section 368(a)(1)(B) of the Internal Revenue Code of 1954.

The capital stock of *M* corporation was owned equally by *X* corporation and *Y* corporation. For good business reasons *Y* was interested in acquiring *X*'s one-half interest in *M*. Because *M* was closely held it was difficult to ascertain the fair market value of the *M* stock. Accordingly, *X* and *Y* entered into an agreement pursuant to which *X* transferred its one-half interest in *M* to *Y* in exchange for 40,000 shares of *Y*'s voting stock. In addition, the agreement accorded *X* the right to receive additional shares of *Y*'s voting stock in each of the succeeding 4 years following the date of the initial exchange in which *M*'s net income exceeded a specified amount. If *M*'s net income in the succeeding 4 years did not exceed the specified amount, no additional shares

were to be received by *X*. The maximum number of additional shares of *Y* voting stock which could be received under the plan of reorganization was 20,000 shares. The right to receive such additional shares was not assignable and such right could give rise to the receipt of only additional voting stock.

Section 368(a)(1)(B) of the Code provides that the term "reorganization" includes the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition).

Section 354(a)(1) of the Code provides that in general no gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of a plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

The "control" requirement of section 368(a)(1)(B) of the Code is clearly satisfied since *Y* owns all of the stock of *M* immediately after the initial exchange. The only question remaining is whether the "solely for voting stock" requirement has been met. Whether this requirement has been met is dependent on the treatment to be accorded the contractual right of *X* to receive additional voting shares of *Y* based upon the net income of *M*. If such right is considered other property, the "solely for voting stock" requirement of section 368(a)(1)(B) of the Code will not have been satisfied nor will the requirements of section 354(a) of the Code have been met.

Under the facts of this case, the reorganization exchange has been fully consummated, except insofar as the contingent contractual right to receive additional voting stock of *Y* is concerned. This right is not assignable and it can give rise to only additional *Y* voting stock. Because of this and the fact that only voting stock has been and can be issued under the terms of the plan of reorganization, the initial receipt by *X* of 40,000 shares of *Y* voting stock and the later receipt by *X* of up to 20,000 additional shares of such stock that may be issued in the 4-year period following the initial exchange will satisfy the "solely for voting stock" requirement of section 368(a)(1)(B) of the Code.

In *James C. Hamrick*, 43 T.C. 21 (1964), the Tax Court held that taxpayer's contractual right to receive additional stock, contingent upon the earnings of the corporation exceeding a specified amount, is the equivalent of "stock or securities" within the meaning of section 351(a) of the Code so that the receipt of additional shares in later years pursuant to the original incorporation agreement does not result in recognizable gain to him. The Tax Court relied to a large extent on *Carlberg* v. *United States*, 281 Fed. (2d) 507 (8th Cir., 1960), in support of its conclusion, which case conflicts with the Service's position as announced in Revenue Ruling 57–586, C.B. 1957–2, 249.

The position expressed above that a reorganization exchange can be fully consummated, except insofar as the right to receive additional stock is concerned, is equally applicable to section 351 exchanges. Since the contingent contractual right in *James C. Hamrick* was not specifically assignable nor readily marketable and could only give rise

to the receipt of additional stock by one who was a party to the transfer, both the "stock or securities" and the "control" tests of section 351(a) of the Code were satisfied. Accordingly, the Internal Revenue Service acquiesces in result only in *James C. Hamrick.* See page 2 of this Bulletin.

The facts involved in the present case and in *James C. Hamrick* are distinguishable from those in Revenue Ruling 57–586 which, contrary to *Carlberg*, holds that negotiable certificates distributed to shareholders of an acquired corporation in connection with a statutory merger, representing contingent interests in shares of the common stock of the surviving corporation to be issued in certain eventualities along with cash representing the value of dividends which would have been paid in the meantime, are considered "other property" within the meaning of section 356 of the Code, relating to the treatment of additional consideration received in connection with reorganizations and other distributions.

In that ruling, a mere contract right only to future distributions of stock provided for in a reorganization agreement was not in question. The question was whether negotiable certificates of contingent interest were merely evidence of the existing right to receive additional common stock or whether they provided the holder of such certificates with something more. Since the issuance of these certificates created a transferable interest which contained a dividend income element, it was determined that the holder had been granted something more than a mere right to receive additional common stock. Therefore, the certificates were considered "other property" under section 356 of the Code.

In the present case the contingent contractual right to additional voting stock in the future is not assignable and can only ripen into additional voting stock. Accordingly, under the circumstances set forth above, the existence of this right will not be treated as violating the "solely for voting stock" requirement of section 368(a)(1)(B) of the Code.

The facts of every delayed stock issuance case, whether arising under section 368 or section 351 of the Code, will be carefully examined to insure that bona fide business reasons justify not issuing all of the stock immediately, and will also be examined to insure that stock issued as a bonus or compensation to the exchanging shareholders is not treated as received in the exchange.

For the effect section 483 of the Code, dealing with interest on certain deferred payments, has on delayed issuance of stock exchanges see sections 1.483–1(b)(6) Example 7, 1.483–1(e)(3) Example 2 and 1.483–2(a)(2) of the Income Tax Regulations.

Revenue Ruling 57–586, C.B. 1957–2, 249, distinguished.

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 1.401–1: Qualified pension, profit-sharing, and stock bonus plans. Rev. Rul. 66–11

A pension, profit-sharing, or stock bonus plan which qualifies under section 401(a) of the Internal Revenue Code of 1954 must provide for full vesting of an employee's interest upon attaining normal retirement age, or the stated age, and completion of the required years of service and any other reasonable requirements set forth in the plan, and the distribution of such employee's interest must commence at that time. However, if employment is continued beyond normal retirement age, or the stated age, distribution of the employee's interest may be deferred to actual termination of employment except that, in the case of plans which include owner-employees, distribution of an owner-employee's interest must commence to be paid to him no later than age 70½.

Advice has been requested as to the requirement for vesting of an employee's interest under a plan which is intended to qualify under section 401(a) of the Internal Revenue Code of 1954 and for distribution of such interest when an employee reaches normal retirement age, in the case of a pension plan, or attains the stated age, in the case of a profit-sharing or stock bonus plan, including plans covering owner-employees.

Revenue Ruling 65–178, C.B. 1965–2, 94, at page 122, provides in Part 5(g), that an employee who has reached the normal retirement age, in the case of a pension plan, and has fulfilled the service requirement and other uniformly applicable provisions of the plan must be permitted to retire and to commence receiving the benefits payable under the plan. In the case of a profit-sharing or stock bonus plan an employee must be permitted to commence receiving benefits payable upon attainment of a stated age or the occurrence of an event as specified in section 1.401–1(b)(ii) of the Income Tax Regulations. In any case, provision may be made for continued employment beyond normal retirement age, or stated age or occurrence of a specified event, but upon separation from the service of the employer after such age has been attained or event has occurred, distributions must commence. Where, however, an employee has separated from the service before attainment of normal retirement or stated age, the plan may provide for deferment of distributions of his vested interest to a time no later than attainment of such age.

Under section 401(a)(9) of the Code as amended by the Self-Employed Individuals Tax Retirement Act of 1962, Public Law 87–792, C.B. 1962–3, 89, a plan which includes self-employed individuals must provide for the commencement of distributions of an owner-employee's interest no later than age 70½, or in the case of an employee other than an owner-employee, on retirement if later than age 70½.

In meeting the requirements for qualification under section 401 of the Code a plan, other than a bond purchase plan within the purview of section 405 of the Code, which includes self-employed individuals

will be classified either as a pension plan as defined in section 1.401–1(b)(i) of the regulations, or as a profit-sharing or stock bonus plan as defined in section 1.401–1(b) (ii) and (iii) of the regulations. The rules with respect to normal retirement age in the case of a pension plan, or the stated age in the case of a profit-sharing or stock bonus plan will similarly apply.

Accordingly, a qualified plan must provide for commencement of distributions of an employee's interest no later than actual retirement after attainment of normal retirement age, stated age, or occurrence of a specified event, and completion of service and other reasonable and uniform requirements, except, in the case of an owner-employee, no later than age 70½.

Rev. Rul. 66–12

An employees' pension plan, intended to qualify under section 401a of the Internal Revenue Code of 1954, limits participation to salaried employees and excludes hourly paid employees who are not covered under a comparable plan. Eleven of the twenty-six participants are either officers, shareholders, supervisors, or highly compensated employees. The compensation of each of the remaining 15 participants is substantially the same as that of the 83 excluded hourly paid employees. *Held,* under these facts, the coverage requirement of section 401(a)(3)(B) of the Code is satisfied regardless of whether the excluded employees are covered under a similar or comparable plan.

Advice has been requested whether an employees' pension or profit-sharing plan which limits participation to salaried employees and excludes hourly paid employees would, by reason of this fact alone, fail to meet the nondiscriminatory coverage requirement of section 401(a)-(3)(B) of the Internal Revenue Code of 1954.

A corporate employer established a pension plan under which participation is limited to full-time salaried employees. Hourly paid employees are excluded and they are not covered under any other plan of deferred compensation. Of a total of 109 full-time employees, 83 are hourly paid and therefore cannot participate. The remaining 26 employees are salaried and covered under the plan. Among these 26 participants, 11 are either officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees. The compensation of each of the remaining 15 participants is substantially the same as that of the excluded hourly paid employees.

The issue in this case is whether a plan intended to qualify under section 401(a) of the Code may limit coverage solely to salaried employees and still satisfy the nondiscriminatory classification requirement of section 401(a)(3)(B) of the Code.

Section 401(a) of the Code provides, in part, that a trust forming a part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries constitutes a qualified trust provided it meets the further requirements set forth in such section as to, among other things, coverage. Section 401(a)(3) of the Code, relating to coverage, provides that the plan must benefit either a number of employees which is at least equal to that determined under the percentage provisions of section 401(a)(3)(A) of the Code, or such employees who qualify under section 401(a)-

(3)(B) of the Code relating to a classification set up by the employer and found by the Secretary or his delegate not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

Section 1.401–1(b)(3) of the Income Tax Regulations provides, in part, that a plan must benefit the employees in general, although it need not provide benefits for all of the employees. A plan is not for the exclusive benefit of employees in general if it discriminates either in eligibility requirements, contributions, or benefits in favor of employees who are officers, shareholders, supervisors, or highly compensated employees. All the surrounding and attendant circumstances and the details of the plan will be indicative of whether it is a bona fide plan for the exclusive benefit of employees in general.

Section 401(a)(5) of the Code provides, in pertinent part, that a classification shall not be considered discriminatory within the meaning of section 401(a)(3)(B) of the Code *merely because* it is limited to salaried or clerical employees. Section 401(a)(5) of the Code sets out certain classifications of employees which will not in themselves be considered discriminatory. This section does not stand alone but must be considered in conjunction with section 401(a)(3)-(B) of the Code. See section 1.401–3 (d) and (e) of the regulations. This position is one of long standing and originated with the Revenue Act of 1942, which inserted paragraph 5 in section 165(a) of the Internal Revenue Code of 1939. [Section 401(a)(5) of the 1954 Code.] See Senate Report No. 1631, 77th Congress, 2d session, C.B. 1942–2, 504, at 606. See also discussion in Revenue Rulings 66–14, page 75, this Bulletin, and 66–13, below.

In this case the employer has adopted a plan intended to qualify under section 401(a) of the Code, with eligibility limited to salaried employees. Since this classification does not result in covering primarily employees in whose behalf discrimination is prohibited, the nondiscriminatory requirement of section 401(a)(3)(B) of the Code is met.

In Revenue Ruling 66–15, page 83, this Bulletin, the salaried classification was found to be discriminatory and therefore the coverage of hourly paid employees under a plan similar or comparable to that of the salaried plan had to be considered. This is not the case here. The salaried classification in the instant case is found to be nondiscriminatory within the meaning of section 401(a)(3)(B) of the Code and, therefore, it is immaterial whether the excluded employees are covered under a similar or comparable plan.

Accordingly, it is held, upon the basis of the above-stated facts, that the pension plan of the employer which limits participation to employees who are compensated on a salary basis satisfies the coverage requirement of section 401(a)(3)(B) of the Code, regardless of whether the excluded employees are covered under a similar or comparable plan.

Rev. Rul. 66–13

A profit-sharing plan limited to salaried or clerical employees which results in covering only individuals who are officers, shareholders, highly paid, or supervisory employees, to the exclusion of

lower paid wage earners, does not meet the coverage requirements of section 401(a)(3)(B) of the Internal Revenue Code of 1954.

Advice has been requested whether coverage under a profit-sharing plan is acceptable within the meaning of section 401(a)(3)(B) of the Internal Revenue Code of 1954, where it is limited to salaried or clerical employees and the effect of such classification results in covering employees all of whom are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

An employer established a profit-sharing plan for the benefit of his full-time salaried employees. Under the plan's eligibility requirements, all salaried or clerical employees who have attained the age of 30 and have completed 6 months of service may participate. The employer has 20 employees, 2 of whom meet the eligibility requirements and are plan participants. Of the 18 ineligible employees, 17 are excluded because they are hourly rated. The other excluded employee is salaried but does not meet the service or minimum age requirements under the plan.

The two participants are officers and supervisors and each is compensated at a substantially higher rate than the hourly rated employees. The employer makes no contributions to any qualified deferred compensation plan for the benefit of the hourly paid employees.

A plan intended to qualify under section 401(a) of the Code must, among other requirements, benefit employees in general. Section 401(a)(3) of the Code prescribes two alternative rules for employee coverage. The first, set forth in subparagraph (A) of such section, calls for coverage of at least 70 percent of the employer's employees or, if at least 70 percent of such employees are eligible to participate, coverage of 80 percent or more of the eligible employees satisfies this requirement. In each case there are excluded from consideration all employees who have been employed not more than a minimum period prescribed by the plan, not exceeding 5 years, employees whose customary employment is for not more than 20 hours in any one week, and employees whose customary employment is for not more than 5 months in any calendar year. The other rule for employee coverage, in subparagraph (B), provides for a classification set up by the employer and found by the Secretary or his delegate not to discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated.

Coverage under this plan does not satisfy the percentage requirement of section 401(a)(3)(A) of the Code. Therefore, if it is to qualify as to coverage, it must be demonstrated that the plan covers a classification of employees, as described in section 401(a)(3)(B) of the Code, which does not discriminate in favor of officers, shareholders, highly paid, or supervisory employees.

The first sentence of section 401(a)(5) of the Code provides, in part, that a classification of employees shall not be considered discriminatory within the meaning of section 401(a)(3)(B) of the Code, merely because it excludes employees the whole of whose remuneration constitutes wages under section 3121(a)(1) of the Code (relating to the Federal Insurance Contributions Act) or merely because it is limited to salaried or clerical employees.

Section 1.401–1(b)(3) of the Income Tax Regulations provides, in part, "* * * All of the surrounding and attendant circumstances and the details of the plan will be indicative of whether it is a bona fide stock bonus, pension, or profit-sharing plan for the exclusive benefit of employees in general. The law is concerned not only with the form of a plan but also with its effects in operation. For example, section 401(a)(5) specifies certain provisions which of themselves are not discriminatory. However, this does not mean that a plan containing these provisions may not be discriminatory in actual operation."

Part 4(c) of Revenue Ruling 65–178, C.B. 1965–2, 94, at 112, states, in part, that in lieu of meeting the percentage requirements of section 401(a)(3)(A) of the Code, an employer may set up a classification of employees which, if found by the Commissioner of Internal Revenue not to discriminate in favor of the enumerated groups, will satisfy the requirements of section 401(a)(3)(B) of the Code.

A plan covering only salaried or clerical employees may qualify depending on the facts and circumstances of the particular case. The reference to salaried and clerical employees in the first sentence of section 401(a)(5) of the Code clearly indicates that a plan under which participation is so limited will not be considered discriminatory merely because of such limitation. On the other hand this does not mean that all such classifications are *ipso facto*, nondiscriminatory. If the use of a salaried or clerical classification, or any other classification, results in covering primarily employees in whose favor discrimination is prohibited, the requirements of section 401(a)(3)(B) of the Code are not met. Section 401(a)(5) of the Code does not make a classification acceptable under section 401(a)(3)(B) of the Code where such classification results in discrimination in favor of officers, shareholders, highly paid, or supervisory employees.

In the case under consideration the employer employs 20 persons and has established a profit-sharing plan providing coverage under a classification which benefits only two individuals. The two covered employees are officers, shareholders, supervisors, and are highly compensated when compared to the hourly rated employees excluded from participation. Thus, the effect of this classification discriminates in favor of the enumerated group and the plan therefore does not meet the coverage requirement of section 401(a)(3)(B) of the Code.

Rev. Rul. 66–14

A profit-sharing plan will fail of qualification under section 401(a) of the Internal Revenue Code of 1954 where it is found that its coverage provisions, which restrict participation to salaried employees, result in benefiting primarily persons who are highly paid officers and shareholders, to the exclusion of hourly paid employees. The fact that hourly rated employees are unionized does not, of itself make the salaried classification nondiscriminatory within the meaning of section 401(a)(3)(B) of the Code.

Advice has been requested whether an employees' profit-sharing plan which limits participation to salaried employees while excluding hourly rated employees from coverage may qualify under section

401(a) of the Internal Revenue Code of 1954, where the excluded hourly rated employees are unionized.

A corporate employer established a profit-sharing plan for the benefit of its full-time salaried employees. The employer has 60 employees, 6 of whom are salaried and are plan participants. Of the six covered employees, five are officer-shareholders each of whom earns an annual salary of $26,000. The other participant has an annual salary of $6,160. All employees not included under the plan are hourly paid and are represented by a union. The union has submitted demands for a contract covering hourly paid employees, but such demands have not included establishment of a qualified deferred compensation plan. Earnings of each of the 54 excluded union employees are considerably less than the 5 officer-shareholder employees. The employer contends that he has a strict obligation to bargain in good faith with the duly designated representative of the employees in the bargaining unit over wages, hours, and other conditions of employment, and that he cannot unilaterally include union employees in a profit-sharing plan.

Section 401(a) of the Code provides, in part, that a trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust if it benefits such employees as qualify under a classification set up by the employer and found not to be discriminatory in favor of employees who are officers, shareholders, supervisory personnel, or highly compensated employees.

Section 401(a)(5) of the Code states, in effect, that a classification shall not be considered discriminatory merely because all employees whose annual remuneration constitutes "wages" under section 3121(a)(1) of the Code (for purposes of the Federal Insurance Contributions Act) are excluded from the plan or merely because it is limited to salaried or clerical employees.

Although section 401(a)(5) of the Code sets forth certain classifications, including "salaried or clerical," that will not in themselves be considered discriminatory, such classifications are not intended to be exclusive nor automatically nondiscriminatory. In other words, no classification is acceptable under section 401(a)(3)(B) of the Code that has the effect of discriminating in favor of the proscribed groups. See also discussion in Revenue Ruling 66–13, page 73, this Bulletin.

The requirements of section 401(a)(3)(B) of the Code cannot be ignored merely because some of the employer's employees are unionized, have the power to collectively bargain for eligibility under the plan and do not choose to do so, or decide against coverage under the plan or a similar plan. None of these situations alter the fact that the employer makes no actual contributions on behalf of such nonsalaried, unionized employees under a qualified plan. In the instant situation only 6 of the employer's 60 employees are covered under the plan and, with one exception, they are officers, shareholders, and highly compensated when compared to the excluded employees. Accordingly, the classification of employees eligible to participate under the profit-sharing plan discriminates in favor of officers, shareholders, supervisors, and highly compensated employees. Consequently, the plan

does not meet the coverage requirements of section 401(a)(3)(B) of the Code.

(Also Sections 402, 403; 1.402(a)-1, 1.403(a)-1.) Rev. Rul. 66-92

Guides for resolving issues in connection with the deferred compensation plans established by professional service organizations.

Revenue Procedure 65-27, C.B. 1965-2, 1017, sets forth procedures relating to the tax classification of professional service organizations. The purpose of this Revenue Ruling is to furnish further guides for resolving issues arising in connection with deferred compensation plans, established by professional service organizations, which are intended to qualify under section 401(a) of the Internal Revenue Code of 1954.

1. *Qualification and Operation.*—For purposes of determining whether a deferred compensation plan established and operated by a professional service organization (as defined in section 301.7701-2 of the Regulations on Procedure and Administration and Revenue Procedure 65-27) is a qualified plan within the meaning of section 401(a) of the Code for any taxable year, the same rules are applicable to such plan as are applicable to the plans of other employers.

2. *Effect of Change of Tax Classification.*—A change in the tax classification of a professional service organization may affect the continued qualification of its deferred compensation plan under section 401(a) of the Code. Several alternatives are available if the organization established and operated a qualified plan during taxable years ending on or before December 31, 1964 (for which such organization is treated by the Internal Revenue Service as if it were a corporation), and if such organization desires to maintain a qualified plan for taxable years ending after December 31, 1964, for which such organization is classified as a partnership or as a sole proprietorship for purposes of taxation.

(a) *Continued coverage for common-law employees only.*—For taxable years ending after December 31, 1964, a professional service organization may continue its qualified plan only for those employees of the organization who are common-law employees. If the plan is continued only for such employees, the following is applicable:

(i) If any contributions to the plan made for any taxable year ending after December 31, 1964, are by or in respect of individuals who were covered by the plan and treated as common-law employees for taxable years ending on or before December 31, 1964, and those individuals are not so treated and are not common-law employees for any taxable year ending after December 31, 1964, such contributions must be returned to those who made the contributions together with the increments thereon.

(ii) The vested interests on December 31, 1964, subject to the requirements of section 401(a) of the Code, of individuals who are not common-law employees during taxable years ending after December 31, 1964, are to be credited to a separate account for each such individual and earmarked for subsequent distribution in accordance with the terms of the plan in effect on December 31, 1964. Such accounts shall be credited with their proportionate share of increments for tax-

able years ending after December 31, 1964. They may not, however, be increased by further contributions or by forfeitures in later taxable years.

(b) *Amendment to cover owner-employees.*—For taxable years ending after December 31, 1964, a professional service organization may amend its plan to cover self-employed individuals (including owner-employees), as defined in section 401(c) of the Code. If such amendment is made, the restrictions and limitations contained in section 401(a) of the Code, relating to plans covering self-employed individuals, would be applicable. Such an amendment would be effective on the date it is made, and would not have retroactive effect for any prior taxable year.

(c) *Termination of the plan.*—A professional service organization may terminate its qualified plan without affecting its prior qualified status, provided that such termination is by reason of business necessity and that the plan otherwise meets the requirements of section 401(a) of the Code. See Part 6 of Revenue Ruling 65–178, C.B. 1965–2, 94, at page 125. If a professional service organization terminates a plan because the Service treats such organization, for purposes of taxation, as a partnership or as a sole proprietorship for any taxable year ending after December 31, 1964, and such organization was treated by the Service as if it were a corporation for taxable years ending on or before December 31, 1964, the change in tax classification will be recognized as a valid business reason for termination. In the event of such a termination, the following is applicable:

(i) Amounts actually distributed or made available to any distributee pursuant to the terms of a qualified plan which is terminated by a professional service organization shall be taxable to such distributee in the taxable year in which such amounts are distributed or made available in the manner and to the extent provided by sections 402(a) and 403(a) of the Code. However, no person, who is treated as a common-law employee of a professional service organization for any taxable year for which the organization is treated by the Service as if it were a corporation for Federal income tax purposes, shall be deemed in any later year to have been separated from the service of the organization solely because such organization is no longer treated as a corporation for Federal income tax purposes and the change in status has come about without any action of the organization or its members. See section 5.03 of Revenue Procedure 65–27, C.B. 1965–2, 1017, at page 1021. Thus, the capital gain treatment for distributions provided in sections 402(a)(2) and 403(a)(2) of the Code is available only on account of a covered employee's death or his actual separation from the service of the professional service organization. See Revenue Ruling 60–292, C.B. 1960–2, 153.

(ii) The vested interest of each individual, subject to the requirements of section 401(a) of the Code, must be credited to a separate account, as of the last day of the taxable year of such professional service organization ending on or before December 31, 1964. Each separate account must be credited with its proportionate share of increments for taxable years ending after December 31, 1964. The trust, holding the frozen interests and increments thereon, forming part of a qualified plan, will maintain its exempt status under section 501(a) of the Code.

Issues involving the qualification of plans not expressly covered by the foregoing will be considered by the District Director upon request in accordance with established procedures. See paragraph (o) of section 601.201, Statement of Procedural Rules, C.B. 1963–1, 431, at page 448.

Rev. Rul. 66–143

The limitations, as to the "incidental" use of trust funds for the purchase of ordinary life insurance contracts, which apply to qualified employee profit-sharing plans are similarly applicable to pension plans of the money-purchase type. Furthermore, the aggregate of the insurance premiums subject to such limitation may not be determined by use of the table contained in Revenue Ruling 55–747, C.B. 1955–2, 228, or any other table which merely reflects the net cost of pure life insurance protection.

Advice has been requested concerning the permissible limits of "incidental" life insurance provided under pension plans of the money-purchase type which are funded by a combination of ordinary life insurance policies and a separate fund, and also, whether insurance premiums subject to such limits may be computed in accordance with the table contained in Revenue Ruling 55–747, C.B. 1955–2, 228, or any other table reflecting the net cost of pure life insurance protection.

Revenue Ruling 54–51, C.B. 1954–1, 147, sets forth the principle that if amounts allocated to the respective participants in any type of qualified plan are to be used to provide such participants with life insurance protection, the life insurance feature must be incidental and subordinate to the primary purpose of the plan, which is to permit the employees or their beneficiaries to participate in a plan of deferred compensation. See section 1.401–1(b)(1) (i) and (ii) of the Income Tax Regulations.

In the case of a profit-sharing plan which provides for the use of trust funds, which have not been accumulated for at least 2 years, to purchase and pay premiums on ordinary life insurance contracts, the insurance feature is deemed to be incidental if: (1) the aggregate of life insurance premiums for each participant is less than one-half of the aggregate of the contributions allocated to the credit of the participant at any particular time, and (2) the plan requires the trustee to convert the entire value of the life insurance contract at or before retirement into cash, to provide periodic income so that no portion of such value may be used to continue life insurance protection beyond retirement, or to distribute the contract to the participant. See Rev. Rul. 54–51, as amplified by Rev. Rul. 57–213, C.B. 1957–1, 157, and Rev. Rul. 60–84, C.B. 1960–1, 159.

In a pension or annuity plan funded with insurance contracts, the life insurance benefit is deemed to be incidental where the insurance benefit is no greater than 100 times the monthly annuity, e.g., $1,000 of life insurance for each $10 of monthly annuity. See Rev. Rul. 60–83, C.B. 1960–1, 157.

Therefore, the determination of whether life insurance protection is incidental for participants in pension plans of the fixed benefit and unit benefit types is based upon the application of a ratio of the death benefit to the monthly annuity benefit. In the case of a profit-sharing plan, since benefits are not predetermined, the determination is based

upon a ratio of the aggregate premiums paid to the aggregate contributions.

A plan with a formula requiring a contribution of a specified percentage of the compensation of participating employees, regardless of profits, is not a profit-sharing plan but may be a pension plan of the money-purchase type. See P.S. No. 24, dated September 2, 1944. A pension plan of the money-purchase type is, however, similar to a profit-sharing plan in that in both plans the employer's annual contribution is determined in accordance with a stated procedure, with the amount of any subsequent benefits or distributions flowing from these contributions.

Accordingly, it is held that in the case of a pension plan of the money-purchase type which provides for the use of trust funds to purchase and pay premiums on ordinary life insurance contracts, the insurance feature will be deemed incidental if (1) the aggregate of the premiums for life insurance in the case of each participant is less than one-half of the aggregate of the contributions allocated to him at any particular time, and (2) the plan requires the trustee to convert the entire value of the life insurance contract at or before retirement into cash, to provide periodic income so that no portion of such value may be used to continue life insurance protection beyond retirement, or to distribute the contract to the participant at retirement.

The question of the allowance of "incidental" life insurance protection under a qualified plan was considered by the United States Board of Tax Appeals in *Raymond J. Moore, et al.* v. *Commissioner*, 45 B.T.A. 1073 (1941), acquiescence, C.B. 1944, 20. The issue involved was whether an employees' pension plan could qualify if, in addition to pension benefits, it provided life insurance protection under the terms of the insurance company's policies used to fund the pension. It was held that the mere fact that the policies, under which the pension benefits were funded, incidentally provided life insurance protection, did not cause the plan to fail of qualification as a pension plan. The initial life insurance protection provided under the policies in that case equalled 100 times the monthly annuity. The cost of the pure insurance element in the type of retirement income contracts involved in the *Moore* case varied according to age at issue, but in every case was less than 25 percent of total premiums.

In essence, a 25-percent limitation on pure insurance protection is applicable under a profit-sharing plan or a pension plan of the money-purchase type since the 50-percent limitation on amounts credited to a participant's account, which may be expended for premiums on ordinary life insurance contracts under such plans, recognizes and takes into account the fact, as stated in Revenue Ruling 61–164, C.B. 1961–2, 99, that only approximately one-half of the premiums paid for such a contract are for the pure insurance protection, the remainder being applied to the building up of a reserve.

Accordingly, it is held that the 50-percent limitation under Revenue Ruling 54–51, in the case of a profit-sharing plan, and the foregoing similar limitation applicable to pension plans of the money-purchase type, is to be applied to the aggregate amount of the actual premiums paid under the ordinary life insurance contracts which are purchased as part of the plan and the amount of such premiums may not be determined by use of the table contained in Revenue Ruling 55–747 or

any other table of rates which merely reflect the net cost of pure life insurance protection.

Rev. Rul. 66–174

A plan will not fail to qualify as a profit-sharing plan under section 401 of the Internal Revenue Code of 1954 merely because it provides that employer contributions shall be made from current profits or accumulated earned surplus, as determined under generally accepted accounting principles and practices, without regard to whether the employer has current or accumulated earnings and profits for Federal income tax purposes.

Advice has been requested whether a plan may qualify as an employees' profit-sharing plan under section 401 of the Internal Revenue Code of 1954 although it provides that employer contributions shall be made from current profits and accumulated earned surplus, as determined under generally accepted accounting principles, without regard to whether there are current or accumulated earnings and profits for dividend purposes as defined in section 316(a) of the Code.

A corporation is engaged in the processing and transmission of natural gas. It has no accumulated earnings and profits from which a distribution would be deemed a dividend within the meaning of section 316(a) of the Code and, for a number of years, its distributions to shareholders have exceeded its current earnings and profits. It had no taxable income, for Federal income tax purposes, for its most recent taxable year and it does not expect to have any taxable income for several years.

Under the method of accounting prescribed by the Federal Power Commission (under whose regulatory jurisdiction the corporation operates) and under general accounting principles, the corporation has a substantial amount of current profits and accumulated earned surplus. This difference is caused by the fact that the corporation annually incurs large amounts of intangible drilling and development costs which it is required, by the rules of the Federal Power Commission, to capitalize but which, for Federal income tax purposes, it has elected to deduct annually under the provisions of sections 263(c) and 611 of the Code. The corporation uses its books of account maintained under the rules of the Federal Power Commission for purposes of its annual reports to its stockholders.

The corporation established a profit-sharing plan for the benefit of its employees. The plan, which otherwise qualifies under section 401 of the Code, provides that contributions are to be made from current profits and accumulated earned surplus, as shown on the books used in preparing its annual report, without regard to whether there are any current or accumulated earnings and profits for Federal income tax purposes.

A profit-sharing plan within the meaning of section 401 of the Code is a plan established and maintained by an employer to provide for the participation in his profits by his employees or their beneficiaries. See section 1.401–1(b)(1)(ii) of the Income Tax Regulations. The term "profits" as used in the regulations is not limited to taxable profits or to earnings and profits within the scope of section 316(a) of the Code. "Profit-sharing" refers to sharing in the fruits of the en-

terprise which are determined by law to be distributable to the shareholders or other owners. Thus, the fact that the corporation has no taxable income because certain items are specifically deductible for Federal income tax purposes which it is required to capitalize under a method of accounting prescribed by a Federal regulatory agency does not necessarily mean there are no profits to be shared within the meaning of section 401 of the Code.

Accordingly, it is held that the profit-sharing plan will not fail to qualify under section 401 of the Code merely because it provides that contributions shall be made from current profits and accumulated earned surplus determined without regard to whether there are current or accumulated earnings and profits for dividend purposes as defined in section 316(a) of the Code.

Rev. Rul. 66–175

A union negotiated industry-wide pension plan will not fail to meet the requirements of section 401(a) of the Internal Revenue Code of 1954 where it permits former employees of participating employers to make prescribed voluntary contributions during periods of temporary unemployment or employment with a nonparticipating employer, who is a party to the collective bargaining agreement but who is excused from participation in the plan, if such contribution is made in order to protect the employee's earned but nonvested interest and provided (1) the contribution is not in excess of what an employer would otherwise be required to contribute in order to preserve accrued but nonvested credits, (2) all employees under similar circumstances are treated alike, (3) the employee's contribution so made is nonforfeitable, and (4) such provision does not result in duplication of benefits. Such plan will fail to meet the requirements if it provides coverage for individuals who have never been employees of a participating employer of the plan.

Advice has been requested as to the circumstances under which an employee may be permitted to make pension trust contributions that normally would be required to be made by the employer without causing disqualification of the pension plan.

Pursuant to a collective bargaining agreement, a union sponsored industry-wide pension plan and trust were established. All employers who are parties to the agreement are required to participate in the trust fund, except those excused from doing so because of the maintenance of their own separate pension plans meeting requirements set forth in the agreement. Benefits are provided under the trust agreement only to those members who either complete a specified number of years of continuous covered service or earn a designated number of service credits (based on time worked for contributing employers) without more than two years interruption in covered employment.

The plan provides that any union member otherwise eligible to participate in the plan, but with respect to whom no contributions are made by any employer either because his employer is excused under the collective bargaining agreement or because he is temporarily unemployed, may contribute to the trust the minimum amount that would be required to be contributed by an employer with respect to such employee to preserve accrued but nonvested credits. Hence, union members who are temporarily out of work or are working for employers who are a party to the collective bargaining agreement but

who are excused from participation in the plan may contribute to protect their contingent interests in the plan from forfeiture. However, by its terms it would also permit individual union members who had never worked for a participating employer to contribute to and receive benefits under the plan.

Section 401(a) of the Internal Revenue Code of 1954 sets forth the requirements for qualification of pension trusts. This section makes it clear that only a trust which forms part of a plan of an employer for the exclusive benefit of his employees or their beneficiaries can constitute a qualified trust.

Section 1.401–1 of the Income Tax Regulations, in explaining the requirements for qualification, refers repeatedly to a plan "established and maintained by an employer" as being qualified if it meets certain requirements.

Where an employee has been employed by a participating employer and, hence, covered under the plan a provision permitting the employee to contribute to the trust, when not employed or employed by an employer who is a party to the collective bargaining agreement but who is excused from participation in the plan, in order to protect earned but nonvested credits, is analogous to a provision permitting participation on the part of former employees or employees on leave. Such provisions are permitted in qualified plans by section 1.401–1 (b)(4) of the regulations, provided they do not result in prohibited discrimination, are uniformly applied, and do not result in duplication of benefits. See Part 4 (f), (o), and (r) of Revenue Ruling 65–178, C.B. 1965–2, 94.

Accordingly, it is held that a provision in a pension plan which permits an employee who has never been employed by a participating employer to make contributions to the trust on his own behalf will adversely affect the qualification of the plan under section 401(a) of the Code, since such a plan is not a part of a pension plan established and maintained by his employer.

However, qualification of the union negotiated industry-wide pension plan under section 401(a) of the Code will not be adversely affected where such a provision is restricted to employees who are separated from the service of a participating employer and permits voluntary contributions to the trust during periods of temporary unemployment or employment with a nonparticipating employer who is a party to the collective bargaining agreement if such contributions are made in order to protect the employee's earned but nonvested interest and provided (1) the contributions are not in excess of what an employer would otherwise be required to contribute in order to preserve accrued but nonvested credits, (2) all employees under similar circumstances are treated alike, (3) the employee's contributions made are nonforfeitable, and (4) such provision does not result in duplication of benefits.

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26 CFR 1.401–3: Requirements as to coverage. Rev. Rul. 66–15

A profit-sharing plan established by an employer for the benefit of his salaried employees, which plan when considered by itself does not meet the coverage requirements of section 401(a)(3) of the Internal Revenue Code of 1954, will not qualify merely because the

employer makes contributions on behalf of his hourly rated employees if such contributions are not comparable to those provided for highly compensated salaried employees.

Advice has been requested whether a profit-sharing plan which limits participation to salaried employees while excluding hourly rated employees from participation meets the requirements for qualification under section 401(a) of the Internal Revenue Code of 1954.

A corporate employer established a profit-sharing plan for the benefit of its full-time salaried employees. The plan excludes those employees for whom the employer contributes to a pension or welfare plan, under a collective bargaining agreement. The employer has 62 employees, 6 of whom are salaried and are plan participants and 56 hourly rated employees who are ineligible for participation because they are covered under a union collective bargaining agreement which provides for participation in an industrywide pension plan. Three of the six covered employees are shareholders, officers, and supervisors and the remaining three are considered to be highly compensated.

The employer under the collective bargaining agreement contributes approximately 9 percent of annual wages to provide various benefits for members of the bargaining unit; 4 percent being allocated to a pension plan, and the remaining 5 percent being used to provide the employees with vacation, health, and welfare benefits. The salaried employees' profit-sharing plan does not contain a predetermined formula with respect to the amount the employer will contribute, but permits contributions in amounts not in excess of 15 percent of basic compensation of the covered employees.

Section 401(a) of the Code provides, in part, that a trust forming a part of a profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust if the plan does not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

With respect to employee coverage, an employees' profit-sharing plan established by an employer with the view to qualifying under section 401(a) of the Code must benefit a sufficient number of employees which is at least equal to that determined under the percentage provisions of section 401(a)(3)(A) of the Code, or such employees as qualify under a nondiscriminatory classification within the purview of section 401(a)(3)(B) of the Code.

Section 1.401–3(f) of the Income Tax Regulations provides that an employer may designate several trusts or a trust or trusts and an annuity plan or plans as constituting one plan which is intended to qualify under section 401(a)(3) of the Code, in which case all of such trusts and plans taken as a whole may meet the requirements of such section. The fact that such combination of trusts and plans fails to qualify as one plan does not prevent such of the trusts and plans as qualify from meeting the requirements of section 401(a) of the Code.

Coverage under the instant salaried profit-sharing plan does not satisfy the percentage requirements of section 401(a)(3)(A) of the Code; nor does it satisfy the nondiscrimination requirements of section 401(a)(3)(B) of the code, since the classification results in covering only those persons in whose favor discrimination is prohibited. Therefore, the salaried employees' profit-sharing plan standing alone cannot qualify under section 401(a) of the Code.

However, when the salaried employees' profit-sharing plan and the hourly rated employees' pension plan are viewed as a unit under section 1.401–3(f) of the regulations, it is clear that the percentage requirements of section 401(a)(3)(A) of the Code are met. Nevertheless, the determination still remains as to whether contributions or benefits are discriminatory within the meaning of section 401(a)(4) of the Code. Section 1.401–4 of the regulations states, in substance, that a trust, in order to qualify under section 401(a) of the Code, must not only meet the coverage requirements of section 401(a)(3) of the Code, but, as provided in section 401(a)(4) of the Code, it must also be part of a plan under which there is no discrimination in contributions or benefits in favor of officers, shareholders, employees whose principal duties consist in supervising the work of other employees, or highly compensated employees as against other employees. In this regard, only the cost of providing deferred benefits under a qualified plan may be taken into account. The cost of providing other benefits, such as vacation, health and welfare, and current cash distributions may not be considered. See sections 1.401–3 (b) and (c) and 1.401–4 (a)(1)(ii) of the regulations. See also Revenue Ruling 56–497, C.B. 1956–2, 284.

The employer contributes 15 percent of the base salaries of the participants under the profit-sharing plan, but it contributes only 4 percent of the total payroll of the participants under the hourly rated employees pension plan. Thus, the contributions, or benefits to be derived from such contributions, made to the profit-sharing plan are discriminatory when compared with contributions, or benefits to be derived from such contributions, made to the pension plan, since all of the participants in the profit-sharing plan are highly compensated when compared with those in the pension plan.

Accordingly, the nondiscrimination requirements of section 401 (a)(4) of the Code are not met and the profit-sharing plan for salaried employees fails to qualify under section 401(a) of the Code.

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26 CFR 1.401–4: Discrimination as to contributions or benefits. Rev. Rul. 66–176

> An employees' retirement plan contains a provision applicable to section 1.401–4(c) of the Income Tax Regulations setting forth limitations on employer contributions which may be used for the benefit of any of the 25 highest paid employees in the event of termination of the plan within ten years of its establishment. Such provision is set forth in the group annuity contract which forms a part of the retirement plan, but the insurer is required under such contract to comply with such limitations only when the employer notifies him that such provision has or will become effective. *Held*, such plan will fail to qualify under section 401(a) of the Internal Revenue Code of 1954. A similar conclusion would apply to a trusteed plan.

Advice has been requested whether an employees' nontrusteed pension plan will qualify under section 401(a) of the Internal Revenue Code of 1954 where such plan contains language applying the restrictions of section 1.401–4(c) of the Income Tax Regulations, but requires the insurer to comply with such restrictions only when the employer notifies him that such provision has or will become operative.

An employer established a pension plan for the benefit of all his salaried employees. It was funded through a deposit administration group annuity contract. The plan contained language applicable to section 1.401–4(c) of the regulations which requires that certain limitations be placed on employer contributions which may be used for benefits of any of the 25 highest paid employees in the event of termination of the plan during the ten years after its establishment. The provision was added to the group annuity contract with the intention of enabling the contract to meet the requirements of section 1.401–4(c) of the regulations. The contract, however, required that the employer notify the insurer when the terms of the provision were to become operative. In absence of such notification, the insurer would not, of his own volition, take any action with respect to the limitation provided for in the special provision.

Part 6(c) of Revenue Ruling 65–178, C.B. 1965–2, 94, at 126, states, in effect, that if benefits for employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or the highly compensated employees, are funded or substantially so, because of their nearness to retirement and benefits for other employees are not similarly funded prior to termination of the plan, the prohibited discrimination will result. Consequently, if employer contributions may be used for the benefit of an employee who is among the 25 highest paid at the time the plan is established and whose anticipated annual pension exceeds $1,500, the plan must include limitations in accordance with the "termination rule". See section 1.401–4(c) of the regulations. (The rules for this purpose are set forth in Mimeograph 5717, C.B. 1944, 321, as modified by Revenue Ruling 61–10, C.B. 1961–1, 143.)

The plan, in the instant case, contains such a restrictive provision in its group contract. But, the group contract completely relieves the insurer of any responsibility, for enforcing its terms pertaining to early termination, unless the employer notifies him that such provision has or will become operative. In other words, if the employer having such a contract as a part of its plan should neglect, or elect not, to notify the insurer when the section 1.401–4(c) restrictions of its contract become operative, the plan is, in effect, completely without such a restriction.

Accordingly, it is held that if an employees' pension plan contains language applicable to section 1.401–4(c) of the regulations in an annuity contract made part of such plan, but such contract contains a provision relieving the insurer of any liability to observe such provision unless the employer notifies him that such provision has or will become operative, then such plan will fail to qualify under section 401(a) of the Code. A similar conclusion applies to a trusteed plan.

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26 CFR 1.401–8: Custodial accounts. Rev. Rul. 66–101
(Also Section 402; 1.402(a)–1.)

In lieu of an actual stock certificate, a regulated investment company, as defined in section 851(a) of the Internal Revenue Code of 1954, issues a "confirmation" to the bank custodian of a custodial account which, as provided by section 401(f) of the Code, constitutes

a qualified trust under section 401(a) of the Code. The "confirmation" represents the purchaser's evidence of stock ownership and is utilized to avoid the administrative cost of preparing a formal stock certificate each time a share is sold and cancelling the separate certificates as the shares are redeemed. When a distribution is made from the custodial account the "confirmation" representing shares standing in the name of the custodian is cancelled and a new confirmation is transmitted directly to and in the name of the beneficiary-distributee who has all of the rights of a shareholder including voting, liquidation and redemption rights as if he were in possession of the actual share certificates.

Held, the requirement of section 401(f)(1)(C)(i) of the Code regarding the investment of funds solely in regulated investment company stock is satisfied upon the purchase of the shares, and the investment may appropriately be evidenced by the "confirmation" issued to the bank custodian. Further, cancellation of the shares in the custodian's name and reissuance in the distributee's name under these circumstances constitutes a distribution to, and receipt by, such distributee for purposes of section 402 of the Code.

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26 CFR 1.401–10: Definitions relating to plans covering self-employed individuals. (Also Section 911; 1.911–2.) Rev. Rul. 66–56

Interest income is derived from the investment of capital and is not "earned income" for the purpose of computing allowable contributions and deductions under a self-employed retirement plan qualified under section 401 of the Internal Revenue Code of 1954. However, if interest income is derived from financing activities which are an integral part of a taxpayer's business in which he also renders personal services, such interest income would enter into the computation of the amount which may be considered "earned income" where both personal services and capital are material income-producing factors.

Advice has been requested whether interest income, derived from the financing activities of a real estate broker, constitutes "earned income" for purposes of section 401(c)(2) of the Internal Revenue Code of 1954.

In his business as a real estate broker, which the taxpayer conducts by himself on a full-time basis, he performs substantial personal services including solicitation of home buyers and sellers, escorting prospective buyers on house visits, arranging appraisal, financing, and legal services, and other related tasks. In the course of conducting such business, the taxpayer often finances sales of real estate with his own capital, performs the necessary paper work incident to such financing, and receives a substantial amount of interest income from such financing.

The taxpayer has established a self-employed retirement plan which is qualified under section 401 of the Code. The amount of the taxpayer's "earned income" serves as a basis for calculating allowable contributions and deductions under the plan.

Section 1.401–10(c)(3)(i) of the Income Tax Regulations states the general rule that for purposes of section 401 of the Code, the term "earned income" includes only that portion of an individual's net

earnings from self-employment which is compensation for personal services actually rendered within the meaning of section 911(b) of the Code. The term "earned income," as defined in section 911(b) of the Code, means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, a reasonable allowance 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. However, in the event a self-employed individual renders personal services on a full-time, or substantially full-time basis to only one trade or business in which capital is a material income-producing factor, the amount of such individual's earned income from the trade or business for purposes of section 401 of the Code is considered to be not less than so much of his share in the net profits of such trade or business as does not exceed $2,500.

Interest income is derived from the investment of capital and not from the performance of personal services. Therefore, it is not earned income as defined in section 911(b) of the Code. However, the aggregate of the duties performed in soliciting house buyers and sellers and arranging sales do constitute the performance of substantial personal services in the operation of the real estate business in which the financing of sales of real estate is an integral part. The interest income derived from such financing constitutes part of the net profits from the business.

It is clear, therefore, that both personal services and capital are material income-producing factors. Accordingly, under the facts present in the case, the taxpayer's earned income from his real estate business, for purposes of the self-employed retirement plan, is equal to a reasonable allowance as compensation for the personal services he actually renders, not in excess of the greater of 30 percent of the net profits from the business, including the interest income derived from financing sales of real estate, or so much of the net profits of such business as does not exceed $2,500.

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. 66-16

An employee, on account of termination of his services from one of two corporate employers whose qualified pension plans are funded by contributions to a single trust, received a distribution representing the balance to his credit from the plan of the one employer while continuing his employment with the other. Section 402(a)(2) of the Internal Revenue Code of 1954 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 dis-

tributee in one taxable year on account of the employee's death or other separation from the service, or death after separation, 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 6 months. *Held*, the distribution received by the employee upon his termination of employment from one employer representing the balance to his credit under the pension plan of such employer while continuing his employment with the other employer may be accorded long-term capital gains treatment under section 402(a)(2) of the Code, provided no part of the distribution is attributable to contributions made by the employer with whom he remains employed.

Rev. Rul. 66–57

The temporary investment of part of the funds of an exempt employees' profit-sharing trust in short-term United States Government obligations will not prevent the application of section 1.402(a)–1(b)(2)(ii)(*c*) of the Income Tax Regulations in computing the cost or other basis to the trust of securities of the employer corporation.

The question has been raised as to whether the method of computing the net unrealized appreciation on stock of an employer corporation as provided by section 1.402(a)–1(b)(2)(ii)(*c*) of the Income Tax Regulations will be affected by the temporary investment of part of the funds of an exempt employees' profit-sharing trust in short-term United States Government obligations.

A corporation established an employees' profit-sharing plan and trust which 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. Under the plan, amounts contributed to the trust are split into four separate funds for investment purposes. Each participating employee elects one of the four funds in which his share of the employer's contributions will be invested.

One such fund is invested solely in one particular type of security of the corporation which is purchased quarterly during the year rather than making all such purchases in the early part of the year immediately after receipt of the corporation's annual contribution. As a result of this investment practice a portion of the employer's contributions may not be invested for a large part of the year. The plan provides that such unused sums may be temporarily invested in obligations of the United States until securities of the corporation are subsequently purchased.

Distributions from an exempt employees' trust are taxed in accordance with the provisions of section 402(a) of the Code which provides, among other things, that the net unrealized appreciation in value of securities of the employer is excluded, in certain cases, from the computation of the amount taxable as a result of a distribution.

In the determination of the amount of net unrealized appreciation in securities of the employer corporation, section 1.402(a)–1(b)(2)(ii)(*c*) of the regulation provides that if the trust fund, or a specified portion thereof, is invested exclusively in one particular type of security of the employer corporation, and if during the period the distributee participated in the plan none of such securities has been sold except for the

purpose of paying benefits under the trust or for the purpose of obtaining funds with which to exercise rights which have accrued to the trust, the cost or other basis to the trust of all securities distributed to such distributee shall be the total amount credited to the account of such distributee (or such portion thereof as was available for investment in such securities) reduced by the amount available for investment but uninvested on the date of distribution.

This method of determining the cost or other basis of the employer securities is a simplified process whereby the cost is merely the total amount credited to a participant's account less any amounts credited but uninvested as the date of distribution. To maintain this simplicity it is necessary that investments be limited to one particular type of employer security. However, this limitation does not mean that uninvested funds may not be used to earn interest, such as is paid on short-term Government obligations, during the period the funds are held pending quarterly purchases of employer securities.

Accordingly, it is held that the temporary investment of part of the funds of an exempt employees' trust in short-term United States Government obligations will not preclude the use of the method provided by section 1.402(a)-1(b)(2)(ii)(*c*) of the regulations, for computing the cost basis of employer stock in determining the net unrealized appreciation on such stock distributed by the trust.

Any interest earned on such temporary investments must be credited to the participants' accounts in the trust and must be taken into consideration in determining the amount of funds available for investment.

Taxability of beneficiaries on amounts received as distributions from a trust forming a part of a qualified plan established and maintained by a professional service organization. See Rev. Rul. 66–92, page 77.

Distributions under a custodial account which uses a "confirmation procedure." See Rev. Rul. 66–101, page 86.

SECTION 403.—TAXATION OF EMPLOYEE ANNUITIES

26 CFR 1.403(a)-1: Taxability of beneficiary under a qualified annuity plan.

Taxability of beneficiaries on amounts received under an annuity contract purchased by a professional service organization for an employee. See Rev. Rul. 66–92, page 77.

SECTION 404.—DEDUCTION 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 employees' trust or annuity plan and compensation under a deferred-payment plan; general rule. Rev. Rul. 66–144

Where a corporation on the accrual method of accounting has obtained an extension of time for filing its income tax return, a contribution paid to its qualified employees' trust within such extended period for filing will be deemed to be timely regardless of when the return is actually filed.

Advice has been requested concerning the time allowable for a corporation on the accrual method of accounting to make a contribution to its qualified employees' trust for a taxable year for which the corporation has obtained an extension of time for filing its income tax return.

A corporation, on an accrual method of accounting, established an employees' trust which is qualified under section 401(a) of the Internal Revenue Code of 1954. Following the close of its calendar taxable year, the corporation obtained an automatic extension of 3 months for filing its income tax return as provided by section 6081(b) of the Code. Subsequently, but before March 15, the corporation filed its income tax return and paid all tax due thereon. Its contribution to the employees' trust was made on June 1.

Section 404(a)(6) of the Code provides that for purposes of deductions for contributions under qualified stock bonus, pension, profit-sharing, or annuity plans, a taxpayer using the accrual method of accounting shall be deemed to have made payment on the last day of the year of accrual, if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year, including extensions thereof.

Section 404(a)(6) of the Code provides that a contribution for a taxable year made by a taxpayer reporting on the accrual basis shall be deemed to be made within such taxable year if paid within the time prescribed for filing its return plus any extension of time in which to file. Therefore, a contribution paid within an extended filing period is deemed to have been made during the taxable year. Thus, a contribution made during such extended period, as provided for under section 6081(b) of the Code, is deemed to have been made during the taxable year regardless of when the return is filed.

Accordingly, the contribution made by the taxpayer in the instant case will be deemed to have been timely made for purposes of section 404(a)(6) of the Code.

PART II.—CERTAIN STOCK OPTIONS

SECTION 421.—GENERAL RULES

26 CFR 1.421–5: Operation of section 421. Rev. Rul. 66–5

An individual who ceases to be an employee of the grantor of a restricted stock option on the last day of any calendar month

must exercise a restricted stock option on or before the last day of the third succeeding calendar month in order to have exercised such option "within 3 months after he ceases to be an employee," within the meaning of section 421(a) of the Internal Revenue Code of 1954 as in effect prior to the enactment of section 221(a) of the Revenue Act of 1964. Similarly, where stock is transferred to such an individual on the last day of any calendar month, the stock is disposed of "within 6 months after the transfer of such stock to him" where the disposition is made on or before the last day of the sixth succeeding calendar month.

I.T. 3287, C.B. 1939–1 (Part 1), 138, and I.T. 3985, C.B. 1949–2, 51, amplified.

Advice has been requested concerning the proper computation of the periods, prescribed in section 421(a) of the Internal Revenue Code of 1954 as in effect prior to the enactment of section 221(a) of the Revenue Act of 1964, Public Law 88–272, C.B. 1964–1 (Part 2), 6, at 41, of "3 months after the date he ceases to be an employee" and "6 months after the transfer of such share to him," where the date of cessation of employment and the date of transfer were on the last day of a calendar month.

Section 421(a) of the Code, as then in effect, provides for certain Federal income tax results if, among other requirements, an option is exercised by the employee *within 3 months after he ceases to be an employee* of the grantor and if the stock acquired upon the exercise of such an option is not disposed of within 2 years from the date of the granting of the option nor *within 6 months after the transfer of such share to him.*

It is long and well established that, in computing a period of "years" or "months" prescribed in a contract or statute, "from" or "after" a designated day, date, act, or other event, the day thus designated is excluded and the last day of the prescribed period is included, unless a different intent is definitely evidenced. See I.T. 3287, C.B. 1939–1 (Part 1), 138.

I.T. 3985, C.B. 1949–2, 51, states the position of the Internal Revenue Service that the determination of the holding period of "capital assets" under sections 117 (a) (2), (3), (4), (5), and h(4) of the Internal Revenue Code of 1939, must be made with reference to calendar months and fractions thereof, rather than with reference to days. The ruling was concerned primarily with the determination of the total holding period of securities purchased and sold where the provisions of section 117(h) (4) of the 1939 Code, relating to "wash sales," were applicable. Although similar provisions are not involved in the instant case, the principles enunciated in that ruling apply here. Furthermore, although I.T. 3287 was not cited in I.T. 3985 the rule stated in the former was actually applied in all the appropriate illustrative examples of the latter, that is, in examples 1 through 6.

I.T. 3287, C.B. 1939–1 (Part 1), 138 and I.T. 3985, C.B. 1949–2, 51, are hereby amplied to the extent that the principles enunciated above are applicable in determining the 3-month and 6-month periods referred to in section 421(a) of the Code as in effect prior to the enactment of section 221(a) of the Revenue Act of 1964. Thus, for example, if an individual ceases to be an employee on April 30, 1963,

the last day of the 3-month period thereafter would be July 31, 1963, and if the date of the share transfer were June 30, 1963, the last day of the 6-month period thereafter would be December 31, 1963.

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 : Period for computation of taxable income.

Filing of initial income tax return for a different taxable year from that specified on Form 2553, Election by Small Business Corporation. See Rev. Rul. 66–68, page 197.

SECTION 442.—CHANGE OF ANNUAL ACCOUNTING PERIOD

26 CFR 1.442–1 : Change of annual accounting period. Rev. Rul. 66–158

Revenue Ruling 56–374, C.B. 1956–2, 296, provides that where it is necessary for an exempt employees' trust to change its annual accounting period it shall accomplish the change by filing Form 1128, Application for Change in Accounting Period, with the Commissioner of Internal Revenue, Washington, D.C.

Revenue Ruling 56–374 is modified to the extent that where a change in accounting period is necessary it may be accomplished by filing Form 1128 in accordance with the procedures set forth in Revenue Procedure 66–13, page 626, this Bulletin.

Circumstances under which changes in annual accounting period will be approved even though the short taxable year has a net operating loss. See Rev. Proc. 66–6, page 615.

Organizations wholly exempt from Federal income tax wishing to change annual accounting period. See Rev. Proc. 66–13, page 626.

PART II.—METHODS OF ACCOUNTING

Subpart A.—Methods of Accounting in General

SECTION 446.—GENERAL RULE FOR METHODS OF ACCOUNTING

26 CFR 1.446–1: General rule for methods of accounting.

Procedure with respect to a request for change in accounting practice of reporting wheat and feed grain diversion payments. See Rev. Proc. 66–1, page 598.

Request for permission to change to a method of depreciating returnable bottles. See Rev. Proc. 66–7, page 617.

Subpart B.—Taxable Year for Which Items of Gross Income Included

SECTION 451.—GENERAL RULE FOR TAXABLE YEAR OF INCLUSION

26 CFR 1.451–2: Constructive receipt of income. Rev. Rul. 66–44

> The increment in value of growth savings certificates issued by a bank shall be included in the gross income of a taxpayer employing the cash receipts and disbursements method of accounting in each taxable year in which the increase occurs, since the taxpayer (certificate holder) has a right to redeem the certificate in such taxable year.
>
> Revenue Ruling 57–452, C.B. 1957–2, 302, revoked.

Advice has been requested with respect to constructive receipt of income earned on growth savings certificates issued by a bank.

These growth savings certificates have face amounts greater than the amounts with respect to which they are issued and are redeemable at any time for amounts equal to the issue price plus increments which accrue regularly up to their maturity date. Thus, these certificates are in the nature of deposits.

At one time, such growth savings certificates were regarded as obligations issued at a discount and similar to series E, United States savings bonds. These certificates received tax treatment similar to series E bonds under Revenue Ruling 57–452, C.B. 1957–2, 302, which held that the increase in redemption price (increment in value) during a taxable year did not constitute income in such year to a taxpayer-depositor holding such certificate and employing the cash receipts and disbursements method of accounting. However, the Revenue Ruling permitted the taxpayer to elect, under section 454(a) of the Internal Revenue Code of 1954, to report the increase in the taxable year in which it occurs.

Section 1.451–2(a) of the Income Tax Regulations, as amended by Treasury Decision 6723, C.B. 1964–1 (Part 1), 73, provides that income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year in which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, it also provides that income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

The phrase "or otherwise made available" which was inserted in the first sentence of paragraph (a) of section 1.451–2 of the regulations makes it clear that it is a right of withdrawal during the taxable year, rather than the formal setting apart or crediting of income, which causes such income to be constructively received.

The regulations, as amended, list four specific conditions which do not constitute substantial limitations or restrictions on the taxpayer's control over the receipt of earnings payable in respect of any deposit or account in a "bank or other financial institution," which term includes banks, building and loan associations, savings and loan associations, and Federal savings and loan associations.

Upon reconsideration of the matter, the increment in value of growth savings certificates issued by a bank shall be included in the gross income of a taxpayer, employing the cash receipts and disbursements method of accounting, in each taxable year in which the increase occurs since the taxpayer (certificate holder) has a right to redeem the certificate in such taxable year.

The provisions of Revenue Procedure 64–24, C.B. 1964–1 (Part 1), 693, relating to closing agreements for interest earned on deposits or accounts opened before November 15, 1962, apply to the increment in value of these growth savings certificates.

Revenue Ruling 57–452, C.B. 1957–2, 302, is hereby revoked.

Rev. Rul. 66–45

Interest on nonnegotiable savings certificates issued by a bank, which is not credited periodically to a certificate holder but paid only upon the surrender and redemption of the certificates, is includible in the gross income of the holder, employing the cash receipts and disbursements method of accounting, in each taxable year in which the holder either has the right to redeem the certificate or could have had such right through making written demand for payment.

Revenue Ruling 60–145, C.B. 1960–1, 182, modified.

Advice has been requested with respect to the application of section 1.451–2 of the Income Tax Regulations relating to constructive receipt of interest earned on nonnegotiable savings certificates described below.

A bank issued interest-bearing nonnegotiable savings certificates in multiples of $100. The bank agreed to pay the face amount of the certificate, with interest, to the holder at the end of 1 year, provided the holder made written demand for such payment on or before the expiration of such year.

If written demand was not made, the certificate remained in force and was redeemable at the end of each 6-month period thereafter.

The bank was obligated to pay the face amount of the certificate, with interest, at the expiration of any such period within which demand for payment was made.

No crediting of interest on this certificate was made until the holder presented it for redemption, at which time the bank paid the face amount and all earned interest. The certificate could be redeemed only at the end of the first year or any subsequent 6-month period within which the holder made demand for payment and surrendered the certificate.

Section 1.451–2(a) of the regulations, as amended by Treasury Decision 6723, C.B. 1964–1 (Part 1), 73, provides that income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year in which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

The phrase "or otherwise made available" was added to the first sentence of paragraph (a) of section 1.451–2 of the regulations to make it clear that it is a right of withdrawal during the taxable year, rather than the formal setting apart or crediting of income, which causes such income to be constructively received.

Section 1.451–2(a)(3) of the regulations provides that a requirement that the earnings may be withdrawn only upon a withdrawal of all or part of the deposit or account is not a substantial limitation or restriction on the taxpayer's control over the receipt of such earnings.

It is further provided in section 1.451–2(a)(4) of the regulations that a requirement that notice be given prior to withdrawal is also not a substantial limitation.

Accordingly, interest on nonnegotiable savings certificates issued by a bank, which is not credited periodically to a certificate holder but paid only upon the surrender and redemption of the certificates, is includible in the gross income of the holder, employing the cash receipts and disbursements method of accounting, in each taxable year in which the holder either has the right to redeem the certificate or could have had such right through making written demand for payment.

The provisions of Revenue Procedure 64–24, C.B. 1964–1 (Part 1), 693, relating to closing arrangements for interest earned on deposits or accounts opened before November 15, 1962, apply to interest on these nonnegotiable savings certificates.

Revenue Ruling 60–145, C.B. 1960–1, 182, to the extent that it is in conflict with the result required by section 1.451–2 of the regulations as explained above, is hereby modified.

Earnings credited to the secondary reserve account of a savings and loan institution by the Federal Savings and Loan Insurance Corporation. See Rev. Rul. 66–49, page 36.

Subpart C.—Taxable Year for Which Deductions Taken

SECTION 461.—GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION

26 CFR 1.461–1: General rule for taxable year of deduction.
(Also Sections 165, 471; 1.165–1, 1.471–1.)

Rev. Rul. 66–64

Where a purchaser of natural gas for resale enters into a "take-or-pay" contract under which a liability arises to make a payment for a contract year's gas not yet taken, the asset acquired by the incurring of the liability must be treated by the purchaser as a deferred charge. When title to the "make-up gas" vests in the purchaser, such gas enters into the computation of cost of goods sold.

If the gas is not taken and the right to take the make-up gas is not assigned, a loss for the amount paid for such gas is allowable under section 165 of the Internal Revenue Code of 1954, for the taxable year in which it can be determined that the gas will never be taken and that the amount paid will not be refunded.

Advice has been requested whether, under a "take-or-pay" contract, the cost of that portion of a contract year's specified quantity of gas contracted for which is not taken is deductible in the taxable year in which the liability to make payment arose. Advice has also been requested as to the treatment of such payment when it is determined that the gas paid for will not be taken and that the payment will not be refunded.

The taxpayer is on an accrual method of accounting and purchases natural gas for resale. For the year 1960 and subsequent years, the taxpayer entered into take-or-pay gas purchase contracts. Under such a contract, the taxpayer agrees to purchase and make payment for a specified quantity of gas for each contract year. In the event the taxpayer does not take the entire contract year's specified quantity he may accept, in a period ("make-up period") which extends beyond the contract year in which the failure to take occurred, all or part of the contract year's gas not taken. Gas taken in a contract year subsequent to that in which the liability to take such gas arose is termed "make-up gas." The cost of the make-up gas taken in the make-up period may be based on the unit price of gas effective during the contract year the gas is taken or it may be based on the unit price in effect during the contract year in which the failure to take occurred, depending upon the terms of the contract. In either case, the purchaser is entitled to offset the amount originally paid with respect to the make-up gas against such cost. The make-up gas may be taken only after the purchaser has accepted the quantity of gas specified for the current contract year.

Make-up periods last for the life of the contract or some lesser period. Payments made for gas not taken in the contract year in which the liability to make such payments arose are not refundable if the gas, through no fault of the seller, is not taken. The producer-seller is required to dedicate specific gas reserves and make available specified quantities of gas as stated in the contract. The rights created under

the contract to purchase gas and to acquire make-up gas are assignable.

It is clear that the cost of gas purchased for resale and taken during the contract year in which liability for payment was incurred gives rise to the acquisition of an asset. Similarly, the fact that the taxpayer defers the taking of all or any portion of the gas until a contract year subsequent to that in which the failure to take the specified quantity of gas contracted for occurred does not alter the nature of that which was acquired by the payment for such gas—*viz*, an asset with an ascertainable fair market value.

Accordingly, when the taxpayer incurs a liability under the contract to pay for a specified quantity of gas but defers the taking of all or a portion thereof to a later period, the amount of the liability to pay for the contract year's gas not taken must be treated as a deferred charge. When title to the make-up gas vests in the purchaser, such gas enters into the computation of cost of goods sold. If the gas is not taken and the right to take the make-up gas is not assigned, a loss for the amount paid for such gas is allowable under section 165 of the Internal Revenue Code of 1954, for the taxable year in which it can be determined that the make-up gas will never be taken and that the amount paid will not be refunded.

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26 CFR 1.461–2: Timing of deductions in certain cases where asserted liabilities are contested.

Additional premiums required to be paid by an insured savings and loan institution to the Federal Savings and Loan Insurance Corporation. See Rev. Rul. 66–49, page 36.

Subpart D.—Inventories

SECTION 471.—GENERAL RULE FOR INVENTORIES

26 CFR 1.471–1: Need for inventories.

Prepayment made for the purchase of natural gas under a "take-or-pay" contract—test for includibility in inventory. See Rev. Rul. 66–64, page 97.

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26 CFR 1.471–3: Inventories at cost. Rev. Rul. 66–145

Demand charges and other charges incurred by retail gas utilities in obtaining gas for resale from gas storage companies or from transmission companies are a part of the cost of gas purchased and, therefore, are includible in inventory cost.

Advice has been requested as to whether costs in the form of demand charges, capacity charges, injection charges, storage charges, withdrawal charges, delivery charges, etc., incurred by retail gas utilities in obtaining natural gas for resale, are to be charged to expense as incurred or are part of the cost of gas purchased and therefore includible in inventory cost.

Retail gas utilities are engaged in the sale of natural gas to customers for cooking, heating, or industrial purposes. They purchase the gas from suppliers at a price pursuant to the applicable provisions of the Federal Power Commission "Gas Tariff." Natural gas may be purchased from pipeline transmission companies, gas processors, or refineries for delivery directly to consumers or to storage before such delivery.

The purchase price paid for natural gas by retail utilities usually consists of two elements, a commodity charge and a demand (or capacity) charge. The commodity charge is expressed in cents per thousand cubic feet and is directly proportionate to the quantity of gas actually purchased. The demand charge may be described as a charge imposed by the transmission company which represents an incremental cost of providing the facilities necessary for it to meet the utility's demand for peak volumes of gas. This demand charge ordinarily is paid every month throughout the year regardless of the amount of gas received in any given month and is an integral part of the cost of all gas purchased during the year.

Sometimes, the purchase price includes in addition to a commodity charge and a demand charge, a storage charge for storage services rendered prior to delivery to the retail utility. This storage charge may include an injection charge, a withdrawal charge, and a delivery charge.

Section 1.471–3(b) of the Income Tax Regulations states in part that inventory cost means:

> In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, * * *. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

For the purpose of this provision of the regulations, a retail gas utility acquires possession of purchased gas at the point where the gas is delivered into its distribution system, or, in the case of a storage reservoir owned by, or contracted for, the utility, at the point of injection into such storage facility.

Accordingly, all charges incurred up to delivery into the utility's distribution system or injection into the utility's storage facility, whether such charges be denominated commodity charge, demand charge, capacity charge, storage charge, injection charge, withdrawal charge, delivery charge, etc., are necessary charges incurred in acquiring possession of the gas and are includible in inventory cost.

SECTION 472.—LAST-IN, FIRST-OUT INVENTORIES

26 CFR 1.472–1: Last-in, first-out inventories. Rev. Rul. 66–84

> Price indexes for January 1966, published by the Bureau of Labor Statistics on March 4, 1966, for use by department stores employing the retail inventory and last-in, first-out inventory methods.

The following price indexes for January 1966, published by the Bureau of Labor Statistics on March 4, 1966, 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 sec-

tion 1.472–1(k) of the Income Tax Regulations and Mimeograph 6244, C.B. 1948–1, 21, for appropriate application to inventories for taxable years of 12 months ended December 31, 1965, and January 31, 1966.

Indexes are given on a national basis for the store total, for 20 major groups of departments and for two special combinations—soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wallpaper, as well as contract departments.

Bureau of Labor Statistics, Department Store Inventory Price Indexes, by Department Groups

[January 1941 =100]

	Department group	January 1966	January 1965	Percent change from January 1965 to January 1966*
I	Piece goods	206. 6	205. 7	0. 4
II	Domestics and draperies	209. 6	206. 0	1. 7
III	Women's and children's shoes	281. 9	275. 1	2. 5
IV	Men's and boys' shoes	275. 7	263. 1	4. 8
V	Infants' wear	177. 2	179. 0	−1. 0
VI	Women's underwear	182. 5	182. 0	. 3
VII	Women's and girls' hosiery	155. 2	155. 0	. 1
VIII	Women's and girls' accessories	207. 9	202. 0	2. 9
IX	Women's outerwear and girls' wear	192. 4	189. 9	1. 3
X	Men's clothing	252. 5	241. 8	4. 4
XI	Men's furnishings	205. 5	202. 4	1. 5
XII	Boys' clothing and furnishings	221. 2	220. 9	. 1
XIII	Jewelry	198. 1	195. 2	1. 5
XIV	Notions	186. 0	184. 3	. 9
XV	Toilet articles and drugs	211. 2	206. 7	2. 2
XVI	Furniture and bedding	237. 1	234. 0	1. 3
XVII	Floor covering	199. 5	198. 7	. 4
XVIII	Housewares	246. 7	242. 3	1. 8
XIX	Major appliances	128. 0	130. 0	−1. 5
XX	Radio and television sets	111. 6	118. 2	−5. 6
	Groups I–XV: Soft goods	211. 5	208. 2	1. 6
	Groups XVI–XX: Durable goods	202. 2	201. 5	. 3
	Store total	209. 4	206. 8	1. 3

*Absence of a minus sign before percent change in this column signifies price increase.

PART III.—ADJUSTMENTS

SECTION 481.—ADJUSTMENTS REQUIRED BY CHANGES IN METHOD OF ACCOUNTING

26 CFR 1.481–1: Adjustments in general.

Procedure with respect to a request for change in accounting practice of reporting wheat and feed grain diversion payments. See Rev. Proc. 66–1, page 598.

SECTION 483.—INTEREST ON CERTAIN DEFERRED PAYMENTS

26 CFR 1.483: Statutory provisions; interest on certain deferred payments. T.D. 6873 [1]

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

Interest on certain deferred payments

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

On April 20, 1965, a notice of proposed rulemaking to conform the Income Tax Regulations (26 CFR Part 1) to the amendment made to the Internal Revenue Code of 1954 by section 224(a) of the Revenue Act of 1964 (78 Stat. 77) [P.L. 88-272, C.B. 1964-1 (Part 2), 6], relating to interest on certain deferred payments, was published in the Federal Register (30 F.R. 5584). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendments of the regulations are hereby adopted. Sections 1.483 through 1.483-2 of the regulations supersede § 19.3-1 of Treasury Decision 6720, approved April 2, 1964 (29 F.R. 4882) [C.B. 1964-1 (Part 1), 622].

PARAGRAPH 1. Section 1.61-7 is amended by revising paragraph (a) to read as follows:

§ 1.61-7 INTEREST.—(a) *In general.*—As a general rule, interest received by or credited to the taxpayer constitutes gross income and is fully taxable. Interest income includes interest on savings or other bank deposits; interest on coupon bonds; interest on an open account, a promissory note, a mortgage, or a corporate bond or debenture; the interest portion of a condemnation award; usurious interest (unless by State law it is automatically converted to a payment on the principal; interest on legacies; interest on life insurance proceeds held under an agreement to pay interest thereon; and interest on refunds of Federal taxes. For rules determining the taxable year in which interest, including interest accrued or constructively received, is included in gross income, see section 451 and the regulations thereunder. For the inclusion of interest in income for the purpose of the retirement income credit, see section 37 and the regulations thereunder. For credit of tax withheld at source on interest on tax-free covenant bonds, see section 32 and the regulations thereunder. For rules relating to interest on certain deferred payments, see section 483 and the regulations thereunder.

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[1] The publication of this Treasury Decision in 31 F.R. 941, dated Jan. 25, 1966, contains (1) instructions for modifying the notice of proposed rulemaking published in 30 F.R. 5584, dated Apr. 20, 1965, and (2) the full context of the regulations with such modification. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

PAR. 2. Section 1.163–1 is amended by revising paragraph (a) to read as follows:

§ 1.163–1 INTEREST DEDUCTION IN GENERAL.—(a) Except as otherwise provided in sections 264 to 267, inclusive, interest paid or accrued within the taxable year on indebtedness shall be allowed as a deduction in computing taxable income. For rules relating to interest on certain deferred payments, see section 483 and the regulations thereunder.

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PAR. 3. Section 1.453–1 is amended by revising paragraph (b) to read as follows:

§ 1.453–1 INSTALLMENT METHOD OF REPORTING INCOME.

* * * * * * *

(b) *Income to be reported.*—(1) Persons permitted to use the installment method of accounting prescribed in section 453 may return as income from installment sales in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when the property is paid for bears to the total contract price. In the case of dealers in personal property, for this purpose, gross profit means sales less cost of goods sold. See § 1.453–2 for rules applicable to the computation of income of dealers in personal property reporting on the installment method. In the case of sales of real estate and casual sales of personal property, gross profit means the selling price less the adjusted basis as defined in section 1011 and the regulations thereunder. Gross profit, in the case of a sale of real estate by a person other than a dealer and a casual sale of personal property, is reduced by commissions and other selling expenses for purposes of determining the proportion of installment payments returnable as income. For rules applicable in determining "selling price" and the use of certain other terms, see also paragraph (c) of § 1.453–4.

(2) For purposes of section 453, any total unstated interest (as defined in section 483(b)) under a contract for the sale or exchange of property, payments on account of which are subject to the application of section 483, shall not be included as a part of the selling price or the total contract price. For rules relating to payments received prior to January 1, 1964, see paragraph (a)(2) of § 1.483–2.

PAR. 4. There are inserted immediately after § 1.482–1 the following new sections:

§ 1.483 STATUTORY PROVISIONS; INTEREST ON CERTAIN DEFERRED PAYMENTS.

SEC. 483. INTEREST ON CERTAIN DEFERRED PAYMENTS.

(a) AMOUNT CONSTITUTING INTEREST.—For purposes of this title, in the case of any contract for the sale or exchange of property there shall be treated as interest that part of a payment to which this section applies which bears the same ratio to the amount of such payment as the total unstated interest under such contract bears to the total of the payments to which this section applies which are due under such contract.

(b) TOTAL UNSTATED INTEREST.—For purposes of this section, the term "total unstated interest" means, with respect to a contract for the sale or exchange of property, an amount equal to the excess of—

(1) The sum of the payments to which this section applies which are due under the contract, over

(2) The sum of the present values of such payments and the present values of any interest payments due under the contract.

For purposes of paragraph (2), the present value of a payment shall be determined, as of the date of the sale or exchange, by discounting such payment at the rate, and in the manner, provided in regulations prescribed by the Secretary or his delegate. Such regulations shall provide for discounting on the basis of 6-month brackets and shall provide that the present value of any interest payment due not more than 6 months after the date of the sale or exchange is an amount equal to 100 percent of such payment.

(c) PAYMENTS TO WHICH SECTION APPLIES.—(1) IN GENERAL.—Except as provided in subsection (f), this section shall apply to any payment on account of the sale or exchange of property which con-

stitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract—

(A) Under which some or all of the payments are due more than 1 year after the date of such sale or exchange, and

(B) Under which, using a rate provided by regulations prescribed by the Secretary or his delegate for purposes of this subparagraph, there is total unstated interest.

Any rate prescribed for determining whether there is total unstated interest for purposes of subparagraph (B) shall be at least one percentage point lower than the rate prescribed for purposes of subsection (b)(2).

(2) TREATMENT OF EVIDENCE OF INDEBTEDNESS.—For purposes of this section, an evidence of indebtedness of the purchaser given in consideration for the sale or exchange of property shall not be considered a payment, and any payment due under such evidence of indebtedness shall be treated as due under the contract for the sale or exchange.

(d) PAYMENTS THAT ARE INDEFINITE AS TO TIME, LIABILITY, OR AMOUNT.—In the case of a contract for the sale or exchange of property under which the liability for, or the amount or due date of, any portion of a payment cannot be determined at the time of the sale or exchange, this section shall be separately applied to such portion as if it (and any amount of interest attributable to such portion) were the only payments due under the contract; and such determinations of liability, amount, and due date shall be made at the time payment of such portion is made.

(e) CHANGE IN TERMS OF CONTRACT.—If the liability for, or the amount or due date of, any payment (including interest) under a contract for the sale or exchange of property is changed, the "total unstated interest" under the contract shall be recomputed and allocated (with adjustment for prior interest (including unstated interest payments) under regulations prescribed by the Secretary or his delegate.

(f) EXCEPTIONS AND LIMITATIONS.—(1) SALES PRICE OF $3,000 OR LESS.—This section shall not apply to any payment on account of the sale or exchange of property if it can be determined at the time of such sale or exchange that the sales price cannot exceed $3,000.

(2) CARRYING CHARGES.—In the case of the purchaser, the tax treatment of amounts paid on account of the sale or exchange of property shall be made without regard to this section if any such amounts are treated under section 163(b) as if they included interest.

(3) TREATMENT OF SELLER.—In the case of the seller, the tax treatment of any amounts received on account of the sale or exchange of property shall be made without regard to this section if no part of any gain on such sale or exchange would be considered as gain from the sale or exchange of a capital asset or property described in section 1231.

(4) SALES OR EXCHANGES OF PATENTS.—This section shall not apply to any payments made pursuant to a transfer described in section 1235(a) (relating to sale or exchanges of patents).

(5) ANNUITIES.—This section shall not apply to any amount the liability for which depends in whole or in part on the life expectancy of one or more individuals and which constitutes an amount received as an annuity to which section 72 applies.

[Sec. 483 as added by sec. 224(a), Rev. Act 1964 (78 Stat. 77) [P.L. 88–272, C.B. 1964–1 (Part 2), 6]]

§ 1.483–1 COMPUTATION OF INTEREST ON CERTAIN DEFERRED PAYMENTS.—(a) *Computation of amount constituting interest.*—(1) *General rule.*—For all purposes of the Internal Revenue Code, in the case of any contract for the sale or exchange of property, there shall be treated as interest that part of a payment to which section 483 applies (see paragraph (b) of this section) which bears the same ratio to the amount of such payment as the total unstated interest (as defined in paragraph (c) of this section) under such contract bears to the total of the payments to which section 483 applies which are due under such contract. Thus, the amount to be treated as interest under section 483 is determined by multiplying each payment to which such section applies by a fraction, the numerator of which is the total unstated interest under the contract, and the denominator of which is the total of all the payments to which

section 483 applies which are due under such contract. The effect of this ratio is to allocate the total unstated interest on a pro rata basis among the total payments to which section 483 applies. Accordingly, the total amount to be treated as interest for a taxable year with respect to a contract under which there are payments which include unstated interest is an amount equal to the unstated interest allocated to the payments under the contract for such year plus any stated interest reportable under the contract for such year. See paragraph (b)(2) of this section for rules relating to allocation of contract price, payments, and stated interest; paragraph (e) of this section for rules relating to indefinite payments; paragraph (f) of this section for rules relating to changes in terms of contract; and paragraph (b) of § 1.483–2 for exceptions and limitations to the application of section 483.

(2) *Examples.*—The provisions of this paragraph may be illustrated by the following examples:

Example (1).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make three payments of $2,000 each, such payments being due, respectively, at the end of each year for the next 3 years. No interest is provided for in the contract. Assume that section 483 applies to each of the payments, and that the total unstated interest under the contract is $559.88. The portion of each $2,000 payment which is treated as interest is $186.63 $\left($2,000 × $\frac{\$559.88}{\$6,000.00}$$\right)$.

Example (2).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make payments of $4,000, $3,000, and $2,000, such payments being due, respectively, at the end of each year for the next 3 years. No interest is provided for in the contract. Assume that section 483 applies to each of the payments, and that the total unstated interest under the contract is $750.31. The portion of the $4,000 payment which is treated as interest is $333.47 $\left($4,000 × $\frac{\$750.31}{\$9,000.00}$$\right)$, the portion of the $3,000 payment which is treated as interest is $250.10 $\left($3,000 × $\frac{\$750.31}{\$9,000.00}$$\right)$, and the portion of the $2,000 payment which is treated as interest is $166.74 $\left($2,000 × $\frac{\$750.31}{\$9,000.00}$$\right)$.

Example (3).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make payments of $2,040 ($2,000 sales price plus $40 interest), $2,080 ($2,000 sales price plus $80 interest), and $2,120 ($2,000 sales price plus $120 interest), such payments being due, respectively, 1, 2, and 3 years from the date of sale. Assume that both *A* and *B* are calendar year taxpayers, that section 483 applies to each of the payments, and that the total unstated interest under the contract is $345.85. The portion of each $2,000 payment (sales price) which is treated as interest is $115.28 $\left($2,000 × $\frac{\$345.85}{\$6,000.00}$$\right)$. Thus, for 1964, the total amount to be treated as interest by *A* and *B* with respect to the contract is $155.28 ($115.28 unstated interest plus $40 stated interest), for 1965 such total amount is $195.28 ($115.28 unstated interest plus $80 stated interest), and for 1966 such total amount is $235.28 ($115.28 unstated interest plus $120 stated interest).

(b) *Payments to which section 483 applies.*—(1) *In general.*—Except as provided in subparagraph (4) of this paragraph, section 483 applies to any payment made after December 31, 1963, on account of the sale or exchange of property occurring after June 30, 1963, which payment constitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract—

(i) Under which one or more of the payments are due more than 1 year after the date of such sale or exchange, and

(ii) Under which there is "total unstated interest" (within the meaning of paragraph (d) of this section).

For purposes of the preceding sentence, the term "sales price" does not include any interest payments provided for in the contract. The term "sale or exchange" includes any transaction treated as a sale or exchange for purposes of the Code. For purposes of section 483, a payment may be made in cash, stock or securities, or other property (except as provided in subparagraph (5) of this paragraph). Section 483 does not apply to any deferred payments under a contract under which all of the payments are due no more than 1 year after the date of the sale

or exchange. Section 483 does not apply to a distribution in complete liquidation of a corporation, regardless of whether the corporation is liquidated in one distribution or in a series of distributions. For special rules relating to the time a sale or exchange takes place in the case of a disposal of timber, coal, or domestic iron ore, which qualifies under section 631 (relating to gain or loss in the case of timber, coal, or domestic iron ore), see that section and the regulations thereunder. See paragraph (e) of this section for special rules relating to indefinite payments, and paragraph (f) of this section for rules relating to the effect of a late payment on the determination of the due date of such payment. Section 483 may apply whether the contract providing for deferred payments is express (whether written or oral) or implied. In general, for purposes of section 483, all sales or exchanges involving deferred payments are considered as made under a contract.

(2) *Allocation of contract price, payments, and stated interest.*—If payments are due under a contract both for the sale or exchange of property to which section 483 applies (for example, capital assets) and for either the sale or exchange of property to which such section does not apply (for example, the transfer of patents described in section 1235(a)) or services rendered or to be rendered, the parties to the contract may agree at the time of the sale or exchange on a reasonable determination of the portion of the contract price and the stated interest (if any), and of each payment due under the contract, which is allocable to each such type of property and to services. However, if the parties do not so agree on a reasonable determination of the allocation of the contract price, or the stated interest (if any), or each payment due under the contract, the district director shall make such a reasonable determination.

(3) *Effect of other provisions of law.*—If there is total unstated interest under a contract, a portion of each payment to which section 483 applies shall be treated as interest to the extent provided in such section, notwithstanding that some other provision of law (for example, section 1245, relating to gain from dispositions of certain depreciable property) would, without regard to section 483, treat a portion of the payment as ordinary income or in some other manner. In such a case, section 483 shall apply first and the other provision of law shall apply only to the remainder of the payment not treated as interest under section 483. For example, if a portion of a payment is treated as interest under section 483 and such portion would otherwise be treated as gain from the sale or exchange of property which is not a capital asset under section 1232 (relating to bonds and other evidences of indebtedness), section 483 shall apply first and section 1232 shall apply only to the remainder of the payment after the interest portion has been determined. In such case, in order to avoid a double inclusion in income, for purposes of section 1232(b) the "stated redemption price at maturity" shall be reduced by any amount treated as interest under section 483.

(4) *Effective date.*—Section 483 does not apply to any payments on account of a sale or exchange made pursuant to a binding written contract (including an irrevocable written option) entered into before July 1, 1963. For purposes of the preceding sentence, a restricted stock option (as defined in section 424(b)) shall be considered as irrevocable. For rules relating to certain stock options granted prior to January 1, 1965, see paragraph (a)(2) of § 1.483-2. For purposes of this subparagraph, if after June 30, 1963 (or December 31, 1964, in the case of certain stock options granted prior to such date), there is a substantial change in the terms of such a contract or option, then any payments made pursuant to such changed contract or option shall not be considered as payments on account of a sale or exchange made pursuant to a contract or option entered into before July 1, 1963 (or January 1, 1965, as the case may be). For example, a payment made after December 31, 1963, pursuant to a "buy-sell" agreement entered into before July 1, 1963, between shareholders, is not subject to section 483 unless such agreement is substantially changed after June 30, 1963. For purposes of this subparagraph, a mere prepayment or early payment of part or all of the sales price or stated interest, or a change in the sales price arising from an independent appraisal or a mechanical formula, if such appraisal or formula is specified in the contract, or the mere transfer of the obligation to make or of the right to receive deferred payments under a contract, is not considered a substantial change in the terms of the contract. Furthermore, a late payment of part or all of the sales price or stated interest shall not be considered a substantial change in the terms of the contract if such payment is made no later than 90 days after the date the payment was due under the contract, or, if the payment is made after such 90-day period, any additional interest provided for under the terms of the contract or under local law is collected.

(5) *Evidence of indebtedness.*—For purposes of section 483, an evidence of indebtedness (whether or not negotiable and whether or not includible in gross income) of the purchaser given in consideration for the sale or exchange of property is not a payment, and any payment due under such evidence of indebtedness shall be treated as due under the contract for the sale or exchange.

(6) *Examples.*—The provisions of this paragraph may be illustrated by the following examples:

Example (1).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to pay $3,000 on the date of sale, $1,000 on June 1, 1964, and $1,000 on December 26, 1964. No interest is provided for in the contract. Since none of the payments under the contract is due more than 1 year after the date of the sale, section 483 does not apply to any of the payments due under the contract.

Example (2).—The facts are the same as in example (1), except that there is an additional $1,000 payment due on June 1, 1965. Since, under the contract, there is at least one payment due more than 1 year after the date of the sale, section 483 applies to any definite payment under the contract which is due more than 6 months after the date of the sale. Thus, section 483 applies to the $1,000 payments due on December 26, 1964, and on June 1, 1965.

Example (3).—On December 31, 1963, *A* sells property to which section 483 applies and renders services to *B* under a contract which provides that *B* is to pay $10,000 on the date of sale, $5,000 on December 31, 1964, and $5,000 on December 31, 1965. No interest is provided for in the contract. Assume that the parties make no allocation of the contract price between property and services but that a reasonable allocation of the $20,000 total contract price and of each $5,000 payment is 75 percent for the sale of the property and 25 percent for the services rendered. The district director may allocate the contract price and each payment in those proportions and section 483 would then apply to 75 percent of each $5,000 payment ($3,750) since this is the portion that was allocated to the sale of the property.

Example (4).—On December 31, 1963, *M* Corporation redeems 500 shares of its stock from *A*, one of its shareholders. *M* pays *A* $10,000 on the date of redemption and gives *A* a non-interest-bearing promissory note which provides that *M* is to pay *A* $2,000 at the end of each of the next 5 years. Section 483 applies to each of the $2,000 payments.

Example (5).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to pay *A* $10,000 on the date of sale and transfer to *A* a total of 4,000 shares of *X* Corporation stock owned by *B*, 2,000 of such shares being due on June 30, 1965, and 2,000 shares on June 30, 1966. No interest is provided for in the contract. Section 483 applies to each of the transfers of *X* stock to *A*. See paragraph (e) of this section for special rules relating to indefinite payments.

Example (6).—On December 31, 1963, *M* Corporation sells 500 shares of its stock to *A*, one of its employees, for a lump-sum payment of $10,000. At the same time, *A* borrows $10,000 from *M* Corporation and gives *M* a non-interest-bearing promissory note which provides that *A* is to pay *M* $2,000 at the end of each of the next 5 years. Section 483 applies to any payments made by *A* under the promissory note in the same manner as if such payments were being made under a deferred-payment contract for the sale or exchange of the stock.

Example (7).—*M* Corporation and *N* Corporation each owns one-half of the stock of *O* Corporation. On December 31, 1963, pursuant to a reorganization qualifying under section 368(a)(1)(B), *M* contracts to acquire the one-half interest held by *N* for an initial distribution on such date of 30,000 shares of *M* voting stock, and a nonassignable right to receive up to 10,000 additional shares of *M*'s voting stock during the next 3 years, provided the net profits of *O* Corporation exceed certain amounts specified in the contract. No interest is provided for in the contract. No additional shares are received in 1964 or in 1965, but in 1966 the annual earnings of *O* Corporation exceed the specified amount and on December 31, 1966, an additional 3,000 *M* voting shares are transferred to *N*. Section 483 applies to the transfer of the 3,000 *M* voting shares to *N* on December 31, 1966. See example (2) of paragraph (e)(3) of this section for an illustration of the computation of total unstated interest in this case.

Example (8).—*P* Corporation and *Q* Corporation each owns one-half of the stock of *R* Corporation. On December 31, 1963, pursuant to a reorganization qualifying under section 368(a)(1)(B), *P* contracts to acquire the one-half interest held by *Q* for a distribution on such date of 40,000 shares of *P* voting stock. As a part of the plan of reorganization, *Q* immediately places 10,000 of

such voting shares in escrow. The escrow agreement provides that all or a portion of the stock placed in escrow is to be returned to *P* within 3 years (together with dividends and earnings thereon) if *R*'s net profits do not exceed certain amounts specified in the agreement and that *Q* Corporation is entitled to vote the escrowed stock until such time as it may be returned to *P* Corporation. The agreement further provides that the escrow will terminate at the end of 3 years and that any stock then remaining in escrow (together with dividends and earnings thereon) is to be redelivered to *Q* Corporation. *Q* Corporation currently includes in income all dividends and earnings thereon with respect to the escrowed stock. Since *Q* Corporation is treated as having received, on December 31, 1963, all payments due under the exchange, section 483 does not apply to the transfer of any of the escrowed stock to *Q* Corporation.

(c) *Total unstated interest.*—(1) *In general.*—For purposes of paragraph (a) of this section (that is, for purposes of determining the portion of a payment to which section 483 applies which is to be treated as interest), the term "total unstated interest" means, with respect to a contract for the sale or exchange of property, an amount equal to the excess of—

(i) The sum of the payments to which section 483 applies which are due under the contract (within the meaning of paragraph (b) of this section), over

(ii) The sum of the present values of such payments and the present values of any stated interest payments due under the contract.

(2) *Present value of a payment.*—The present value of any interest payment due under the contract not more than 6 months after the date of the sale or exchange is an amount equal to 100 percent of such payment. The present value of any other interest payment, and of any payment to which section 483 applies, which is due under the contract shall be determined by discounting such payment at an interest rate of 5 percent per annum compounded semiannually, from the nearest date (to the date such payment is actually due under the contract) which marks a 6-month interval from the date of the sale or exchange. For purposes of computing the present value of a payment at such rate and in such manner, column (b) of the appropriate table set forth in paragraph (g) of this section shall be used.

(3) *Examples.*—The provisions of this paragraph may be illustrated by the following examples:

Example (1).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make three payments of $2,000 each, such payments being due, respectively, at the end of each year for the next 3 years. No interest is provided for in the contract. For purposes of paragraph (a) of this section, the total unstated interest under the contract is $559.88, computed as follows:

Sum of payments to which sec. 483 applies		$6,000.00
Less:		
Present value of $2,000 due every 12 months for 3 years ($2,000×2.72006 (factor for 3 years, col. (b), table III))		5,440.12
Total unstated interest		$559.88

Example (2).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make two payments of $1,000 each, payable August 1, 1964, and November 1, 1964, and a third payment of $2,000, payable March 1, 1965. No interest is provided for in the contract. For purposes of paragraph (a) of this section, the total unstated interest under the contract is $168.96, computed as follows:

Sum of payments to which sec. 483 applies		$4,000.00
Less:		
Present value of $1,000 due Aug. 1, 1964 ($1,000×0.97561 (factor for 6 to 9 months, col. (b), table I))	$975.61	
Present value of $1,000 due Nov. 1, 1964 ($1,000×0.95181 (factor for 9 to 15 months, col. (b), table I))	951.81	
Present value of $2,000 due Mar. 1, 1965 ($2,000×0.95181 (factor for 9 to 15 months, col. (b), table I))	1,903.62	
		3,831.04
Total unstated interest		$168.96

Example (3).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make payments of $2,040 ($2,000 sales price plus $40 interest), $2,080 ($2,000 sales price plus $80 interest), and $2,120 ($2,000 sales price plus $120 interest), such payments being due, respectively, 1, 2, and 3 years from the date of sale. For purposes of paragraph (a) of this section, the total unstated interest under the contract is $345.85, computed as follows:

Sum of payments to which sec. 483 applies		$6,000.00
Less:		
Present value of $2,040 due 1 year from date of sale ($2,040×0.95181 (factor for 9 to 15 months, col. (b), table I))	$1,941.69	
Present value of $2,080 due 2 years from date of sale ($2,080×0.90595 (factor for 21 to 27 months, col. (b), table I))	1,884.38	
Present value of $2,120 due 3 years from date of sale ($2,120×0.86230 (factor for 33 to 39 months, col. (b), table I))	1,828.08	
		5,654.15
Total unstated interest		$345.85

Example (4).—The facts are the same as in example (3), except that the first payment of $2,040 ($2,000 sales price plus $40 interest) is due on March 1, 1964. Since this payment is not due more than 6 months after the date of the sale, the $2,000 payment of sales price is not a payment to which section 483 applies. For purposes of paragraph (a) of this section, the total unstated interest under the contract is $247.54, computed as follows:

Sum of payments to which sec. 483 applies		$4,000.00
Less:		
Present value of $40 stated interest due Mar. 1, 1964 ($40 × 1.00000 (0 to 6 months, col. (b), table I))	$40.00	
Present value of $2,080 due 2 years from date of sale ($2,080 × 0.90595 (factor for 21 to 27 months, col. (b), table I))	1,884.38	
Present value of $2,120 due 3 years from date of sale ($2,120 × 0.86230 (factor for 33 to 39 months, col. (b), table I))	1,828.08	
		3,752.46
Total unstated interest		$247.54

(d) *Test of whether there is total unstated interest under a contract.*—(1) *In general.*—Except as provided in subparagraphs (2) and (3) of this paragraph, for purposes of determining whether section 483 applies to payments under a contract (that is, for purposes of paragraph (b)(1)(ii) of this section), the determination of whether there is total unstated interest under a contract shall be made in accordance with the method for computing total unstated interest provided in paragraph (c) of this section, except that column (a) of the appropriate table contained in paragraph (g) of this section (which provides for discounting payments at a test rate of 4 percent per annum simple interest) shall be used to determine the present value of a payment. If, after applying the test rate provided in the preceding sentence, there is total unstated interest (regardless of amount) with respect to a contract, section 483 applies to the payments described in paragraph (b) of this section which are due under the contract. In such case, the amount of total unstated interest under the contract which is includible in or deductible from income must be computed by using the higher interest rate prescribed in paragraph (c) of this section, and then allocating such amount among the payments due under the contract in the manner provided in paragraph (a) of this section.

(2) *Alternative test where contract rate is at least 4 percent per annum simple interest.*—The method provided in subparagraph (1) of this paragraph for determining whether there is total unstated interest need not be used in the case of a contract which provides for interest at a rate of at least 4 percent simple interest per annum, payable on each installment of principal at the time such installment is payable. For purposes of paragraph (b)(1)(ii) of this section, there is no total unstated interest under such a contract and, therefore,

section 483 does not apply to payments under such a contract. For purposes of this paragraph, simple interest means straight interest computed on the principal amount of a payment from the time of the sale or exchange to the time the payment is required to be made. As an illustration of the meaning of simple interest, if a contract provides for payments totaling $6,000 in three equal installments of $2,000 plus 4 percent per annum simple interest, such installments of principal and interest being due 1, 2, and 3 years, respectively, from the date of the sale, the amount of interest due with the first installment is $80 ($2,000×0.04×1), the amount of interest due with the second installment is $160 ($2,000×0.04×2), and the amount of interest due with the third installment is $240 ($2,000×0.04×3).

(3) *Test rate of interest for governmental obligation described in section 103.*—In the case of a contract under which the purchaser is the United States, a State, or any other governmental body described in section 103 (relating to interest on certain governmental obligations), and under which the deferred payments are made pursuant to an obligation to which section 103 applies the test rate of interest for determining whether there is total unstated interest shall be zero.

(4) *Examples.*—The provisions of this paragraph may be illustrated by the following examples:

Example (1).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make payments at the end of each of the next 3 years of $2,000 principal, plus 5 percent per annum simple interest. Since the interest rate specified in the contract with respect to each payment is higher than the test rate (4 percent per annum simple interest), it is not necessary to compute whether there is total unstated interest under subparagraph (1) of this paragraph, and section 483 does not apply to any payments due under the contract.

Example (2).—The facts are the same as in example (1), except that the interest rate provided in the contract is 2 percent per annum simple interest. Since the interest rate specified in the contract is less than the test rate (4 percent per annum simple interest), section 483 applies to each of the payments of sales price due under the contract. For the method of computing the amount of total unstated interest which is includible in or deductible from income, see paragraph (c) of this section.

Example (3).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make payments of $2,040 ($2,000 sales price plus $40 interest), $2,080 ($2,000 sales price plus $80 interest), and $2,120 ($2,000 sales price plus $120 interest), such payments being due, respectively, 1, 2, and 3 years from the date of sale. The determination of whether there is total unstated interest under the contract is made in the following manner:

(i) Sum of payments to which sec. 483 applies		$6,000.00
(ii) Sum of:		
Present value of $2,040 due 1 year from date of sale ($2,040×0.96154 (factor for 9 to 15 months, col. (a), table I))	$1,961.54	
Present value of $2,080 due 2 years from date of sale ($2,080×0.92593 (factor for 21 to 27 months, col. (a), table I))	1,925.93	
Present value of $2,120 due 3 years from date of sale ($2,120×0.89286 (factor for 33 to 39 months, col. (a), table I))	1,892.86	
		$5,780.33

Since the sum of the payments to which section 483 applies ($6,000) exceeds the sum of the present values of such payments and the present values of the stated interest payments ($5,780.33), there is total unstated interest under the contract and the provisions of section 483 apply to the payments of sales price due under the contract. For the method of computing the amount of total unstated interest which is includible in or deductible from income, see paragraph (c) of this section.

Example (4).—(i) On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make four $1,000 payments, each payment bearing 4 percent per annum simple interest. Such payments are due, respectively, 1, 2, 3, and 4 years from the date of sale. Thus, the payments would be: $1,040 ($1,000 sales price plus $40 interest), $1,080 ($1,000 sales price plus $80 interest), $1,120 ($1,000 sales price plus $120 interest), and $1,160 ($1,000 sales

price plus $160 interest). The total interest stated in the contract for the 4-year period is $400. Since the interest rate specified in the contract between *A* and *B* is equal to the test rate (4 percent per annum simple interest), subparagraph (2) of this paragraph applies. Therefore, it is not necessary to compute whether there is total unstated interest under subparagraph (1) of this paragraph, and section 483 does not apply to any payments due under the contract.

(ii) On the same date, *A* sells property to *C* under a contract which provides that *C* is to make four payments of $1,000 each, such payments being due, respectively, 1, 2, 3, and 4 years from the date of sale. No interest is due until the last payment at which time *C* is to pay $400 interest. Since the contract between *A* and *C* does not provide for interest at a rate of at least 4 percent per annum, payable on each installment of principal at the time such installment is payable, subparagraph (2) of this paragraph does not apply and the determination of whether there is total unstated interest must be made under subparagraph (1) of this paragraph, as follows:

(*a*) Sum of payments to which sec. 483 applies			$4,000.00
(*b*) Sum of:			
Present value of $1,000 due every 12 months for 4 years ($1,000×3.64240 (factor for 4 years, col. (a), table III))	$3,642.40		
Present value of $400 stated interest due 4 years from date of sale ($400×0.86207 (factor for 45 to 51 months, col. (a), table I))	344.83		
			$3,987.23

Since the sum of the payments to which section 483 applies ($4,000) exceeds the sum of the present values of such payments and the present value of the stated interest payment ($3,987.23), there is total unstated interest under the contract, and the provisions of section 483 apply to the payments of sales price due under the contract. For the method of computing the amount of total unstated interest which is includible in or deductible from income, see paragraph (c) of this section.

(e) *Payments that are indefinite as to time, liability, or amount.*—(1) *In general.*—In the case of a contract for the sale or exchange of property under which there are any indefinite payments, section 483 shall be separately applied to each such indefinite payment as if it (and any amount of interest attributable to such indefinite payment) was the only payment due under the contract, and the effect of the application of section 483 shall be determined at the time such payment is made. For purposes of section 483, a payment shall be considered as indefinite if the liability for, or the amount or due date of, such payment cannot be determined at the time of the sale or exchange. Thus, if, at the time of the sale or exchange, some or all of the payments under the contract are indefinite, the determination as to whether there is total unstated interest (see paragraph (d) of this section), and if so, the computation of the amount of total unstated interest which is includible in or deductible from income (see paragraph (c) of this section), shall be made separately with respect to each indefinite payment as of the time it is received, taking into account the time interval between the sale or exchange and the receipt of the payment (to the nearest 6-month interval). Section 483 shall be applied separately to the aggregate of any definite payments which may also be due under the contract. Section 483 does not apply to any indefinite payment which is made no more than 1 year after the date of the sale or exchange even if there are other payments (definite or indefinite) under the contract made more than a year after such date. The provisions of this subparagraph shall apply notwithstanding the fact that the obligation under which such payment is made has been valued and the transaction treated as "closed" for purposes of determining gain or loss. See paragraph (b)(5) of this section for rules relating to evidence of indebtedness. See paragraph (b)(1)(i) of § 1.483–2 for rule relating to the effect on indefinite payments of the exception for contracts with a sales price of $3,000 or less.

(2) *Contingent interest.*—If a deferred-payment contract provides for contingent interest, no part of such contingent interest shall be taken into account for purposes of section 483 until it is actually paid. For example, contingent interest shall not be taken into account in determining whether there is total unstated interest under the contract. For purposes of section 483, interest shall be considered as contingent if the liability for, or the amount or due date of,

such interest cannot be determined at the time of the sale or exchange. If any part of the interest provided for in the contract is not contingent interest, such part shall be taken into account as stated interest for purposes of section 483. In case any amount of contingent interest is actually paid, such payment shall be treated in accordance with the rules prescribed for indefinite payments in subparagraph (1) of this paragraph if the payment of the portion of the sales price to which the interest is attributable is indefinite, or in accordance with the rules prescribed for changes in the terms of the contract (see paragraph (f) of this section) if the payment of the portion of the sales price to which the interest is attributable is definite. If the contract provides that all or a definite part of the interest must in all events be paid by a date specified in the contract (whether or not in certain circumstances it must be paid earlier), then such interest (or the definite part thereof) shall not be considered contingent interest and shall be taken into account as stated interest due on such specified date. If any amount of interest described in the preceding sentence is actually paid before such specified date then such payment shall be treated in accordance with the rules prescribed for indefinite payments in subparagraph (1) of this paragraph if the payment of the portion of the sales price to which the interest is attributable is indefinite, or in accordance with the rules prescribed for changes in the terms of the contract (see paragraph (f) of this section) if the payment of the portion of the sales price to which the interest is attributable is definite.

(3) *Examples.*—The provisions of this paragraph may be illustrated by the following examples:

Example (1).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to pay $40,000 at the time of sale and $10,000 on December 29th of each year for the next 3 years, unless profits derived from the property exceed a specified amount during the year, in which case, in such year, *B* is to pay $12,000. No interest is provided for in the contract. For the year 1964, profits have exceeded the specified amount and *B* pays $12,000. For 1965 *B* pays only $10,000, but for 1966 profits have again exceeded the specified amount and *B* pays $12,000. Since, on the date of sale, there are definite payments due under the contract, total unstated interest is computed with respect to the aggregate of such definite payments. The total unstated interest under the contract, determined as of December 31, 1963, is $2,799.40, computed as follows:

Sum of definite payments to which sec. 483 applies	$30,000.00
Less:	
Present value of $10,000 due every 12 months for 3 years ($10,000×2.72006 (factor for 3 years, col. (b), table III))	27,200.60
Total unstated interest	$2,799.40

At the time of receipt of the indefinite portion ($2,000) of the first payment ($12,000), additional unstated interest is not computed on the amount of such indefinite portion since payment was made no more than 1 year after the date of the sale. At the time of receipt of the indefinite portion ($2,000) of the last payment ($12,000), additional unstated interest is computed based on the amount of such indefinite portion. The additional unstated interest at the end of the third year is $275.40, computed as follows:

Indefinite portion of payment to which sec. 483 applies	$2,000.00
Less:	
Present value of such portion ($2,000×0.86230 (factor for 33 to 39 months, col. (b), table I))	1,724.60
Total unstated interest	$275.40

Example (2).—*M* Corporation and *N* Corporation each own one-half of the stock of *O* Corporation. On December 31, 1963, pursuant to a reorganization qualifying under section 368(a)(1)(B), *M* contracts to acquire the one-half interest held by *N* for an initial distribution on such date of 30,000 shares of *M* voting stock, and a nonassignable right to receive up to 10,000 additional shares of *M*'s voting stock during the next 3 years, provided the net profits of *O* Corporation exceed certain amounts specified in the contract. No interest is provided for in the contract. No additional shares are received in 1964 or in 1965, but in 1966 the annual earnings of *O* Corporation exceed the specified amount and on December 31, 1966, an additional 3,000 *M* voting shares are transferred to *N*.

The fair market value of such shares on the date of transfer is $60,000 ($20 per share). The total unstated interest applicable to the indefinite payment is $8,262, computed as follows:

Indefinite payment to which sec. 483 applies	$60,000
Less:	
Present value of such payment ($60,000×0.86230 (factor for 33 to 39 months, col. (b), table I))	51,738
Total unstated interest	$8,262

See paragraph (a)(2) of § 1.483–2 for the effect on a reorganization defined in section 368(a)(1) of treating a portion of voting stock as interest under section 483.

Example (3).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make one payment on May 1, 1965. No interest is provided for in the contract and, at the time of sale, adjusted basis of the property to *A* is $2,000. Assume that the amount of the payment is indefinite but that the contract has an ascertainable fair market value of $8,000. For the year 1963, *A* includes $6,000 ($8,000 value of contract minus $2,000 adjusted basis) in gross income from the sale of the property and the transaction is treated as "closed" for purposes of determining gain or loss. On May 1, 1965, *A* collects $9,000 on the contract (which is more than the valuation that was placed on the contract in 1963). Section 483 applies to the $9,000 payment and $642.60 is treated as total unstated interest, computed as follows:

Indefinite payment to which sec. 483 applies	$9,000.00
Less:	
Present value of such payment ($9,000×0.92860 (factor for 15 to 21 months, col. (b), table I))	8,357.40
Total unstated interest	$642.60

The excess of the amount collected ($9,000) reduced by the amount treated as unstated interest ($642.60) under section 483 is $8,357.40. The excess of such amount ($8,357.40) over the value of the contract as determined in 1963 ($8,000) shall be included in income in accordance with the other applicable provisions of the Code. Thus, $357.40 is included in income.

Example (4).—The facts are the same as in example (3), except that on May 1, 1965, *A* collects only $6,000 on the contract (which is less than the valuation that was placed on the contract in 1963). Section 483 applies to the $6,000 payment and $428.40 is treated as total unstated interest, computed as follows:

Indefinite payment to which sec. 483 applies	$6,000.00
Less:	
Present value of such payment ($6,000×0.92860 (factor for 15 to 21 months, col. (b), table I))	5,571.60
Total unstated interest	$428.40

The amount collected ($6,000) reduced by the amount treated as unstated interest ($428.40) under section 483 is $5,571.60. The excess of the value of the contract as determined in 1963 ($8,000) over such amount ($5,571.60) shall be treated as a loss in accordance with the other applicable provisions of the Code. Thus, $2,428.40 is treated as a loss.

Example (5).—On December 31, 1963, *A* sells a capital asset which has an adjusted basis in *A*'s hands of $100,000 to *B* under a contract which provides that *B* is to make payments on January 15th of 1965, 1966, and 1967, the amount of such payments being dependent solely on the profits derived from the property. No interest is provided for in the contract. Assume that this is a rare and extraordinary case (see paragraph (a)(2) of § 1.453–6) in which the contract does not have an ascertainable fair market value and that *A* is permitted to apply payments of sales price in reduction of basis before being required to include any amount as gain on the transaction. For 1965, *B* pays *A* $50,000, for 1966 $100,000, and for 1967 $100,000.

(i) For the year 1965, the $50,000 payment would be allocated $2,409.50 as total unstated interest and $47,590.50 as return of capital, computed as follows:

(*a*) Indefinite payment to which sec. 483 applies	$50,000.00
Less:	
Present value of such payment ($50,000×0.95181 (factor for 9 to 15 months, col. (b), table I))	47,590.50
Total unstated interest	$2,409.50
(*b*) Return of capital	$47,590.50

(ii) For the year 1966, the $100,000 payment would be allocated $9,405 as total unstated interest, $52,409.50 as return of capital, and $38,185.50 as capital gain, computed as follows:

(*a*) Indefinite payment to which sec. 483 applies	$100,000.00
Less:	
Present value of such payment ($100,000×0.90595 (factor for 21 to 27 months, col. (b), table I))	90,595.00
Total unstated interest	$9,405.00
(*b*) Payment of principal	$90,595.00
Plus:	
Amount of capital returned in 1965	47,590.50
	$138,185.50
Less:	
Adjusted basis of property	100,000.00
Capital gain	$38,185.50

(iii) For the year 1967, the $100,000 payment would be allocated $13,770 as total unstated interest and $86,230 as capital gain, computed as follows:

(*a*) Indefinite payment to which sec. 483 applies	$100,000
Less:	
Present value of such payment ($100,000×0.86230 (factor for 33 to 39 months, col. (b), table I))	86,230
Total unstated interest	$13,770
(*b*) Capital gain	$86,230

(f) *Changes in terms of contract.*—(1) *In general.*—If the liability for, or the amount or due date of, any payment (including interest) under a contract for the sale or exchange of property is changed during any taxable year (referred to as the "year of change"), the total unstated interest under the contract shall be recomputed under the rules of paragraphs (c) and (d) of this section (as if the original contract had contained the changed terms) and allocated (in the manner provided in subparagraph (4) of this paragraph) with adjustment for prior interest (including unstated interest) payments. The provisions of this paragraph apply regardless of whether there was total unstated interest under the original contract. In general, a late payment or an early payment (including a prepayment) is considered a change in the due date of such payment to the date on which the payment is actually made, and therefore is considered a change in the terms of the contract. However, for purposes of the preceding sentence, the due date of a payment shall not be considered changed merely because the payment is late (or early), provided the payment is made no later (or earlier) than 90 days after (or before) the date the payment was due under the contract. Furthermore, any additional interest which is paid by the purchaser because of a late payment, either under the terms of the contract or under the provisions of local law, shall be taken into account as stated interest

for purposes of any recomputation of total unstated interest under the contract. In general, a novation is considered a change in the terms of the contract. However, for special rules relating to the transfer of the obligation to make deferred payments or of the right to receive deferred payments, see subparagraph (6) of this paragraph. A default in remaining payments under a contract (regardless of whether the property is repossessed or the debtor is released from liability under the contract) is also considered a change in the terms of the contract for purposes of section 483. In such case, the contract shall be considered as having been changed so as to provide for a reduction in the stated sales price to the amount that has actually been paid by the debtor as of the date of the default, and total unstated interest shall be recomputed based on such revised contract. Any payments subsequently made by or on behalf of the debtor with respect to his obligation (including payments on a deficiency judgment) shall be treated as indefinite payments under the contract in accordance with the rules prescribed in paragraph (e) of this section. For purposes of section 483, the value of the repossessed property is not considered a payment under the contract.

(2) *Effect of change in terms of contract on characterization as principal or interest.*—Except as otherwise provided in this paragraph, the characterization as principal or interest of any portion of a payment under a contract for the sale or exchange of property is not changed as a result of events occurring after the close of the taxable year in which the payment is made. Thus, for example, if a portion of a payment was characterized as interest for a prior year, and such characterization resulted in a corporation being treated as a personal holding company for such prior year, any change in the terms of the contract does not decrease the portion of such payment characterized as interest for purposes of redetermining personal holding company status for such prior year. However, the parties to a contract may change its terms so as to alter for the year of change and for any subsequent years the characterization as principal and interest of any portion of a payment under the contract.

(3) *Effect on basis of change in terms of contract.*—If the terms of the contract are changed so that the amount of total unstated interest (if any) under the revised contract differs from the amount of total unstated interest (if any) under the original contract, the basis to the purchaser of any property which was sold or exchanged under the original contract (or to any other person whose basis for such property is determined in whole or in part by reference to the basis of the purchaser) shall be redetermined as of the date of the change by taking into account any recomputation of total unstated interest. Thus, such purchaser (or such other person) shall redetermine his basis only if he has not sold, exchanged, or otherwise disposed of such property at the time the change in the terms of the contract is made.

(4) *Allocation of recomputed total unstated interest.*—(i) If the amount of total unstated interest recomputed under the contract (as changed) exceeds the amount of total unstated interest previously returned as income or deducted under the contract (prior to the change in terms), such excess amount shall be allocated on a pro rata basis among the remaining definite payments due under the revised contract; that is, there shall be treated as interest that part of a definite payment (due under the revised contract) to which section 483 applies which bears the same ratio to the amount of such payment as such excess amount bears to the total of the remaining definite payments to which section 483 applies which are due under such revised contract. For purposes of this subdivision, the determination of whether a payment is definite shall be made at the time the contract is changed.

(ii) If the amount of total unstated interest recomputed under the contract (as changed) is less than the amount of total unstated interest previously returned as income or deducted (under the contract prior to the change in terms) the amount of the difference shall be deducted from the income of the seller or added to the income of the purchaser for the year of the change.

(5) *Examples.*—The provisions of subparagraphs (1) through (4) of this paragraph may be illustrated by the following examples:

Example (1).—(i) On December 31, 1963, *A*, a calendar year taxpayer, sells a capital asset (which *A* has held more than 6 months and which has an ad-

justed basis to *A* of $4,000) to *B* under a contract which provides that *B* is to make three payments of $2,000 each, such payments being due on December 31st of 1964, 1965, and 1966. No interest is provided for in the contract. After applying section 483, total unstated interest is determined to be $559.88, and the amount of each $2,000 payment which is treated as interest is determined to be $186.63. For the year 1963, *A* includes $1,440.12 ($5,440.12 ($6,000 value of *B*'s obligation minus $559.88 total unstated interest) minus $4,000 adjusted basis) as long-term capital gain on the sale of the property. In 1964, *A* includes $186.63 as interest income. On June 1, 1965, *A* and *B* change the terms of the contract making the balance of the payments due immediately. Total unstated interest under the revised contract is $381.98, computed as follows:

Sum of payments to which sec. 483 applies		$6,000.00
Less:		
Present value of $2,000 due Dec. 31, 1964 ($2,000 × 0.95181 (factor for 9 to 15 months, col. (b), table I))	$1,903.62	
Present value of $4,000 due June 1, 1965 ($4,000 × 0.92860 (factor for 15 to 21 months, col. (b), table I))	3,714.40	
		5,618.02
Total unstated interest (recomputed)		$381.98

(ii) The portion of the recomputed total unstated interest to be allocated to the final definite payment of $4,000 is $195.35, computed as follows:

Total unstated interest (recomputed)	$381.98
Less:	
Portion of original total unstated interest previously included in income	186.63
Total unstated interest allocated to final definite payment	$195.35

(iii) Since after the change in the terms of the contract a lesser portion of *B*'s payments is treated as interest, a correspondingly greater portion of *B*'s payments is treated as part of the sales price. Accordingly, for the year 1965, *A* includes as long-term capital gain an additional $177.90, which may be computed as follows:

Total unstated interest (original)	$559.88
Less:	
Total unstated interest (recomputed)	381.98
Additional long-term capital gain for 1965	$177.90

Example (2).—(i) The facts are the same as in example (1), except that on June 1, 1965, *A* and *B* change the terms of the contract by providing that the last two payments shall be due on December 31st of 1966 and 1968. Total unstated interest under the revised contract is $809.38, computed as follows:

Sum of payments to which sec. 483 applies		$6,000.00
Less:		
Present value of $2,000 due Dec. 31, 1964 ($2,000 × 0.95181 (factor for 9 to 15 months, col. (b), table I))	$1,903.62	
Present value of $2,000 due Dec. 31, 1966 ($2,000 × 0.86230 (factor for 33 to 39 months, col. (b), table I))	1,724.60	
Present value of $2,000 due Dec. 31, 1968 ($2,000 × 0.78120 (factor for 57 to 63 months, col. (b), table I))	1,562.40	
		5,190.62
Total unstated interest (recomputed)		$809.38

(ii) The portion of the recomputed total unstated interest to be allocated among the remaining payments under the contract is $622.75, computed as follows:

Total unstated interest (recomputed)	$809.38
Less:	
Portion of original total unstated interest previously included in income	186.63
Total unstated interest allocated to remaining payments	$622.75

(iii) The portion of each remaining $2,000 payment which is treated as interest under the revised contract is $311.38 $\frac{(\$2{,}000 \times \$622.75)}{\$4{,}000.00}$.

(iv) Since after the change in the terms of the contract a greater portion of *B*'s payments is treated as interest, a correspondingly lesser portion of *B*'s payments is treated as part of the sales price. Accordingly, for the year 1965, *A* would treat as long-term capital loss the amount of $249.50, which may be computed as follows:

Total unstated interest (recomputed)	$809.38
Less:	
Total unstated interest (original)	559.88
Amount treated as long-term capital loss for 1965	$249.50

Example (3).—(i) The facts are the same as in example (1), except that in May 1965 *A* and *B* change the terms of the contract by reducing the sales price to a total of $3,000, and by agreeing that *B* is to pay the remaining balance of $1,000 on June 1, 1965. Total unstated interest under the revised contract is $167.78, computed as follows:

Sum of payments to which sec. 483 applies		$3,000.00
Less:		
Present value of $2,000 due Dec. 31, 1964 ($2,000×0.95181 (factor for 9 to 15 months, col. (b), table I))	$1,903.62	
Present value of $1,000 due June 1, 1965 ($1,000×0.92860 (factor for 15 to 21 months, col. (b), table I))	928.60	2,832.22
Total unstated interest (recomputed)		$167.78

(ii) Since the amount of the recomputed total unstated interest under the contract as changed ($167.78) is less than the amount of total unstated interest previously returned as income ($186.63), the amount of the difference ($18.85) shall be deducted from *A*'s income for 1965, and such amount shall be added to *B*'s income for such year.

Example (4).—(i) The facts are the same as in example (1), except that *B* fails to make the payment due on December 31, 1965, and *A* repossesses the property. The contract is considered as having been changed in 1965 to provide for one $2,000 payment due at the end of 1964. Total unstated interest under the revised contract is $96.38, computed as follows:

Sum of payments to which sec. 483 applies	$2,000.00
Less:	
Present value of $2,000 due Dec. 31, 1964 ($2,000×0.95181 (factor for 9 to 15 months, col. (b), table I))	1,903.62
Total unstated interest (recomputed)	$96.38

(ii) Since the amount of the recomputed total unstated interest under the contract as changed ($96.38) is less than the amount of total unstated interest previously returned as income ($186.63), the amount of the difference ($90.25) shall be deducted from *A*'s income for 1965, and such amount shall be added to *B*'s income for such year.

Example (5).—(i) On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make a $1,000 payment at the end of each year for the next 4 years, each payment bearing 4 percent per annum simple interest. Thus the payments will be in the following amounts: $1,040 ($1,000 sales price plus $40 interest), $1,080 ($1,000 sales price plus $80 interest), $1,120 ($1,000 sales price plus $120 interest), and $1,160 ($1,000 sales price plus $160 interest). Since the interest rate specified in the contract is equal to the test rate (4 percent per annum simple interest) provided in paragraph (d)(2) of this section, it is determined, as of December 31, 1963, that there is no total unstated interest under the contract. *B* makes the first two payments on time, but the third payment, which is due on December 31, 1966, is not made until December 31, 1967, a year late. At the same time, *B* makes the final payment. *A* does not collect any additional interest on the late payment. Since the third payment is more than 90 days late, the date of the payment is considered changed to December 31, 1967. Accordingly, a new determination of whether there is total unstated interest under the revised contract must be made by applying the method provided in paragraph (d)(1) of this section, as follows:

(*a*)	Sum of payments to which sec. 483 applies		$4,000.00
(*b*)	Sum of:		
	Present value of $1,040 due 1 year from date of sale ($1,040×0.96154 (factor for 9 to 15 months, col. (a), table I))	$1,000.00	
	Present value of $1,080 due 2 years from date of sale ($1,080×0.92593 (factor for 21 to 27 months, col. (a), table I))	1,000.00	
	Present value of $2,280 due 4 years from date of sale ($2,280×0.86207 (factor for 45 to 51 months, col. (a), table I))	1,965.52	
			$3,965.52

Since the sum of the payments to which section 483 applies ($4,000) exceeds the sum of the present values of such payments and the present values of the stated interest payments ($3,965.52), there is total unstated interest under the revised contract and the provisions of section 483 now apply to the payments due under the contract.

(ii) The amount of total unstated interest to be allocated to the final $2,000 payment of sales price under the contract and which is includible in *A*'s income and deductible from *B*'s income for 1967 is $160.38, computed as follows:

Sum of payments to which sec. 483 applies		$4,000.00
Less:		
Present value of $1,040 due 1 year from date of sale ($1,040×0.95181 (factor for 9 to 15 months, col. (b), table I))	$989.88	
Present value of $1,080 due 2 years from date of sale ($1,080×0.90595 (factor for 21 to 27 months, col. (b), table I))	978.43	
Present value of $2,280 due 4 years from date of sale ($2,280×0.82075 (factor for 45 to 51 months, col. (b), table I))	1,871.31	
		3,839.62
Total unstated interest		$160.38

Example (6).—The facts are the same as in example (5). On December 31, 1963 (the date of the sale), the basis of the property in the hands of *B* is $4,000. On March 1, 1968, after all the payments have been made under the contract, *B* sells the property. Assuming that there were no adjustments to the basis of the property, *B*'s basis for purposes of determining gain or loss on the sale of the property would be $3,839.62 ($4,000 original basis minus $160.38 unstated interest). On the other hand, if *B* sold the property on November 1, 1966 (prior to the date of the change) his basis for the property would be $4,000.

(6) *Transfer of obligation to make or contract right to receive deferred payments.*—(i) If an obligation to make deferred payments (whether definite or indefinite) under a contract under which there is total unstated interest is transferred by sale, exchange, distribution, or other disposition (for example, if the purchaser under a deferred-payment contract for the sale or exchange of property later transfers that property and the transferee either assumes the purchaser's obligation to the seller or takes the property subject to such obligation), the following rules shall apply—

(*a*) The person who has the right to receive payments under the obligation shall not be affected with respect to section 483 merely by reason of such transfer.

(*b*) The transferor of the obligation to make deferred payments shall not be entitled to any deductions for unstated interest with respect to payments due under the obligation after the date of the transfer, unless, by reason of the default of the transferee, the transferor is liable for and makes payments under the obligation.

(*c*) Section 483 shall apply to the transferee in the same manner that it applied to the transferor; that is, the transferee is entitled to the same deductions (if otherwise allowable) for unstated interest as the transferor would have been entitled to if the transfer had not occurred. Thus, the transferee may be entitled to deduct unstated interest notwithstanding that the sales price to the transferee is no more than $3,000. However, if section 163(b) (relating to deduction for interest on certain installment purchases) applies to the transferee, he shall compute his interest deductions under that section (see paragraph (b)(2) of § 1.483–2) regardless of whether the transferor so computed his interest deductions.

(*d*) A separate determination must be made, in accordance with the rules prescribed in this section and in § 1.483–2, as to the application of section 483 to the contract between the transferor and the transferee under which the obligation to make the deferred payments is transferred. For purposes of such separate determination, the assumption by the transferee of the obligation of the transferor shall be treated as a payment made at the time of the transfer.

The rules set forth in this subdivision shall apply regardless of whether the transferor is completely released from liability with respect to the person having the right to receive the payments, or remains liable to such person under the obligation if the transferee defaults.

(ii) If a right to receive deferred payments (whether definite or indefinite) under a contract under which there is total unstated interest is transferred by sale, exchange, distribution, or other disposition, the following rules shall apply (except to the extent that such transfer constitutes an assignment of future income)—

(*a*) The person who has the obligation to make payments under the contract shall not be affected with respect to section 483 merely by reason of such transfer.

(*b*) The transferor of the contract right to receive deferred payments shall treat any amount realized (as defined in section 1001(b)) from the transferee as the final payment under his contract with the person having the obligation to make the payments, and shall recompute his total unstated interest under such contract under the rules provided in subparagraphs (1) through (5) of this paragraph.

(*c*) The transferee of such contract right shall treat the payments he receives from the person having the obligation to make the payments as if they were received under a contract for the sale or exchange of property entered into with such person on the date of the transfer. Thus, the transferee shall determine, in accordance with the rules prescribed in this section and in § 1.483–2, the applicability of section 483 to such payments.

(*d*) A separate determination must be made, in accordance with the rules prescribed in this section and in § 1.483–2, as to the application of section 483 to the contract between the transferor and transferee under which the contract right to receive the deferred payments is transferred.

The rules set forth in this subdivision shall apply regardless of whether the transferor is made liable (under the contract with the transferee) for any payments which are not received by the transferee by reason of the default of the person having the obligation to make such payments.

(iii) If section 483 does not apply to an obligation to make or a contract right to receive deferred payments (for example, because of an exception set forth in section 483(f)), the following rules shall apply in the case of a transfer of such obligation or contract right, whether by sale, exchange, distribution, or other disposition—

(*a*) Section 483 shall not become applicable to the obligation or contract right merely by reason of such a transfer. However, if the transferee and the person having the obligation to make (or the right to receive) the payments under the contract change its terms, a determination must be made as to whether section 483 applies to the contract as changed. For example, if the only reason section 483 did not apply to a deferred-payment contract was because no payment was due more than 1 year after the date of the sale or exchange, any change in the terms of the contract by the transferee and such person, which makes a payment fall due more than 1 year after the date of such sale or exchange would make section 483 apply to the contract. For special rules relating to the application of the effective date provisions to transfers, see paragraph (b)(4) of this section.

(*b*) A separate determination must be made as to the application of section 483 to the contract between the transferor and the transferee under which an obligation to make or a contract right to receive deferred payments is transferred. For purposes of such separate determination, the assumption by the transferee of the obligation of the transferor shall be treated as an evidence of indebtedness of the transferee.

(iv) The provisions of this subparagraph may be illustrated by the following examples:

Example (1).—(*a*) On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make four payments of $2,000 each, such payments being due, respectively, at the end of each year for the next 4 years. No interest is provided for in the contract. Assume that section 483 applies to each of the payments and that the portion of each payment which is treated as interest is $229.60. On January 1, 1966, *B* transfers other property to *C* in exchange for *C*'s non-interest-bearing promissory note which provides that *C* is to pay *B* $1,000 at the end of each of the next 4 years, and *C*'s assumption of the obligation to make the two remaining $2,000 payments to *A*.

(*b*) With respect to each of the two remaining $2,000 payments, *C* may deduct $229.60 and *A* continues to include such amount in income. *B* has no deductions with respect to the payments by *C*.

(*c*) With respect to the contract between *B* and *C*, section 483 applies to each of the $1,000 payments to be made by *C* at the end of each of the next 4 years, and total unstated interest with respect to such payments must be computed in the manner provided in paragraph (c) of this section and then allocated in the manner provided in paragraph (a) of this section. Because the assumption of *B*'s obligation by *C* is treated as a payment made at the time of the transfer, section 483 does not apply to the two remaining $2,000 payments for purposes of the contract between *B* and *C*.

Example (2).—(*a*) The facts are the same as in example (1), except that on January 1, 1966, *A* transfers his contract right to receive the two remaining $2,000 payments to *C* in exchange for property having a fair market value of $3,000.

(*b*) *B* is not affected by the transaction and continues to deduct $229.60 with respect to each of the two remaining $2,000 payments. *A* treats his contract with *B* as having been changed to provide for two payments of $2,000 each, due December 31st of 1964 and 1965, respectively, and a final payment of $3,000 (the fair market value of the property transferred by *C* to *A*), due January 1, 1966. *A* recomputes his total unstated interest in accordance with the rules provided in paragraph (c) of this section (as if the original contract with *B* had contained the changed terms) and allocates such unstated interest in the manner provided in subparagraph (4) of this paragraph.

(c) *C* treats the two remaining $2,000 payments from *B* as if they are due under a contract for the sale of property entered into with *B* on January 1, 1966. Thus, *C* computes total unstated interest under paragraph (c) of this section as if he had entered into a contract subject to section 483 which provided for $2,000 due December 31, 1966, and $2,000 due December 31, 1967, and then allocates such total unstated interest in the manner provided in paragraph (a) of this section.

(d) With respect to the contract between *A* and *C*, section 483 does not apply because there are no deferred payments.

Example (3).—(a) On December 31, 1963, *A*, a holder described in section 1235(b), sells property, consisting of all substantial rights to a patent, to *B* under a contract which provides that *B* is to pay *A* $1,000 at the end of each year for the next 10 years. No interest is provided for in the contract, but section 483 does not apply because the deferred payments are made pursuant to a transfer described in section 1235(a) (see paragraph (b)(4) of § 1.483–2). On January 1, 1972, *B*, who is not a holder described in section 1235(b), sells the patent right to *C* under a contract which provides that *C* is to assume *B*'s remaining obligation to pay *A* $1,000 at the end of each year for the next 2 years. There is no other consideration and no interest provided for in the contract between *B* and *C*.

(b) Since section 483 did not apply to the contract between *A* and *B*, *B* was not entitled to a deduction for unstated interest with respect to his obligation. Accordingly, section 483 does not become applicable to the obligation merely by reason of its transfer to *C*. Thus, *C* is not entitled to a deduction for unstated interest with respect to the obligation he has assumed and *A* is not required to include any unstated interest income.

(c) With respect to the contract between *B* and *C*, section 483 does not apply because the sales price under such contract is no more than $3,000, so that the exception set forth in section 483(f)(1) is applicable.

Example (4).—(a) The facts are the same as in example (3), except that *B* sells the patent right to *C* on January 1, 1966, under a separate contract which provides that *C* is to assume *B*'s remaining obligation to pay *A* $1,000 at the end of each year for the next 8 years. There is no other consideration and no interest provided for in the contract between *B* and *C*.

(b) Since section 483 did not apply to the contract between *A* and *B*, *B* was not entitled to a deduction for unstated interest with respect to his obligation. Accordingly, section 483 does not become applicable to the obligation merely by reason of its transfer to *C*. Thus, *C* is not entitled to a deduction for unstated interest because he is *B*'s transferee.

(c) With respect to the contract between *B* and *C*, section 483 applies, and for purposes of paragraph (a) of this section, total unstated interest under such contract is $1,553.09, computed as follows:

Sum of payments to which sec. 483 applies	$8,000.00
Less:	
Present value of $1,000 due every 12 months for 8 years ($1,000×6.44691 (factor for 8 years, col. (b), table III))	6,446.91
Total unstated interest	$1,553.09

Thus, *C* may deduct and *B* must include in income, 194.14\left(\$1{,}000\times\frac{\$1{,}553.09}{\$8{,}000.00}\right)$ with respect to each payment *C* makes to *A*.

(g) *Present value tables.*—(1) *Computation of present value.*—If the purpose of the present value computation is to determine under paragraph (d) of this section whether there is total unstated interest under a contract, column (a) (which incorporates a rate of 4 percent per annum simple interest) of the appropriate table set forth in subparagraph (2) of this paragraph shall be used. For the rules relating to certain governmental obligations, see paragraph (d)(3) of this section. If the purpose of the present value computation is to determine under paragraph (c) of this section the amount of total unstated interest under a contract to be included in or deducted from income (that is, after it has already been determined by using column (a) of the appropriate table that the contract contains total unstated interest), column (b) (which incorporates an

interest rate of 5 percent per annum, compounded semiannually) of the appropriate table set forth in subparagraph (2) of this paragraph shall be used. If a contract provides for deferred payments for a period in excess of 60 years, the factor (or factors) necessary may be obtained upon request to the Commissioner of Internal Revenue, Washington, D.C., 20224. In general, such request must be accompanied by a copy of the contract (or the proposed contract) and other relevant instruments.

(2) *Tables.*—The following tables shall be used for computing the present value of a payment to which section 483 applies and the present value of any interest payment due under a contract:

TABLE I.—*Present value of deferred payment*

[Column (a), 4% simple interest; Column (b), 5% interest, compounded semiannually]

Number of months deferred		Column (a)	Column (b)	Number of months deferred		Column (a)	Column (b)	Number of months deferred		Column (a)	Column (b)
More than	But not more than	Present value of $1 at 4% simple interest	Present value of $1 at 5% compounded semiannually	More than	But not more than	Present value of $1 at 4% simple interest	Present value of $1 at 5% compounded semiannually	More than	But not more than	Present value of $1 at 4% simple interest	Present value of $1 at 5% compounded semiannually
0	6	1.00000	1.00000	243	249	0.54945	0.36335	489	495	0.37879	0.13202
6	9	.98039	.97561	249	255	.54348	.35448	495	501	.37594	.12880
9	15	.96154	.95181	255	261	.53763	.34584	501	507	.37313	.12566
15	21	.94340	.92860	261	267	.53191	.33740	507	513	.37037	.12259
21	27	.92593	.90595	267	273	.52632	.32917	513	519	.36765	.11960
27	33	.90909	.88385	273	279	.52083	.32115	519	525	.36496	.11669
33	39	.89286	.86230	279	285	.51546	.31331	525	531	.36232	.11384
39	45	.87719	.84127	285	291	.51020	.30567	531	537	.35971	.11106
45	51	.86207	.82075	291	297	.50505	.29822	537	543	.35714	.10836
51	57	.84746	.80073	297	303	.50000	.29094	543	549	.35461	.10571
57	63	.83333	.78120	303	309	.49505	.28385	549	555	.35211	.10313
63	69	.81967	.76214	309	315	.49020	.27692	555	561	.34965	.10062
69	75	.80645	.74356	315	321	.48544	.27017	561	567	.34722	.09816
75	81	.79365	.72542	321	327	.48077	.26358	567	573	.34483	.09577
81	87	.78125	.70773	327	333	.47619	.25715	573	579	.34247	.09343
87	93	.76923	.69047	333	339	.47170	.25088	579	585	.34014	.09116
93	99	.75758	.67362	339	345	.46729	.24476	585	591	.33784	.08893
99	105	.74627	.65720	345	351	.46296	.23879	591	597	.33557	.08676
105	111	.73529	.64117	351	357	.45872	.23297	597	603	.33333	.08465
111	117	.72464	.62553	357	363	.45455	.22728	603	609	.33113	.08258
117	123	.71429	.61027	363	369	.45045	.22174	609	615	.32895	.08057
123	129	.70423	.59539	369	375	.44643	.21633	615	621	.32680	.07860
129	135	.69444	.58086	375	381	.44248	.21106	621	627	.32468	.07669
135	141	.68493	.56670	381	387	.43860	.20591	627	633	.32258	.07482
141	147	.67568	.55288	387	393	.43478	.20089	633	639	.32051	.07299
147	153	.66667	.53939	393	399	.43103	.19599	639	645	.31847	.07121

153	159	.65789	.52623	399	405	.42735	.19121	645	651	.31646	.06947
159	165	.64935	.51340	405	411	.42373	.18654	651	657	.31447	.06778
165	171	.64103	.50088	411	417	.42017	.18199	657	663	.31250	.06613
171	177	.63291	.48866	417	423	.41667	.17755	663	669	.31056	.06451
177	183	.62500	.47674	423	429	.41322	.17322	669	675	.30864	.06294
183	189	.61728	.46511	429	435	.40984	.16900	675	681	.30675	.06140
189	195	.60976	.45377	435	441	.40650	.16488	681	687	.30488	.05991
195	201	.60241	.44270	441	447	.40323	.16085	687	693	.30303	.05845
201	207	.59524	.43191	447	453	.40000	.15693	693	699	.30120	.05702
207	213	.58824	.42137	453	459	.39683	.15310	699	705	.29940	.05563
213	219	.58140	.41109	459	465	.39370	.14937	705	711	.29762	.05427
219	225	.57471	.40107	465	471	.39063	.14573	711	717	.29586	.05295
225	231	.56818	.39128	471	477	.38760	.14217	717	723	.29412	.05166
231	237	.56180	.38174	477	483	.38462	.13870				
237	243	.55556	.37243	483	489	.38168	.13532				

TABLE II.—*Present value of annuity certain: $1.00 every 6 months*

[Column (a), 4% simple interest; Column (b), 5% interest, compounded semiannually]

Number of years final payment deferred	Column (a) Present value at 4% simple interest	Column (b) Present value at 5% compounded semiannually	Number of years final payment deferred	Column (a) Present value at 4% simple interest	Column (b) Present value at 5% compounded semiannually	Number of years final payment deferred	Column (a) Present value at 4% simple interest	Column (b) Present value at 5% compounded semiannually
			20. 0	29. 16829	25. 10278	40. 0	47. 46935	34. 45182
*0. 5	0. 98039	0. 97561	20. 5	29. 71774	25. 46612	40. 5	47. 85103	34. 58714
1. 0	1. 94193	1. 92742	21. 0	30. 26122	25. 82061	41. 0	48. 22982	34. 71916
1. 5	2. 88533	2. 85602	21. 5	30. 79885	26. 16645	41. 5	48. 60576	34. 84796
2. 0	3. 81126	3. 76197	22. 0	31. 33076	26. 50385	42. 0	48. 97889	34. 97362
2. 5	4. 72035	4. 64583	22. 5	31. 85708	26. 83302	42. 5	49. 34926	35. 09621
3. 0	5. 61321	5. 50813	23. 0	32. 37791	27. 15417	43. 0	49. 71691	35. 21582
3. 5	6. 49040	6. 34939	23. 5	32. 89337	27. 46748	43. 5	50. 08187	35. 33251
4. 0	7. 35247	7. 17014	24. 0	33. 40357	27. 77315	44. 0	50. 44419	35. 44635
4. 5	8. 19993	7. 97087	24. 5	33. 90862	28. 07137	44. 5	50. 80390	35. 55741
5. 0	9. 03326	8. 75206	25. 0	34. 40862	28. 36231	45. 0	51. 16104	35. 66577
5. 5	9. 85293	9. 51421	25. 5	34. 90367	28. 64616	45. 5	51. 51565	35. 77148
6. 0	10. 65938	10. 25776	26. 0	35. 39387	28. 92308	46. 0	51. 86776	35. 87462
6. 5	11. 45303	10. 98318	26. 5	35. 87931	29. 19325	46. 5	52. 21741	35. 97524
7. 0	12. 23428	11. 69091	27. 0	36. 36008	29. 45683	47. 0	52. 56463	36. 07340
7. 5	13. 00351	12. 38138	27. 5	36. 83627	29. 71398	47. 5	52. 90946	36. 16917
8. 0	13. 76109	13. 05500	28. 0	37. 30797	29. 96486	48. 0	53. 25193	36. 26261
8. 5	14. 50736	13. 71220	28. 5	37. 77526	30. 20962	48. 5	53. 59207	36. 35376
9. 0	15. 24265	14. 35336	29. 0	38. 23822	30. 44841	49. 0	53. 92991	36. 44269
9. 5	15. 96729	14. 97889	29. 5	38. 69694	30. 68137	49. 5	54. 26548	36. 52946
10. 0	16. 68158	15. 58916	30. 0	39. 15149	30. 90866	50. 0	54. 59881	36. 61411
10. 5	17. 38581	16. 18455	30. 5	39. 60194	31. 13040	50. 5	54. 92994	36. 69669
11. 0	18. 08025	16. 76541	31. 0	40. 04837	31. 34673	51. 0	55. 25889	36. 77726
11. 5	18. 76518	17. 33211	31. 5	40. 49085	31. 55778	51. 5	55. 58569	36. 85586
12. 0	19. 44086	17. 88499	32. 0	40. 92945	31. 76369	52. 0	55. 91037	36. 93255
12. 5	20. 10753	18. 42438	32. 5	41. 36423	31. 96458	52. 5	56. 23295	37. 00736
13. 0	20. 76542	18. 95061	33. 0	41. 79526	32. 16056	53. 0	56. 55346	37. 08035

13. 5	21. 41477	19. 46401	33. 5	42. 22261	32. 35177	53. 5	56. 87193	37. 15156
14. 0	22. 05580	19. 96489	34. 0	42. 64634	32. 53831	54. 0	57. 18839	37. 22104
14. 5	22. 68871	20. 45355	34. 5	43. 06651	32. 72030	54. 5	57. 50286	37. 28882
15. 0	23. 31371	20. 93029	35. 0	43. 48318	32. 89786	55. 0	57. 81536	37. 35494
15. 5	23. 93099	21. 39541	35. 5	43. 89640	33. 07108	55. 5	58. 12592	37. 41946
16. 0	24. 54075	21. 84918	36. 0	44. 30624	33. 24008	56. 0	58. 43456	37. 48240
16. 5	25. 14316	22. 29188	36. 5	44. 71274	33. 40495	56. 5	58. 74131	37. 54380
17. 0	25. 73840	22. 72379	37. 0	45. 11597	33. 56581	57. 0	59. 04619	37. 60371
17. 5	26. 32664	23. 14516	37. 5	45. 51597	33. 72274	57. 5	59. 34922	37. 66216
18. 0	26. 90804	23. 55625	38. 0	45. 91280	33. 87584	58. 0	59. 65042	37. 71918
18. 5	27. 48275	23. 95732	38. 5	46. 30650	34. 02521	58. 5	59. 94982	37. 77481
19. 0	28. 05093	24. 34860	39. 0	46. 69713	34. 17094	59. 0	60. 24744	37. 82908
19. 5	28. 61273	24. 73034	39. 5	47. 08473	34. 31311	59. 5	60. 54330	37. 88203
						60. 0	60. 83742	37. 93369

*The factor for 0.5 year is applicable to a payment due more than 6 months but not more than 9 months from the date of the sale or exchange. In the case of a payment due not more than 6 months from the date of the sale or exchange, see the instructions in subparagraph (4)(iii) of this paragraph.

Table III.—*Present value of annuity certain: $1.00 every 12 months*

[Column (a), 4% simple interest; Column (b), 5% interest, compounded semiannually]

Number of years final payment deferred	Column (a) Present value at 4% simple interest	Column (b) Present value at 5% compounded semiannually	Number of years final payment deferred	Column (a) Present value at 4% simple interest	Column (b) Present value at 5% compounded semiannually
1	0. 96154	0. 95181	31	19. 88780	15. 47987
2	1. 88747	1. 85777	32	20. 32640	15. 68577
3	2. 78033	2. 72006	33	20. 75743	15. 88176
4	3. 64240	3. 54081	34	21. 18116	16. 06830
5	4. 47573	4. 32201	35	21. 59783	16. 24586
6	5. 28218	5. 06556	36	22. 00767	16. 41485
7	6. 06343	5. 77329	37	22. 41090	16. 57571
8	6. 82101	6. 44691	38	22. 80773	16. 72881
9	7. 55630	7. 08808	39	23. 19836	16. 87454
10	8. 27059	7. 69835	40	23. 58298	17. 01324
11	8. 96503	8. 27922	41	23. 96177	17. 14526
12	9. 64071	8. 83209	42	24. 33490	17. 27092
13	10. 29860	9. 35833	43	24. 70255	17. 39053
14	10. 93963	9. 85920	44	25. 06487	17. 50437
15	11. 56463	10. 33595	45	25. 42201	17. 61273
16	12. 17439	10. 78972	46	25. 77412	17. 71586
17	12. 76963	11. 22162	47	26. 12134	17. 81402
18	13. 35103	11. 63272	48	26. 46381	17. 90746
19	13. 91921	12. 02400	49	26. 80165	17. 99639
20	14. 47477	12. 39643	50	27. 13498	18. 08104
21	15. 01825	12. 75092	51	27. 46393	18. 16161
22	15. 55016	13. 08832	52	27. 78861	18. 23829
23	16. 07099	13. 40947	53	28. 10912	18. 31129
24	16. 58119	13. 71514	54	28. 42558	18. 38076
25	17. 08119	14. 00608	55	28. 73808	18. 44689
26	17. 57139	14. 28300	56	29. 04672	18. 50983
27	18. 05216	14. 54658	57	29. 35160	18. 56973
28	18. 52386	14. 79746	58	29. 65280	18. 62675
29	18. 98682	15. 03625	59	29. 95042	18. 68103
30	19. 44137	15. 26353	60	30. 24454	18. 73268

(3) *Instructions for Table I.*—Table I is the basic present value table, and may be used for computing the present value of any payment or payments regardless of the amount of the payments or the interval the payments are deferred. The present value of a payment is computed under table I as follows:

(i) Determine the factor contained in the applicable present value column (that is, col. (a) or col. (b)) for the appropriate number of months the payment under the contract is deferred; and

(ii) Multiply the amount of the payment by the factor determined under subdivision (i) of this subparagraph.

For example, the present value, using a rate of 4 percent per annum simple interest, of a payment of $1,000 due 3 years (36 months) from the date of sale is $892.86 ($1,000×0.89286 (factor for 33 to 39 months, col. (a), table I)).

(4) *Instructions for Table II.*—(i) Table II shows the present value of a series of equal deferred payments due at 6-month intervals For purposes of determining whether the payments under a contract are due at 6-month intervals and whether such payments are equal in amount, a payment shall be treated as due on the nearest date (to the date such payment is actually due under the contract) which marks a 6-month interval from the date of the sale or exchange. For example, a payment due 13 months, 14 months, or exactly 15 months from

the date of sale would be treated as due 12 months from such date, and a payment due 15 months and 1 day, 16 months, or 17 months from the date of sale would be treated as due 18 months from such date. In the case of a payment due 6 months or less from the date of the sale or exchange, see subdivision (iii) of this subparagraph.

(ii) Table II may be used, without adjustment, for computing the present value of a series of equal payments, under a contract under which the first payment is actually due more than 6 months but not more than 9 months from the date of the sale or exchange, and all payments thereafter are due at regular 6-month intervals with respect to the date of the first payment (all such payments being treated under the rule of subdivision (i) of this subparagraph as due on the nearest date which marks a 6-month interval from the date of the sale or exchange). The present value of such a series of equal payments is computed under table II as follows:

(*a*) Determine the factor contained in the applicable present value column (that is, col. (a) or col. (b)) for the appropriate number of years the final payment under the contract is deferred; and

(*b*) Multiply the amount of a single payment under the contract by the factor determined under (*a*) of this subdivision.

For example, the present value, using a rate of 4 percent per annum simple interest, of a series of eight $1,000 payments, the first payment being due 7 months from the date of sale, and the remaining seven payments being due, respectively, every 6 months thereafter (so that under the rule of subdivision (i) of this paragraph the final payment is deferred 4 years), is $7,352.47 ($1,000×7.35247 (factor for 4 years, col. (a), table II)).

(iii) Table II may also be used, with adjustment, for computing the present value of a series of equal payments under a contract under which the first payment is actually due not more than 6 months from the date of the sale or exchange, and all payments thereafter are due at regular 6-month intervals with respect to the date of the first payment (all such payments being treated under the rule of subdivision (i) of this subparagraph as due on the nearest date which marks a 6-month interval from the date of the sale or exchange), provided that no payment is actually due (before application of subdivision (i) of this subparagraph) more than 6 months but not more than 9 months from the date of the sale or exchange. The present value of such a series of equal payments is computed under table II as follows:

(*a*) Determine the factor contained in the applicable present value column (that is, col. (a) or col. (b)) for the appropriate number of years the final payment under the contract is deferred;

(*b*) Adjust the factor determined under (*a*) of this subdivision by increasing such factor either by 0.01961 if the present value computation is made under column (a) or by 0.02439 if the present value computation is made under column (b); and

(*c*) Multiply the amount of a single payment under the contract by the adjusted factor determined under (*b*) of this subdivision.

For example, the present value, using a rate of 4 percent per annum simple interest, of a series of eight $1,000 payments, the first payment being due exactly 6 months from the date of sale, and the remaining seven payments being due, respectively, every 6 months thereafter (so that under the rule of subdivision (i) of this subparagraph the final payment is deferred 4 years), is $7.372.08 ($1,000×7.35247 plus 0.01961).

(iv) Table II may also be used, with adjustment, for computing the present value of a series of equal payments under a contract under which the first payment is due more than 6 months from the date of the sale or exchange and is due on the anniversary (that is, the exact multiple of a 6-month interval) of the date of the sale or exchange, and all payments thereafter are due at regular 6-month intervals with respect to the date of the first payment (all such payments being treated under the rule of subdivision (i) of this subparagraph as due on the nearest date which marks a 6-month interval from the date of the sale or exchange). The present value of such a series of equal payments is computed as follows:

(*a*) Determine the factor contained in the applicable present value column (that is, col. (a) or col. (b)) for the appropriate number of years the final payment under the contract is deferred;

(*b*) Multiply the amount of a single payment under the contract by the factor determined under (*a*) of this subdivision;

(*c*) Determine the factor contained in the applicable present value column (that is, col. (a) or col. (b)) for the 6-month period immediately preced-

ing the 6-month period in which the initial payment under the contract is due;

(*d*) Multiply the amount of a single payment under the contract by the factor determined under (*c*) of this subdivision; and

(*e*) Subtract the amount determined under (*d*) of this subdivision from the amount determined under (*b*) of this subdivision to obtain the present value.

For example, table II may be used to compute the present value, using a rate of 4 percent per annum simple interest, of a series of eight $1,000 payments, the first payment being due exactly 12 months from the date of sale, and the remaining seven payments being due, respectively, every 6 months thereafter (so that under the rule of subdivision (i) of this subparagraph the final payment is deferred 4.5 years). Such computation, including the adjustment, is made as follows:

$1,000 × 8.19993 (factor for 4.5 years, col. (a), table II)	$8,199.93
Less adjustment:	
$1,000 × 0.98039 (factor for 0.5 years, col. (a) table II)	980.39
Present value	$7,219.54

(5) *Instructions for Table III.*—(i) Table III shows the present value of a series of equal deferred payments due at 12-month intervals with respect to the date of the sale or exchange. For purposes of determining whether the payments under a contract are due at 12-month intervals and whether such payments are equal in amount, a payment shall be treated as due on the nearest date (to the date such payment is actually due under the contract) which marks a 6-month interval from the date of the sale or exchange. For example, a payment due 13 months, 14 months, or exactly 15 months from the date of sale would be treated as due 12 months from such date, and a payment due 21 months and 1 day, 22 months, or 23 months from the date of sale would be treated as due 24 months from such date.

(ii) Table III may be used, without adjustment, for computing the present value of a series of equal payments, under a contract under which the first payment is actually due more than 9 months but not more than 15 months from the date of the sale or exchange, and all payments thereafter are due at regular 12-month intervals with respect to the date of the first payment (all such payments being treated under the rule of subdivision (i) of this subparagraph or due on the nearest date which marks a 6-month interval from the date of the sale or exchange). The present value of such a series of equal payments is computed under table III as follows:

(*a*) Determine the factor contained in the applicable present value column (that is, col. (a) or col. (b)) for the appropriate number of years the final payment under the contract is deferred; and

(*b*) Multiply the amount of a single payment under the contract by the factor determined under (*a*) of this subdivision.

For example, the present value, using an interest rate of 5 percent per annum, compounded semiannually, of a series of eight $1,000 payments, the first payment being due 12 months from the date of sale, and the remaining seven payments being due, respectively, every 12 months thereafter (so that under the rule of subdivision (i) of this subparagraph the final payment is deferred 8 years) is $6,446.91 ($1,000 × 6.44691 (factor for 8 years, col. (b), table III)).

(iii) Table III may also be used, with adjustment, for computing the present value of a series of equal payments under a contract in which the first payment is due more than 12 months from the date of the sale or exchange and is due on the anniversary (that is, the exact multiple of a 12-month interval) of the date of the sale or exchange, and all payments thereafter are due at regular 12-month intervals with respect to the date of the first payment (all such payments being treated under the rule of subdivision (i) of this subparagraph as due on the nearest date which marks a 6-month interval from the date of the sale or exchange). The present value of such a series of equal payments is computed under table III as follows:

(*a*) Determine the factor contained in the applicable present value column (that is, col. (a) or col. (b)) for the appropriate number of years the final payment under the contract is deferred;

(*b*) Multiply the amount of a single payment under the contract by the factor determined under (*a*) of this subdivision;

(*c*) Determine the factor contained in the applicable present value column (that is, col. (a) or col. (b)) for the year immediately preceding the year in which the initial payment under the contract is due;

(*d*) Multiply the amount of a single payment under the contract by the factor determined under (*c*) of this subdivision; and

(*e*) Subtract the amount determined under (*d*) of this subdivision from the amount determined under (*b*) of this subdivision to obtain the present value.

For example, table III may be used to compute the present value, using an interest rate of 5 percent, compounded semiannually, of a series of eight $1,000 payments, the first payment being due exactly 3 years from the date of sale, and the remaining seven payments being due, respectively, every 12 months thereafter (so that under the rule of subdivision (i) of this subparagraph the final payment is deferred 10 years). Such computation, including the adjustment, is made as follows:

$1,000×7.69835 (factor for 10 years, col. (b), table III)	$7,698.35
Less adjustment:	
$1,000×1.85777 (factor for 2 years, col. (b), table III)	1,857.77
Present value	$5,840.58

If, in the preceding example, the first payment had been due 3½ years (instead of 3 years) from the date of sale, the method of computation described could not be used and table I should be used for the present value computation.

§ 1.483–2 Treatment as Interest for Purposes of Code; Exceptions and Limitations to Application of Section 483.—(a) *Treatment as interest for purposes of Code.*—(1) *Effect on income, deductions, basis, etc.*—(i) *In general.*—Generally, a contract under which there is total unstated interest (within the meaning of section 483(a)) shall be treated as if such interest were actually provided for in the contract, and such unstated interest shall constitute interest for all purposes of the Code. Thus, for example, except as provided in paragraph (b)(1) of this section, in the case of a sale of property, total unstated interest shall not be treated as part of the selling price of such property. Unless unstated interest is charged to the capital account under section 266 (relating to carrying charges), the basis to the purchaser of property sold or exchanged shall not include any amount treated by the purchaser as total unstated interest under the contract pursuant to section 483. For rules relating to the effect on basis of a change in the terms of the contract, see paragraph (f)(3) of § 1.483–1.

(ii) *Cash and accrual method of reporting unstated interest income and deductions.*—Any amount treated as interest under section 483 by the seller shall be included as interest income for the taxable year in which the payment is received in the case of a cash method taxpayer and for the taxable year in which the payment is due in the case of an accrual method taxpayer. Any amount treated as interest under section 483 by the purchaser shall (if otherwise allowable) be deducted as interest for the taxable year in which the payment is made in the case of a cash method taxpayer and for the taxable year in which the payment is due in the case of an accrual method taxpayer. Notwithstanding the rules of this subdivision with respect to unstated interest, interest which is stated in the contract shall be treated in accordance with the rules of the Code otherwise applicable. For rules relating to defaults, see paragraph (f)(1) of § 1.483–1.

(iii) *Example.*—The provisions of subdivision (ii) of this subparagraph may be illustrated by the following example:

Example.—On December 31, 1963, *A*, a calendar year accrual method taxpayer, sells property to *B*, a calendar year cash method taxpayer, under a contract which provides that *B* is to make three payments of $2,000 each, such payments being due respectively, as of December 31st, 1966, 1967, and 1968. No interest is provided for in the contract. Assume that the total unstated interest under the contract is $1,071.50 and that the portion of each payment which is treated as interest is $357.17. *B* makes the first two payments on time, but the third payment is not made until January 31, 1969. For 1964 and 1965, *A* does not include, nor does *B* deduct, any amount as interest with respect to the contract. For 1966 and 1967, *A* includes $357.17 each year as interest income and *B* deducts the same amount each year as an interest expense. For 1968, *A* includes $357.17 as accrued interest income but *B* is not entitled to an interest deduction. For 1969, *B* may deduct $357.17 as an interest expense with respect to the contract.

(2) *Other effects of treating portion of sales price as unstated interest.*—This subparagraph sets forth some illustrations of the effects of treating a portion of the sales price as unstated interest. These illustrations are not all-inclusive. The treatment as unstated interest under section 483 of a portion of a payment which would otherwise be treated as part of the sales price may have the effect of increasing the amount of a nondeductible loss because of the application of section 165(c) (relating to limitation on losses of individuals) or of an unallowable deduction because of section 267 (relating to losses, expenses, and interest with respect to transactions between related taxpayers), or of changing the character of gains and losses or increasing the amount of an allowable loss under section 1231 (relating to property used in the trade or business). Such treatment may affect eligibility to use the installment method of accounting under section 453(b)(2) (relating to limitation on installment method), except that section 483 shall have no effect in determining whether payments received prior to January 1, 1964, in the taxable year of sale exceed 30 percent of the selling price of the property. Furthermore, the application of section 483 may affect the treatment of a stock option under part II, subchapter D, chapter 1 of the Code, except that section 483 shall have no effect in determining whether options granted prior to January 1, 1965, meet the requirements of section 422(b)(4), 423(b)(6), 424(b)(1), or 424(c). Amounts treated as unstated interest under section 483 may, if otherwise qualified under section 266 (relating to carrying charges), be charged to the capital account. The treatment of any portion of voting stock as interest under section 483 will not prevent an otherwise eligible acquisition from qualifying as a reorganization under section 368(a)(1) (relating to definitions of corporate reorganizations), although the payment of cash or property other than voting stock will prevent certain acquisitions from so qualifying. See section 368(a)(1)(B) and (C) and the regulations thereunder for rules relating to the extent to which voting stock must be exchanged by the acquiring corporation in certain reorganizations. Unstated interest shall be treated as interest for purposes of applying the source rules contained in section 861(a)(1) (relating to income from sources within the United States) and section 862(a)(1) (relating to income from sources without the United States, and for purposes of computing the amount of personal holding company income under section 543 (relating to personal holding company income) and section 1372(e)(5) (relating to election by a small business corporation).

(b) *Exceptions and limitations to the application of section 483.*—(1) *Sales price of $3,000 or less.*—(i) *Determination of sales price.*—Section 483 shall not apply to any payment on account of the sale or exchange of property if it can be determined at the time of such sale or exchange that the sales price cannot exceed $3,000. For purposes of determining the amount of the sales price, the amount of any downpayment and any amount treated as unstated interest under section 483 shall be included, but interest provided for in the contract shall not be included. If property which is encumbered by a liability is sold or exchanged, the amount of the liability (whether the property is merely taken subject to the liability or whether the liability is assumed by the purchaser) shall be included as a part of the sales price. The $3,000 exception provided by this subparagraph does not apply to a contract under which payments are indefinite as to liability or amount if the total of the payments (exclusive of interest specified in the contract) due under the contract could exceed $3,000, notwithstanding that such payments do not subsequently exceed such amount. If the district director ascertains from the surrounding facts and circumstances that a single transaction with a sales price in excess of $3,000 has been fragmented into more than one separate transaction each with a sales price less than $3,000 in order to avoid the operation of the provisions of section 483, he may determine that section 483 applies.

(ii) *Examples.*—The provisions of this subparagraph may be illustrated by the following examples:

Example (1).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make four payments of $700 each, such payments being due, respectively, every 6 months for the next 2 years. No interest is provided for in the contract. Since the total sales price ($2,800) under the contract is not in excess of $3,000, section 483 does not apply.

Example (2).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make four payments as follows: $721 ($700 principal plus $21 interest), $742 ($700 principal plus $42 interest), $763 ($700

principal plus $63 interest), and $784 ($700 principal plus $84 interest), such payments being due, respectively, every 6 months for the next 2 years. Since the total sales price ($2,800) exclusive of stated interest ($210) does not exceed $3,000, section 483 does not apply, even though the total dollar amount of the contract, including both principal and stated interest ($3,010), exceeds $3,000.

Example (3).—On December 31, 1963, *A* sells property to *B* under a contract which provides that *B* is to make three payments of $800 each, such payments being due June 30, 1964, December 31, 1964, and June 30, 1965. A fourth payment of $800 is to be made on December 31, 1965, but only if the profit derived from the property exceeds an amount specified in the contract. No interest is provided for in the contract. Section 483 applies to the contract even though the three definite payments ($2,400) do not exceed $3,000, because the total payments due under the contract could exceed such amount. Furthermore, section 483 applies even though, subsequently, the profit derived from the property does not exceed the amount specified in the contract, so that only $2,400 is actually paid under the contract.

Example (4).—*A* divides a 100-acre tract of unimproved real property into four equal parcels and sells them to *B* under four separate contracts dated, respectively, December 31, 1963, January 31, 1964, February 29, 1964, and March 30, 1964. Each contract provides for payments of $1,000 at the time of sale and $1,000 at the end of 1 year. No interest is provided in any of the contracts. The district director may determine that section 483 applies to the four contracts if he ascertains that a single transaction with a sales price in excess of $3,000 has been fragmented into four separate transactions each with a sales price less than $3,000 in order to avoid the operation of the provisions of section 483.

(2) *Carrying charges.*—In the case of the purchaser, the tax treatment of amounts paid on account of the sale or exchange of property shall be determined without regard to section 483 if such amounts are treated under section 163(b) (relating to deduction for interest on certain installment purchases) as if they included interest. Accordingly, if the provisions of section 163(b) apply to a contract, the purchaser shall, with respect to payments under the contract, compute his interest deductions under that section (without regard to section 483), even though such amount differs from the amount to be treated as interest income by the seller as computed under the provisions of section 483.

(3) *Capital asset or section 1231 property.*—(i) *Treatment of seller.*—In the case of the seller, the determination of the tax treatment of any amounts received on account of the sale or exchange of property shall be made without regard to section 483 if no part of any gain on such sale or exchange would (if the property were sold at a gain) be considered as gain from the sale or exchange of a capital asset or property described in section 1231 (relating to property used in the trade or business and involuntary conversions). The determination of whether the exception of the preceding sentence applies shall be made without regard to whether any gain or loss is realized on the sale or exchange, whether any realized gain or loss would be recognized, or whether some other provision of law, such as section 1245 (relating to gain from dispositions of certain depreciable property) or section 1250 (relating to gain from dispositions of certain depreciable realty) applies, or would apply, to some or all of the gain. For example, the provisions of section 483 apply to deferred payments of stock or securities by a corporation which is a party to a reorganization, notwithstanding that under section 354(a) no gain or loss is recognized on the transaction. Similarly, the provisions of section 483 apply to deferred payments made to a corporation for its stock, notwithstanding the nonrecognition of gain or loss to the corporation under section 1032 (relating to exchange of stock for property).

(ii) *Treatment of purchaser.*—The purchaser under a contract under which there are payments to which section 483 applies shall determine the amount of any interest deduction under such section, notwithstanding that section 483 does not apply to the seller because of the provisions of subdivision (i) of this subparagraph.

(4) *Sales or exchanges of patents.*—Section 483 does not apply to any payments made pursuant to a transfer described in section 1235(a) (relating to sale or exchange of patents). The preceding sentence does not apply to transfers which are not described in section 1235(a) but which receive capital gain treatment under another section of the Code.

(5) *Annuities.*—Section 483 does not apply to any amount the liability for which depends in whole or in part on the life expectancy of one or more individuals and which constitutes an amount received as an annuity to which section 72 (relating to annuities, etc.) applies. Thus, in the case of both the

purchaser and the seller, any such amount is not considered a payment to which section 483 applies.

PAR. 5. Section 1.861–2 is amended by revising so much of paragraph (a) as precedes subparagraph (1) of such paragraph. The amended provision reads as follows:

§ 1.861–2 INTEREST.—(a) *General.*—There shall be included in gross income from sources within the United States all interest (including interest on certain deferred payments, as provided in section 483 and the regulations thereunder) received or accrued, as the case may be, from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents of the United States, whether corporate or otherwise, except—

* * * * * * *

PAR. 6. Section 1.1441–2 is amended by revising paragraph (a)(1) to read as follows:

§ 1.1441–2 INCOME SUBJECT TO WITHHOLDING.—(a) *Fixed or determinable annual or periodical income.*—(1) The gross amount of fixed or determinable annual or periodical income is subject to withholding. Section 1441 specifically includes in such income interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments; but other kinds of income are included, as, for instance, royalties. For purposes of the preceding sentence, the term "interest" includes interest on certain deferred payments, as provided in section 483 and the regulations thereunder. The term "fixed or determinable annual or periodical" income is merely descriptive of the character of a class of income. If an item of income falls within the class of income contemplated by the statute, it is immaterial whether payment of that item is made in a series of repeated payments or in a single lump sum. Thus, $5,000 in royalty income would come within the meaning of the term, whether paid in 10 payments of $500 each or in one payment of $5,000.

(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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved January 17, 1966.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on Jan. 24, 1966, 8:45 a.m., and published in the issue of the Federal Register for Jan. 25, 1966, 31 F.R. 941)

SUBCHAPTER F.—EXEMPT ORGANIZATIONS

PART I.—GENERAL RULE

SECTION 501.—EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

26 CFR 1.501(a)–1: Exemption from taxation. Rev. Rul. 66–177

The fact that an organization has been formed under foreign law will not preclude its qualification as an exempt organization under

section 501(a) of the Internal Revenue Code of 1954 if it meets the tests for exemption under that section.

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26 CFR 1.501(c)(2)-1: Corporations organized to hold title to property for exempt organizations. Rev. Rul. 66-102

Section 501(c)(2) of the Internal Revenue Code of 1954 provides for the exemption of corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from tax under section 501(a) of the Code.

Held, the term "expenses" as used in section 501(c)(2) of the Code includes a reasonable allowance for depreciation determined in accordance with section 167 of the Code.

An organization holding title to a building housing its parent. See Rev. Rul. 66-150, page 147.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals. Rev. Rul. 66-46

> A nonprofit organization which is formed to promote public appreciation of group harmony singing and to educate its members and the general public in this type of music is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

Advice has been requested whether a nonprofit organization which is organized and operated to encourage group harmony singing may qualify for exemption under section 501(c)(3) of the Internal Revenue Code of 1954.

The purposes of the organization are to perpetuate group harmony singing and to educate its members and the general public in their appreciation of this type of music.

The organization's activities consist of frequent meetings of members where they receive training and instruction in vocal harmony and opportunities to practice under trained supervision. The members perform free of charge at local community institutions such as veterans' hospitals. Once each year the organization conducts a public concert at which an admission fee is charged, and the members perform without compensation. The organization's principal source of revenue is the annual public concert. Its expenditures are in connection with expenses of the concert such as theater rentals, scenery and costume rentals, rentals of meeting places, purchases of musical materials and remission of dues to affiliated organizations.

Section 501(c)(3) of the Code provides in part for the exemption from Federal income tax of corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, no part of the

net earnings of which inures to the benefit of any private shareholder or individual.

Organizations such as symphony orchestras and theatrical groups may be exempt from Federal income tax as educational or charitable organizations under section 501(c)(3) of the Code. See example (4) of section 1.501(c)(3)-1(d)(3)(ii) of the Income Tax Regulations and Revenue Ruling 64-175, C.B. 1964-1 (Part 1), 185. See also Revenue Ruling 65-270, C.B. 1965-2, 160; and Revenue Ruling 65-271, C.B. 1965-2, 161. An organization formed to promote group harmony singing falls in the same general category of organizations designed to increase public appreciation of the arts. The methods used by the organization in educating its members and the general public are appropriate to an educational organization under section 501(c)(3) of the Code. Accordingly, the organization is exempt from Federal income tax under section 501(c)(3) of the Code.

An organization which considers itself to be within the scope of this Revenue Ruling must, in order to establish its exemption under section 501(c)(3) of the Code, file an application on Form 1023, Exemption Application, with the District Director for the Internal Revenue district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the regulations.

Rev. Rul. 66-103

A nonprofit organization providing awards and grants, including scholarships and fellowship grants, to needy individuals to enable them to continue their work in the creative arts, as well as to continue their education and studies, with no monetary benefit to the donor organization, is entitled to exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

Advice has been requested whether an organization, organized and operated for the purposes described below, qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization was created for the purpose of encouraging the creative arts and scholarship through making grants available to writers, composers, painters, sculptors, and scholars for projects in their respective fields which they would not otherwise be able to undertake or finish due to the lack of funds.

The grants are unconditional in that the results of the research and rights to the artistic or scholarly work belong to the recipient of the grant. The grantor organization derives no monetary benefit from the activity. In awarding grants, preference is given to persons showing distinction or promise in their respective fields. Recipients of grants promise to make their work available for the benefit of the public in ways customary and appropriate to the particular work.

The funds of the organization are received as contributions and it is required by its articles of incorporation to disburse its funds, after the payment of operating expenses, for charitable, scientific, literary, and educational purposes.

Section 501(c)(3) of the Code provides, in part, for the exemption from Federal income tax of corporations, and any community chest,

fund, or foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)–1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in section 501(c)(3) of the Code unless it serves a public rather than a private interest.

In enacting section 117 of the Code relating to scholarships and fellowship grants Congress specifically recognized that such grants are made by section 501(c)(3) organizations. (Section 117 of the Code provides, in part, that in the case of an individual who is not a candidate for a degree, gross income does not include any amount received as a scholarship or fellowship grant if the grantor is an organization described in section 501(c)(3) which is exempt from tax under section 501(a) of the Code.

An organization which makes unconditional grants to individuals (writers, composers, painters, sculptors, scholars, etc.), who are in need of funds to initiate, develop, or complete creative or scholarly works, or to conduct necessary research for such projects, may qualify for exemption under section 501(c)(3) of the Code, where the purpose of such grants is to assist the recipient to carry on his creative efforts. The fact that the recipient may receive money or other benefits from other sources in addition to the grant or award, as a result of his work does not preclude the grantor organization from qualifying as a charitable organization within the meaning of section 501(c)(3) of the Code.

Accordingly, it is held that the instant organization qualifies for exemption from Federal income tax as an organization described in section 501(c)(3) of the Code. Compare Revenue Ruling 66–104, below, wherein an organization sponsoring the preparation of teaching materials and textbooks, and sharing with the editors and authors the royalties from sales thereof by the publisher, is held not to qualify under section 501(c)(3) of the Code.

An organization may not consider itself exempt from tax merely because it falls within the scope of this Revenue Ruling. In order to establish its status, an organization claiming exemption under section 501(c)(3) of the Code should file its application on Form 1023, Exemption Application, with the District Director of Internal Revenue for the internal revenue district in which is located the principal office of the organization. See section 1.501(a)–1 of the regulations.

Rev. Rul. 66—104

A nonprofit organization which makes funds available to authors and editors for preparing teaching materials and writing textbooks, and, under the terms of the contract with the publisher, receives royalties from sales of the published materials and then shares them with those individuals, does not qualify for exemption from Federal income tax as a charitable, educational or literary organization under section 501(c)(3) of the Internal Revenue Code of 1954.

Advice has been requested whether under the circumstances described below an organization created to meet the need for more

satisfactory teaching materials and textbooks in economics and related fields qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization makes funds available to authors and editors for preparing teaching materials and writing textbooks. The individuals are selected on the basis of their ability as scholars or educators. The organization contracts with commercial publishing firms for the publication of these materials which are used primarily by colleges and universities.

The contracts between the organization and the publishers provide that the publishers pay all publication costs and a royalty to the organization on sales of the publication. In return, the publisher receives the copyright, publishing, and selling rights. The agreement between the organization and the editors and authors provides that the royalty income will first be applied to pay for the costs of preparing the materials for publication, including funds to authors and editors. The remaining royalty will be divided into specific percentages between the organization and the editors and authors.

The organization receives funds from contributions, royalties from sales of publications, and loans. Its expenses are for stationery, office help, statistical work, research, proofreading, advertising, legal and accounting fees, payment of royalties and funds to authors and editors, and repayment of loans.

Section 501(c)(3) of the Code provides, in part, for the exemption from Federal income tax of corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Although educational interests are served by the publication of better teaching materials, the facts in this case show only an enterprise conducted in an essentially commercial manner, in which all the participants expect to receive a monetary return. Accordingly, it is held that the instant organization does not qualify for exemption from Federal income tax as an organization described in section 501(c)(3) of the Code.

Compare Revenue Ruling 66–103, page 134, this Bulletin, wherein an organization which makes grants and awards to scholars and artists, and which does not receive any monetary benefit from the activity, is held to qualify for exemption from Federal income tax under section 501(c)(3) of the Code.

Rev. Rul. 66–146

An organization organized and operated to further, encourage, and recognize outstanding achievements and contributions of citizens of a particular State toward the progress and betterment of human endeavor is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

Advice has been requested whether an organization organized and operated to further, encourage, and recognize outstanding achievements and contributions of citizens of a particular State toward the progress and betterment of human endeavor is exempt from Federal

income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization, in accordance with its purpose, examines and evaluates acts of the citizens of the State and on the basis of its study, selects for public recognition and awards those individuals who are determined to have made outstanding contributions and achievements in social, cultural, and technological areas (including commerce, communications, creative arts and crafts, education, finance, government, law, medicine and health, performing arts, religion, science, social services, sports and athletics, technology, and transportation).

Section 501(c)(3) of the Code provides, in part, for the exemption of corporations organized and operated exclusively for charitable purposes.

In the case of *Bok* v. *McCaughn*, 42 Fed. (2d) 616 (1930), the court held that a trust formed to make awards to citizens of Philadelphia who rendered conspicuous service to that city was a charitable trust and hence that a contribution to the trust was deductible under the charitable contributions provision of the Revenue Act applicable in that case.

Similarly, the organization herein described is exempt from Federal income tax under section 501(c)(3) of the Code.

An organization which considers itself within the scope of this Revenue Ruling must, in order to establish exemption under section 501(c)(3) of the Code, file an application on Form 1023, Exemption Application, 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. See section 1.501(a)–1 of the Income Tax Regulations.

Rev. Rul. 66–147

An organization qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 where it is formed to survey scientific and medical literature published throughout the world and to prepare and distribute free of charge abstracts taken from such literature.

Advice has been requested whether a nonprofit corporation organized and operated as described herein qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization was organized for exclusively educational, scientific, and charitable purposes. Its specific purpose is to inform the interested public of current developments appearing in scientific and medical literature. The organization employs technical personnel who survey the world's medical and scientific publications as soon as they are published. They select and abstract articles appearing in this literature. The abstracts are compiled in monthly publications and are distributed free of charge to anyone having particular interest in the subject matter.

The organization's staff is highly trained in particular fields of medicine, chemistry, and biology. In addition, most of the staff has special training in foreign languages, in which a great many of the articles are written. The organization obtains its operating funds from contributions and governmental grants.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable, scientific, and educational purposes.

Section 1.501(c)(3)–1(d)(2) of the Income Tax Regulations defines the term "charitable" as used in section 501(c)(3) of the Code as including the advancement of education or science.

The activities of the organization, consisting of reviewing medical and scientific publications, and preparing and disseminating free abstracts of meaningful and accurate reference materials based on articles appearing in such publications, are programs which advance education and science.

Therefore, the organization qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

An organization which considers itself within the scope of this Revenue Ruling must, in order to establish exemption under section 501(c)(3) of the Code, file an application on Form 1023, Exemption Application, 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. See section 1.501(a)–1 of the regulations.

Rev. Rul. 66–178

A nonprofit organization created to foster and develop the arts by sponsoring a public art exhibit at which the works of unknown but promising artists are selected by a panel of qualified judges for viewing and are gratuitously displayed is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

A question asked the Internal Revenue Service is whether an organization created to foster and develop the arts by sponsoring an annual art exhibit is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization's sole activity is sponsoring an annual public art exhibit at which works of unknown but promising artists are displayed. Artists eligible to have their works displayed are those who are not affiliated with art galleries and who have no medium for exhibiting their creations. The works exhibited are selected by a panel of qualified art experts. The organization does not charge the artists any fees for the privilege of having their works displayed. Nor does the organization sell or offer the displayed works for sale.

For the exhibit, the organization prepares a catalogue which lists each work displayed, the name of its creator, and the artist's home or studio address. The catalogue is sold for a nominal fee to the public. In addition, the organization receives income from nominal admission fees to the exhibit and contributions. Funds are disbursed for renting the exhibition hall, printing the catalogues, and administrative expenses.

Section 501(c)(3) of the Code provides, in part, for the exemption from Federal income tax of organizations organized and operated exclusively for charitable and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Cultural organizations devoted to the promotion of the arts may qualify for exemption as being educational or charitable in character. See Rev. Rul. 65–271, C.B. 1965–2, 161.

Similarly, an organization created to foster and develop the arts by sponsoring an annual public exhibit at which art works of unknown but promising artists are selected by a panel of expert judges and gratuitously displayed is exempt from Federal income tax under section 501(c)(3) of the Code.

An organization which considers itself within the scope of this Revenue Ruling must, in order to establish exemption under section 501(c)(3) of the Code, file an application on Form 1023, Exemption Application, 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. See section 1.501(a)–1 of the Income Tax Regulations.

(Also 1.501(c)(4)–1, 1.501(c)(5)–1, 1.501(c)(7)–1.) Rev. Rul. 66–179

Situations under which garden clubs may qualify for exemption from Federal income tax under section 501 of the Internal Revenue Code of 1954.

Depending upon its form of organization and method of operation an organization commonly referred to as a "garden club" may qualify for exemption from Federal income tax as a charitable or educational organization described in section 501(c)(3) of the Internal Revenue Code of 1954, a civic organization described in section 501(c)(4), a horticultural organization described in section 501(c)(5), or a social club described in section 501(c)(7) of the Code. The proper classifications for exemption are illustrated by the four situations set out below.

Situation 1.—Garden club qualifying under section 501(c)(3) of the Code.

The organization was incorporated as a nonprofit organization for the purposes of instructing the public on horticultural subjects and stimulating interest in the beautification of the geographic area. In furtherance of these purposes, the organization (1) maintains and operates a free library of materials on horticulture and allied subjects, (2) instructs the public on correct gardening procedures and conservation of trees and plants by means of radio, television, and lecture programs, (3) holds public flower shows of a noncommercial nature at which new varieties of plants and flowers are exhibited, (4) makes awards to children for achievements in gardening, (5) encourages roadside beautification and civic planting, and (6) makes awards for civic achievement in conservation and horticulture.

Membership in the organization is open to the public and consists primarily of amateur gardeners and others not professionally or commercially connected with horticulture. The organization's funds are derived from donations and membership dues, fees, and assessments. No part of its net earnings inures to the benefit of any officer or member.

Section 501(c)(3) of the Code provides that an organization orga-

nized and operated exclusively for charitable or educational purposes is exempt from Federal income tax, provided no part of its net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)–1(d)(2) of the Income Tax Regulations defines the term "charitable" to include the advancement of education and the promotion of social welfare by organization designed to combat community deterioration.

Section 1.501(c)(3)–1(d)(3) of the regulations defines the term "educational" as relating to (a) the instruction or training of the individual for the purpose of improving or developing his capabilities or (b) the instruction of the public on subjects useful to the individual and beneficial to the community. An example in this section states that an organization whose activities consist of presenting public discussion groups, forums, panels, lectures, or other similar programs, may be an educational organization.

This organization is organized and, in carrying out its purposes in the manner described above, is operated exclusively for charitable and educational purposes. Accordingly, the organization qualifies for exemption under section 501(c)(3) of the Code.

Situation 2.—Garden club qualifying under section 501(c)(4) of the Code.

The facts are the same as in *Situation 1* except that a substantial part of the organization's activities, but not its primary activity, consists of social functions for the benefit, pleasure, and recreation of its members.

Section 501(c)(4) of the Code provides that a civic organization not organized for profit but operated exclusively for the promotion of social welfare is exempt from Federal income tax.

Section 1.501(c)(4)–1 of the regulations states that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated to bring about civic betterment and social improvements.

In general, social activities for the benefit, pleasure, and recreation of members do not preclude exemption under section 501(c)(4) of the Code. However, section 1.501(c)(4)–1(a)(2)(ii) of the regulations provides that an organization will not qualify for exemption as a civic organization described in section 501(c)(4) of the Code if its primary activity is the operation of a social club.

The facts in this Situation are distinguishable from those in *Situation 1* in that the instant organization conducts substantial social functions not in furtherance of any of the purposes specified in section 501(c)(3) of the Code. Section 1.501(c)(3)–1(c)(1) of the regulations provides that an organization will not be regarded as "operated exclusively" for one or more exempt purposes described in section 501(c)(3) of the Code if more than an insubstantial part of its activities is not in furtherance of a 501(c)(3) purpose. Accordingly, the organization does not qualify for exemption under section 501(c)(3) of the Code.

However this organization, in carrying out its purposes in the manner described above, is being operated primarily to bring about

civic betterment and social improvements. The social functions for the benefit, pleasure, and recreation of the members do not constitute its primary activity. Accordingly, the organization qualifies for exemption under section 501(c)(4) of the Code.

Situation 3.—Garden club qualifying under section 501(c)(5) of the Code.

This organization was incorporated as a nonprofit organization for the purposes of bettering the conditions of persons engaged in horticultural pursuits and improving the grade of their products. In furtherance of these purposes, the organization (1) publishes a monthly trade journal, (2) reports periodically to its members any new developments in horticultural products, and (3) encourages the development of better horticultural products through a system of awards. The membership of the organization is mainly composed of individuals and firms engaged in the business of horticulture and related fields. No part of its net earnings inures to the benefit of any officer or member.

Section 501(c)(5) of the Code provides that a horticultural organization is exempt from Federal income tax.

Section 1.501(c)(5)-1 of the regulations provides that organizations contemplated by section 501(c)(5) of the Code are those which have no net earnings inuring to the benefit of any member, and have as their objectives 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.

This organization, in carrying out its purposes in the manner described above, is being operated to improve the conditions of its members and the grade of their products and to develop a higher degree of efficiency in their occupations. Accordingly, the organization qualifies for exemption under section 501(c)(5) of the Code.

Situation 4.—Garden club qualifying under section 501(c)(7) of the Code.

The organization was incorporated by amateur gardeners to promote their common interest in gardening. The organization (1) holds flower shows and exhibits to display members' achievements in home gardening, (2) schedules weekly meetings devoted primarily to informal social hours during which matters related to gardening are discussed, and (3) issues a publication containing news about members' social activities and achievements in home gardening. Its funds are derived from membership dues, fees, and assessments. No part of the net earnings of the organization inures to the benefit of any officer or member.

Section 501(c)(7) of the Code provides that a club organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes is exempt from Federal income tax, provided no part of its net earnings inures to the benefit of any private shareholder.

This organization, in carrying out its purposes in the manner described above, is being operated exclusively for pleasure and recreation of its members. Accordingly, it qualifies for exemption under section 501(c)(7) of the Code.

An organization which considers itself within the scope of this Revenue Ruling must, in order to establish exemption, file an application on an appropriate form with the District Director of Internal Revenue for the internal revenue district in which is located the principal office of the organization. An organization claiming exemption under section 501(c)(3) of the Code must file an application on Form 1023, Exemption Application. An organization claiming exemption under section 501(c)(4) or section 501(c)(5) of the Code must file an application on Form 1024. An organization claiming exemption under section 501(c)(7) of the Code must file application on Form 1025. See section 1.501(a)–1 of the regulations.

An exempt organization engaged regularly in the selling of "call" options on certain of its stock. See Rev. Rul. 66–47, page 149.

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26 CFR 1.501(c)(4)–1: Civic organizations and local associations of employees. Rev. Rul. 66–59

An organization of employees whose purpose is to pay lump sum retirement benefits to its eligible members or death benefits to their survivors does not qualify for exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954 as a local association of employees.

Advice has been requested whether an association organized for the purposes hereinafter set forth may qualify for exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954, as a local association of employees described in section 501(c)(4) of the Code.

The association was organized for the purpose of creating and maintaining a fund to provide benefits for hourly paid employee members on their retirement; or, in case of an employee member's death, to pay benefits to his surviving spouse, or a descending heir previously designated as beneficiary. The organization was formed by the employees of a company located in a particular city. Membership is open to every person who has been employed by the company for a specified period of time, and terminates when employment by the company is terminated for any reason. The amount of benefits depends upon the recipient's age at the time of retirement or death and the number of years worked for the company. Both the retirement payment and the death benefit payment are made in a lump sum.

The organization's activities consist primarily of disbursing retirement and death benefits to eligible employee members and their beneficiaries. Its principal source of income is from profits derived from concessions operated within the company plant. Other income is from interest on a savings account, and the sale of scrap materials given to the organization by the company for that purpose. The organization's disbursements are principally for the payment of retirement and death benefits to eligible beneficiaries.

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

(4) * * * local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular

municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

Section 1.501(c)(4)–1(b) of the Income Tax Regulations provides, among other things, that the word "charitable" has the same meaning as it does in the regulations under section 501(c)(3) of the Code.

Amounts disbursed by the organization as retirement and death benefits in fulfillment of its organizational purposes are not devoted to charitable, educational, or recreational purposes within the meaning of section 501(c)(4) of the Code.

In view of the foregoing, the organization described herein does not qualify for exemption from Federal income tax under section 501(c)(4) of the Code.

Rev. Rul. 66–148

A nonprofit organization formed for the purpose of establishing and maintaining a system for the storage and distribution of water in order to increase underground water levels in a community is exempt from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954.

Advice has been requested whether an organization whose function is to improve the water supply of a community is exempt from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954.

The organization was formed as a nonprofit corporation for the purpose of establishing and maintaining a system for the storage and distribution of water in order to raise the underground water levels of a community. Membership in the organization is available to any water user in the community who agrees to pay an assessment based upon the number of gallons of water pumped from the user's private well. Such payments constitute the organization's only source of income. However, the increase in the level of the underground water table which results from the organization's activities benefits all residents of the community whose wells are supplied by the raised water table, regardless of whether they are members and regardless of whether they pay anything to the organization. Memberships and assessments are obtained by the organization on a voluntary basis.

Section 501(c)(4) of the Code provides, in part, for the exemption of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. See section 1.501(c)(4)–1 of the Income Tax Regulations.

By attempting to raise the underground water level, the organization is operating for the benefit of the entire community. Accordingly, the organization is exempt from tax under section 501(c)(4) of the Code.

An organization which considers itself within the scope of this Revenue Ruling must, in order to establish exemption under section 501(c)(4) of the Code, file an application on Form 1024, Exemption Application, 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. See section 1.501(a)–1 of the regulations.

Rev. Rul. 66–180

A local association of employees organized exclusively for recreational purposes operates a gasoline station on property owned by the employer of its members to provide funds in addition to dues income for its recreational activities. Sales are limited to its members and to the employer, and income is used exclusively for members' recreation. *Held,* neither the operation of the gasoline station, nor the selling of gasoline and oil to the employer company adversely affects its qualification for exemption since all of its income is used for recreational purposes, and income from sales to the employer of its members is considered a form of employer support of the association. The organization is therefore exempt as a local association of employees described in section 501(c)(4) of the Internal Revenue Code of 1954.

Advice has been requested whether an employees' association organized exclusively for recreational purposes which operates a gasoline station to supplement its dues income under the circumstances described below may qualify for exemption from Federal income tax as an organization described in section 501(c)(4) of the Internal Revenue Code of 1954.

The organization was incorporated as a nonprofit corporation, for recreational purposes, with membership limited to persons who are employees or former employees (pensioners) of a company in a particular locality. Its activities consist of providing recreation through the sponsorship of a basketball league, bowling league, bridge club, golf tournaments, square dancing, holiday parties, etc., for its members. It also maintains and operates a gasoline station, located on property leased from the company.

Sales are limited to members and the company. The organization's income is derived from membership dues, ticket sales to various recreational functions, and gasoline and oil sales. Expenditures are for recreational activities and for the operation of the gasoline station. Approximately 50 percent of the income from gasoline and oil sales is derived from sales to the employer company. All of the net earnings of the organization are required to be used for its recreational activities; no part is to be distributed to individual members.

Section 501(c)(4) of the Code exempts from Federal income tax local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

In determining this organization's qualification for exemption from tax under the foregoing provision, two factors to be considered are (1) whether the organization may engage in a "service station" type of operation, a business ordinarily carried on for profit; and (2) whether the realization by the organization of a substantial portion of its income from the sale of oil and gasoline to the employer of its members would adversely affect its qualification for exemption.

With respect to factor number (1) a local association of employees may qualify for exemption under section 501(c)(4) of the Code not-

withstanding that it engages in a business of a type ordinarily carried on for profit if, as in this case, such business is with its members, and the net earnings of the business enterprise are used exclusively for charitable, educational, or recreational purposes.

As for factor number (2) an employer may make contributions to an association of its employees to enable the organization to carry on its activities. Where it is found that, as in this case, an association of employees derives a substantial portion of its income from doing business with the employer of its members, exemption will not be denied since profits derived from doing business with the employer may be regarded as a form of employer support of the organization.

Accordingly, this organization is entitled to exemption from Federal income tax as a local association of employees described in section 501(c)(4) of the Code.

An organization which considers itself within the scope of this Revenue Ruling must, in order to establish exemption under section 501(c)(4) of the Code, file an application on Form 1024, Exemption Application, 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. See section 1.501(a)–1 of the Income Tax Regulations.

An organization holding title to a building housing its parent. See Rev. Rul. 66–150, page 147.

Whether an organization engaged in activities relating to horticulture qualifies as a civic organization. See Rev. Rul. 66–179, page 139.

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26 CFR 1.501(c)(5)–1: Labor, agricultural, and horticultural organizations. Rev. Rul. 66–105

An organization composed of agricultural producers whose principal activity is marketing livestock for its members does not qualify for exemption under section 501(c)(5) of the Internal Revenue Code of 1954.

Advice has been requested whether an organization composed of agricultural producers, whose principal activity is marketing livestock for its members, qualifies for exemption under section 501(c)(5) of the Internal Revenue Code of 1954.

The organization was formed as a nonprofit corporation to carry out a livestock improvement program and to sponsor and promote sales of livestock for its members who are owners or operators of farms. The organization's principal activity is marketing livestock as agent for its members at auctions held throughout the year. It furnishes the labor, advertising, bookkeeping services, and physical facilities required for the auctions. A percentage of the sales proceeds is retained for expenses and establishment of a reserve for the future acquisition of land and buildings. The balance is remitted to the members as payment for their livestock.

Section 501(c)(5) of the Code provides for the exemption from Federal income tax of labor, agricultural, or horticultural organizations.

Section 1.501(c)(5)-1 of the Income Tax Regulations provides that the organizations contemplated by section 501(c)(5) of the Code as entitled to exemption from income taxation are those which (1) have no net earnings inuring to the benefit of any member, and (2) 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 sale of members' products with the return to them of the sale proceeds, less expenses and reserves, is neither an object nor an activity within the ambit of the cited sections of the Code and regulations. The principal purpose of the organization is to act as a sales agent for its members. Therefore, the organization does not meet the requirements of section 1.501(c)(5)-1 of the regulations and is not exempt under section 501(c)(5) of the Code.

Whether an organization engaged in activities relating to horticulture qualifies as a horticultural organization. See Rev. Rul. 66-179, page 139.

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26 CFR 1.501(c)(7)-1: Social clubs. Rev. Rul. 66-149

A social club is not exempt from Federal income tax as an organization described in section 501(c)(7) of the Internal Revenue Code of 1954 where it regularly derives a substantial part of its income from nonmember sources such as, for example, dividends and interest on investments which it owns. However, a club's right to exemption under section 501(c)(7) of the Code is not affected by the fact that for a relatively short period a substantial part of its income is derived from investment of the proceeds of the sale of its former clubhouse pending the acquisition of a new home for the club. I.T. 3302, C.B. 1939-2, 105, superseded.

Advice has been requested whether a social club which regularly receives a substantial part of its income from interest and dividends on investments qualifies for exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954.

The income of the club consists of amounts received from its members in the form of fees, dues, and assessments plus a substantial amount from investments. Any excess of income over expenditures is generally reinvested in income producing assets.

Section 501(c)(7) of the Code provides that clubs organized and operated exclusively for pleasure, recreation and other nonprofitable purposes are exempt from Federal income tax provided no part of the net earnings inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1 of the Income Tax Regulations provides that, in general, the exemption extends to social and recreation clubs which are supported by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified merely because it raises revenue from members through the use of club facilities or in connection with club activities.

The statute contemplates that clubs falling within the ambit of section 501(c)(7) of the Code are designed primarily to provide for the pleasure and recreation of members. These activities may be supported by funds obtained from members, such as dues, assessments, and payment for the use of club facilities. However, to the extent that income is derived from nonmember sources, it inures to the benefit of the members. If such activities are other than incidental, trivial, or nonrecurrent, it is considered that they are intended to produce income and are reflective of a purpose inconsistent with exemption under section 501(c)(7) of the Code. See Rev. Rul. 58–589, C.B. 1958–2, 266, at 268, and the cases cited therein.

This case is distinguishable from that described in I.T. 3302, C.B. 1939–2, 105, where it was held that a social club's exemption from Federal income tax was not affected by the fact that, for the time being, a substantial part of its income was derived from interest. There, the investment was found to be not made for profit, but incidental to the acquisition of new club facilities following the sale of its old clubhouse for reasons found not to have been motivated by profit.

Such situation does not prevail in the instant case. Here the club's funds are invested primarily for the purpose of producing income through dividends, interest, or capital appreciation. It is evident (1) that such income is regularly derived from nonmember sources, (2) that the income is received in fulfillment of and pursuant to a profit motive, and (3) that the income from investments is substantial in relation to total income. Furthermore, as stated in Revenue Ruling 58–589, above, net earnings inure to members through an increase in services offered by the club, without a corresponding increase in dues, or through an increase in the amount which would be distributed upon dissolution of the club.

Accordingly, a social club is not exempt from Federal income tax as an organization described in section 501(c)(7) of the Code where it regularly derives a substantial part of its income from nonmember sources such as, for example, dividends and interest on investments which it owns. However, a club's right to exemption under section 501(c)(7) of the Code is not affected by the fact that for a relatively short period a substantial part of its income is derived from investment of the proceeds of the sale of its former clubhouse pending the acquisition of a new home for the club.

I.T. 3302, C.B. 1939–2, 105, is superseded.

(Also 1.501(c)(2)–1, 1.501(c)(4)–1.) Rev. Rul. 66–150

An organization which holds title to a building housing its parent, which is exempt under section 501(c)(4) of the Internal Revenue Code of 1954, maintains the building, and operates the social facilities located in the building, does not qualify for exemption from Federal income tax under section 501(c)(2) or section 501(c)(4) of the Code; but it does qualify under section 501(c)(7) of the Code.

Advice has been requested whether, under the circumstances described below, a subsidiary of a veterans' organization qualifies for exemption from Federal income tax under section 501(c)(2), 501(c)(4), or 501(c)(7) of the Internal Revenue Code of 1954.

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A veterans' organization which is exempt under section 501(c)(4) of the Code established a wholly owned not-for-profit subsidiary. The subsidiary's purpose is to hold title to a building, and to maintain and operate the veterans' organization's social facilities located in the building. Members of the veterans' organization automatically become members of the subsidiary, and a percentage of the membership dues is paid over to the subsidiary. The subsidiary's charter provides that in the event of its dissolution its assets are to be distributed to the veterans' organization.

The subsidiary's activities consist of holding title to the building housing the veterans' organization, maintaining the building, and operating the social facilities, including a bar, restaurant, and gameroom, located in the building. Only members and their bona fide guests are admitted to the social facilities. The subsidiary's income is from membership dues and receipts from the bar, restaurant, and gameroom. Its expenses are for operating and maintenance costs.

Section 501(c)(2) of the Code provides for the exemption of corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under section 501(a) of the Code.

The subsidiary is not organized for the exclusive purpose required by section 501(c)(2) of the Code; and it operates social facilities, which is outside the scope of section 501(c)(2). Accordingly, it does not qualify for exemption under section 501(c)(2) of the Code.

Section 501(c)(4) of the Code provides, in part, for the exemption of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare. An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements. An organization is not operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members. See section 1.501(c)(4)–1 of the Income Tax Regulations.

Unlike its parent, which engages in various activities for the common good and general welfare of the people of the community typical of a veterans' organization, such as promoting patriotism, preserving the memory of those who died in war, and assisting veterans in need, the subsidiary engages in no social welfare activities. Further, its primary activity is operating a social club. Accordingly, it does not qualify for exemption under section 501(c)(4) of the Code.

Section 501(c)(7) of the Code provides for the exemption of clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

An organization which engages in club activities and provides a meeting place for the members of its parent may qualify under section 501(c)(7) of the Code. See Revenue Ruling 56–305, C.B. 1956–2, 307. Accordingly, it is held that the subsidiary is exempt under section 501(c)(7) of the Code.

An organization which considers itself within the scope of this Revenue Ruling must, in order to establish exemption under section 501 (c) (7) of the Code, file an application on Form 1025, Exemption Application, 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. See section 1.501(a)–1 of the regulations.

Whether an organization engaged in activities relating to horticulture qualifies as a social club. See Rev. Rul. 66–179, page 139.

PART II.—TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS

SECTION 511.—IMPOSITION OF TAX ON UNRELATED BUSINESS INCOME OF CHARITABLE, ETC., ORGANIZATIONS

26 CFR 1.511–1: Imposition and rates of tax. Rev. Rul. 66–47
(Also Sections 501, 512, 513; 1.501(c) (3)–1, 1.512(b)–1, 1.513–1.)

> An organization, which is exempt from Federal income tax under section 501(c) (3) of the Internal Revenue Code of 1954, regularly sells "call" options on certain securities held in its investment portfolio. *Held*, the organization is engaged in an unrelated trade or business as defined in section 513 of the Code, and income realized by the organization from unexercised "call" options is subject to the unrelated business income tax imposed by section 511 of the Code.

Advice has been requested whether income realized by an organization exempt from Federal income tax under section 501(c) (3) of the Internal Revenue Code of 1954 from unexercised "call" contracts (options) is subject to the unrelated business income tax imposed by section 511 of the Code.

A "call" option, as referred to herein, is a transferable, bearer contract issued to a buyer (optionee) by an organization (issuer or optioner) for a cash payment (premium) upon delivery of the contract. The contract gives the buyer the right, at his option, to buy from the organization a certain number of shares of a specific stock at a fixed price on or before a stipulated date. Such option contracts terminate upon expiration of the stipulated date if they are not exercised.

The organization does not purchase stock for the purpose of issuing "call" options, but offers "calls" only on selected stocks held in its portfolio. "Call" options are regularly issued by the organization from its large and varied portfolio of stocks.

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations otherwise exempt from tax under section 501(c) (3) of the Code. The term "unrelated business taxable income" is defined in section 512 of the Code, with certain exceptions, additions, and limitations, as the gross income derived by an organization from an unrelated trade or business regularly carried on

by it, less allowable deductions directly connected with conducting such trade or business. Section 513 of the Code defines the term "unrelated trade or business," as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function forming the basis for its exemption under section 501 of the Code.

The organization contends that the selling of "call" options is a part of the management of its investments, and that this activity does not meet the definition of an "unrelated trade or business," within the meaning of section 513 of the Code. *Eugene Higgins* v. *Commissioner*, 312 U.S. 212 (1941), Ct. D. 1486, C.B. 1941–1, 339. It also relies on Senate Report No. 2375, Eighty-first Congress, C.B. 1950–2, 483, at 506, relating to the Revenue Act of 1950, which states, in part, that dividends, interest, royalties, most rents, capital gains and losses, and similar items are excluded from the base of the tax on unrelated income because the Committee believed that they were "passive" in character.

Section 512(b) of the Code excludes from the base of the tax on unrelated income, all capital gains, as well as certain other items of income. However, the fact that income from certain sources and activities is excluded from the computation of "unrelated business taxable income" under the provisions of section 512(b) of the Code is not determinative of whether an organization is engaged in an unrelated trade or business.

Two tests must be met by an organization before an activity is considered an "unrelated trade or business" for the purpose of the tax on unrelated business income: (1) The activity must be regularly carried on with sufficient consistency to indicate a continuing purpose of the organization to derive income from such activity, and (2) the activity must be unrelated to the exempt function or purpose of the organization. See section 1.513–1(a) of the Income Tax Regulations.

The selling of "call" options by an organization is a separate activity from the management of its portfolio of securities. An organization can realize income from the sale of a "call" or "put" option without selling the underlying security.

Revenue Ruling 58–234, C.B. 1958–1, 279, provides that if a "put" or "call" (issued singly) is exercised, the premium is allocated as an adjustment to the price or cost of the underlying stock which is the subject of the option, so that capital gain may result. Where, however, a "put" or "call" issued singly expires without having been exercised, the premium received by the issuer or the writer is ordinary income. Although Revenue Ruling 58–234 is not determinative of whether the activity of writing "call" options constitutes an unrelated trade or business as defined in section 513 of the Code, it recognizes that income from the sale of a capital asset is different from income realized by the seller of an option contract which expires without being exercised.

Revenue Ruling 63–183, C.B. 1963–2, 285, holds that an open end investment company which received more than 10 percent of its gross income from expired, unexercised "put" and "call" options does not qualify as a regulated investment company because of its inability to meet the limitations prescribed in section 851(b)(2) of the Code.

Section 851(b)(2) of the Code includes as eligible income "gains from the sale or other disposition of stock or securities." That Revenue Ruling states in part:

> However, when the optionee permits the "put" or "call" to expire without exercise, the premium the writer has received for writing the option is not associated with, and has no relevance in, fixing the amount of gain from the disposition of any particular stock or securities. Nor can the premium be viewed *as gain from the sale or other disposition of the option* itself. [Emphasis added.]

Since the organization regularly engages in selling "call" options from which it realizes some part of its income, it is engaging in an unrelated trade or business within the meaning of section 513 of the Code. Therefore, income realized by the organization from unexercised "call" options is income from an unrelated trade or business, which is subject to the unrelated business income tax imposed by section 511 of the Code in the taxable year in which the failure to exercise the option becomes final. It is immaterial that income received by the organization from the sale of securities resulting from exercised options is excluded from the base of the unrelated business income by section 512(b) of the Code.

Income realized by a business league from the management of health and welfare plans for a fee. See Rev. Rul. 66-151, page 152.

SECTION 512.—UNRELATED BUSINESS TAXABLE INCOME

26 CFR 1.512(b)-1: Exceptions, additions, and limitations. Rev. Rul. 66-106

> Amounts distributed by a real estate investment trust, within the meaning of section 856 of the Internal Revenue Code of 1954, to an exempt employees' pension trust do not constitute unrelated business taxable income where the distributions were made out of the earnings and profits of the real estate investment trust and hence were dividends.

Advice has been requested whether amounts distributed by a real estate investment trust to an exempt employees' pension trust constitute unrelated business taxable income.

An exempt employees' pension trust invested some of its funds in shares of beneficial interest in a real estate investment trust, which qualified as such under section 856 of the Internal Revenue Code of 1954. Distributions, based upon these shares, were made to the pension trust by the real estate investment trust.

The investment here involved does not differ in any material way from investments in shares of stock of an incorporated enterprise. See in that regard section 1.856-1(e) of the Income Tax Regulations, which makes it clear that other provisions of the subchapter dealing with real estate investment trusts, and particularly the provisions of subchapter C pertaining to corporate distributions, are applicable with respect to both real estate investment trusts and their shareholders in the same manner that they would apply to any other unincorporated trust which would be taxable as a domestic corporation.

The distributions by the real estate investment trust were made out of its earnings and profits, and hence were dividends as defined in section 316 of the Code. They could not represent income to the pension trust from an unrelated trade or business since section 512(b) of the Code specifically provides that all dividends are to be excluded in computing unrelated business taxable income.

Accordingly, it is held that amounts distributed by a qualified real estate investment trust to an exempt employees' pension trust, as the holder of shares of beneficial interest, do not constitute unrelated business taxable income.

Income realized by an exempt organization as a result of unexercised options sold on part of its stock. See Rev. Rul. 66–47, page 149.

Income realized by a business league from the management of health and welfare plans for a fee. See Rev. Rul. 66–151, below.

SECTION 513.—UNRELATED TRADE OR BUSINESS

26 CFR 1.513–1: Definition of unrelated trade or business. Rev. Rul. 66–151

(Also Sections 511, 512; 1.511–1, 1.512(b)–1.)

The management of health and welfare plans for a fee by a business league exempt under section 501(c)(6) of the Internal Revenue Code of 1954 is an unrelated business within the meaning of section 513 of the Code.

Advice has been requested whether the management of health and welfare plans for a fee by a business league exempt under section 501(c)(6) of the Internal Revenue Code of 1954 is an unrelated business within the meaning of section 513 of the Code.

The organization is composed of firms in a particular industry. Its purpose and principal activity is to represent such firms in all matters pertaining to their relations with labor and labor unions. The organization also regularly manages health and welfare plans for its members. It receives a fixed fee for each employee covered by a plan. Significant amounts of its income and expenses are attributable to the management of these plans.

Section 513 of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income of funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt functions.

The management of health and welfare plans under the circumstances described, including the performance of the services connected therewith, constitutes a business not substantially related to the functions forming the basis for the exemption of the organization.

Accordingly, the management of the health and welfare plans by the organization constitutes the conduct of an unrelated trade or business

within the meaning of section 513 of the Code, and the organization is subject to the tax imposed by section 511 of the Code, as computed under section 512, on the income from such activity.

The selling of "call" options on part of its stock, on a regular basis, by an exempt organization. See Rev. Rul. 66–47, page 149.

SECTION 514.—BUSINESS LEASES

26 CFR 1.514(c)–1: Business lease indebtedness. Rev. Rul. 66–107

A mortgage or other similar lien on real property acquired by a charitable organization in a liquidating distribution from a corporation is "business lease indebtedness" within the meaning of section 514(c) of the Internal Revenue Code of 1954.

Advice has been requested whether mortgages on real property under the circumstances described below represent business lease indebtedness as defined in section 514(c) of the Internal Revenue Code of 1954.

A charitable organization, exempt from Federal income tax under section 501(c)(3) of the Code after June 30, 1950, acquired all the capital stock of a corporation. The assets of the corporation consisted of several parcels of real estate, each subject to a mortgage and a 99-year lease. The corporation was subsequently dissolved, and all of its assets, subject to the leases and indebtedness, were distributed in a liquidating distribution to the charitable organization.

A charitable organization exempt under section 501(c)(3) of the Code is subject to the unrelated business income tax imposed by section 511 of the Code on income received from business leases. See sections 512(b)(4), 514(a)(1), and 514(a)(2) of the Code. The term "business lease" is defined in section 514(b) of the Code as a lease of real property for a term of more than 5 years if at the close of the lessor's taxable year there is a business lease indebtedness, as defined in section 514(c) of the Code with respect to such property.

Section 514(c) of the Code provides, in part:

(2) *Property Acquired Subject to Mortgage, etc.* Where property is acquired subject to a mortgage or other similar lien, the amount of the indebtedness secured by such mortgage or lien shall be considered (*whether the acquisition was by gift, devise, or purchase*) as an indebtedness of the lessor incurred in acquiring such property even though the lessor did not agree to pay such indebtedness, except that where real property was acquired by gift, bequest, or devise before July 1, 1950, subject to a mortgage or other similar lien, the amount of such mortgage or other similar lien shall not be considered as indebtedness of the lessor incurred in acquiring such property. [Emphasis added.]

The specific question presented is whether property received by an exempt organization in a corporate liquidating distribution is "acquired" within the meaning of section 514(c) of the Code.

The term "acquired" as used in section 514(c)(2) of the Code applies to all acquisitions of real property subject to a mortgage or similar lien, regardless of the method of acquisition. The parenthetical clause, "whether the acquisition was by gift, devise, or purchase," is illustra-

tive only and is not intended to limit the term "acquired." Furthermore, the term "purchase," as it is used in section 514(c) of the Code, is broad enough to include the receipt of property by a shareholder in a corporate liquidating distribution.

For these reasons property received in a corporate liquidating distribution is "acquired" within the meaning of section 514(c) of the Code. Accordingly, based on the facts in this case, the mortgages on the property acquired by the organization represent business lease indebtedness.

PART III.—FARMERS' COOPERATIVES

SECTION 521.—EXEMPTION OF FARMERS' COOPERATIVES FROM TAX

26 CFR 1.521–1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521. Rev. Rul. 66–108

A farmers' cooperative association whose only activities consist of caring for and maintaining its patrons' orchards and harvesting their crops, does not qualify for exemption as an association described in section 521 of the Internal Revenue Code of 1954.

Advice has been requested whether a farmers' cooperative association organized and operated solely to maintain and care for its patrons' orchards and to harvest their crops qualifies for exemption from Federal income tax under section 521 of the Internal Revenue Code of 1954.

Section 521(b)(1) of the Code describes farmers' cooperative associations which qualify for exemption as follows:

The farmers' cooperatives exempt from taxation to the extent provided in subsection (a) are farmers', fruit growers', or like associations organized and operated on a cooperative basis (A) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (B) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses.

Section 1.521–1(b) of the Income Tax Regulations provides that the term "supplies and equipment" as used in section 521 of the Code "includes groceries and all other goods and merchandise used by farmers in the operation and maintenance of a farm or farmer's household."

The term "marketing" as used in section 521(b)(1) of the Code includes the sale of farm products by a farmers' cooperative for its patrons and other activities necessary in the sale of such products, such as processing, packing, shipping, etc. Grove caretaking and harvesting are farming activities, but they do not involve the sale or the processing for sale of agricultural products. Therefore, they do not constitute "marketing" as that term is used in section 521 of the Code. Moreover, grove caretaking and harvesting do not constitute the

purchase of supplies and equipment. See *Dr. P. Phillips Cooperative* v. *Commissioner*, 17 T.C. 1002 (1951) at 1009–1010.

Accordingly, as the instant organization does not engage in a marketing or a purchasing activity as required by section 521 of the Code, it does not qualify for exemption as a farmers' cooperative association.

Rev. Rul. 66–152

Section 1382 of the Internal Revenue Code of 1954 provides that a farmers' cooperative association exempt under section 521 of the Code may exclude or deduct patronage dividends and nonpatronage distributions which are paid in qualified written notices of allocation defined by section 1388(c) of the Code, provided that at least 20 percent of the payment is made in money or qualified check as required by section 1388(c). To reduce record keeping involved in complying with the 20-percent requirement where small amounts are due to patrons, a cooperative makes full payment in money or qualified check to those patrons who are entitled to patronage dividends or nonpatronage distributions amounting to $10 or less. Patrons who are entitled to more than $10 receive $10 or 20 percent of the amount to which they are entitled, whichever is greater. *Held:* Such distributions will not adversely affect the cooperative's exemption under section 521 of the Code.

SUBCHAPTER H.—BANKING INSTITUTIONS

PART II.—MUTUAL SAVINGS BANKS, ETC.

SECTION 593.—RESERVES FOR LOSSES ON LOANS

26 CFR 1.593–7: Establishment and treatment of reserves for bad debts. Rev. Rul. 66–82

> The permanent nonwithdrawable capital stock account of a domestic building and loan association is not a reserve or similar account within the meaning of section 1.593–7(a) of the Income Tax Regulations. Current earnings credited to such account, by way of stock dividends or otherwise, are not credited to a reserve for bad debts, and, therefore, are not deductible from gross income for Federal income tax purposes.

Advice has been requested whether current earnings credited to the "permanent reserve fund nonwithdrawable stock" (permanent nonwithdrawable capital stock account) of the taxpayer represents an addition to a reserve for bad debts within the meaning of section 593 of the Internal Revenue Code of 1954.

The taxpayer, a domestic building and loan association within the meaning of section 7701(a)(19) of the Code, has permanent nonwithdrawable capital stock represented by shares. During the taxable year the taxpayer paid a stock dividend on the permanent nonwithdrawable capital stock, which was charged, in part, against the current earnings account. Following the issuance of the stock dividend, the permanent nonwithdrawable capital stock account exceeded the amount actually paid in for stock in prior years.

Section 593 of the Code provides, in general, that a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, and a cooperative bank without capital stock organized and operated for mutual purposes and without profit may, as an alternative to a deduction from gross income under section 166(a) of the Code for specific debts which become worthless in whole or in part, deduct amounts credited to a reserve for bad debts.

Section 1.593–7(a) of the Income Tax Regulations relates to the establishment and treatment of reserves for bad debts, and, in part, provides:

> (2) *Accounting for reserves.*
> (i) * * *
> (ii) * * * Minimum amounts credited in compliance with * * * [any] Federal or State statutes, regulations, or supervisory orders to reserve or similar accounts, or additional amounts credited to such reserve or similar accounts and permissive under such statutes, regulations, or orders, against which charges may be made for the purpose of absorbing losses sustained by the taxpayer, may also be credited to the reserve for losses on nonqualifying loans or the reserve for losses on qualifying real property loans * * *

The words "reserve or similar accounts," as used in section 1.593–7(a)(2)(ii) of the regulations, relate only to reserve accounts maintained on the books of account of the taxpayer for the purpose of absorbing losses. The permanent nonwithdrawable capital stock account of the taxpayer is not one of its "reserve or similar accounts," even though amounts appearing therein in excess of the paid-in amount of such stock represent a part of "surplus, undivided profits, and reserves." All of the taxpayer's surplus, undivided profits, and reserves, as well as its capital, are at the risk of the taxpayer's business, but it does not follow that the total amount thereof has been credited to a reserve for bad debts within the scope of section 593 of the Code.

Accordingly, the permanent nonwithdrawable capital stock account of the taxpayer is not a reserve or similar account within the meaning of section 1.593–7(a) of the regulations. Current earnings credited to such account, by way of stock dividends or otherwise, are not credited to a reserve for bad debts, and therefore, are not deductible from gross income for Federal income tax purposes.

SUBCHAPTER I.—NATURAL RESOURCES

PART I.—DEDUCTIONS

SECTION 611.—ALLOWANCE OF DEDUCTION FOR DEPLETION

26 CFR 1.611–2: Rules applicable to mines, oil and gas wells, and other natural deposits.

Method for computing cost depletion deductions by taxpayers in the Southern High Plains of Texas and New Mexico who extract ground water from the Ogallala formation for irrigation purposes. See Rev. Proc. 66–11, page 624.

26 CFR 1.611–3: Rules applicable to timber.

Capital expenditures incurred in planting Christmas trees recoverable through depletion allowance. See Rev. Rul. 66–18, page 59.

SECTION 613.—PERCENTAGE DEPLETION

26 CFR 1.613–2: Percentage depletion rates. (Also Part II Sections 23(m), 114; Regulations 118, Sections 39.23(m)–5, 39.114–1.) Rev. Rul. 66–24

> Clay used, or sold for use, by a mineowner or operator, as one of the constituents of the kiln feed in the manufacture of cement is not regarded as "brick and tile clay." Under the Internal Revenue Code of 1939, percentage depletion is not allowable for such clay unless it is of a variety for which depletion is otherwise specifically provided by that Code.
>
> Under the Internal Revenue Code of 1954, clay used, or sold for use, by a mineowner or operator, as one of the constituents of the kiln feed in the manufacture of cement falls within the category of "all other minerals" and is subject to a depletion rate of 15 percent as provided by section 613(b)(6) of that Code.

Advice has been requested with respect to the percentage depletion rate applicable to clay used, or sold for use, by a mineowner or operator, as one of the constituents of the kiln feed in the manufacture of cement for taxable years to which the Internal Revenue Code of 1939 applies and also for taxable years to which the Internal Revenue Code of 1954 applies.

Under section 114(b)(4)(i) of the 1939 Code, effective for years subsequent to 1950, as well as under section 613(b)(5) of the 1954 Code as first enacted and applicable through 1960, a depletion deduction of 5 percent was allowable for "brick and tile clay." The statute did not define "brick and tile clay."

However, by section 29.23(m)–5 of Regulations 111, by section 39.23(m)–5 of Regulations 118, pertaining to the 1939 Code, and by section 1.613–2(b)(1)(i) of the Income Tax Regulations, pertaining to the 1954 Code, applicable to years prior to 1961, "brick and tile clay" is defined as clay used or sold for use in the manufacture of common brick, drain and roofing tile, sewer pipe, flower pots, and kindred products (other than clay specifically identified as clay for which a 15-percent rate of percentage allowance is provided).

Clay used, or sold for use, in the manufacture of cement is manifestly not clay used, or sold for use, in the manufacture of brick, drainage and roofing tile, sewer pipe, or flower pots. Therefore, under the applicable law and regulations, clay used, or sold for use, in making cement cannot be properly treated as entitled or subject to a 5-percent deduction for depletion as "brick and tile clay." Thus under the 1939 Code, if a particular clay does not qualify as a refractory clay, ball clay, china clay, etc., and is not used in making common brick and tile products, it is not entitled to percentage depletion.

Under the 1954 Code three paragraphs of section 613(b) deal with clay of specified kinds and clay used for specified purposes. As section 613(b) was originally enacted, section 613(b)(3) provided a 15-percent depletion rate for ball clay, bentonite, china clay, and sagger clay. Section 613(b)(5)(A) provided a 5-percent rate for

"brick and tile clay." Section 613(b)(6) provided a 15-percent rate for "all other minerals", including refractory and fire clay. The latter provision was subject to two exceptions: (1) The percentage allowed for "all other minerals" was limited to 5 percent (except under specified circumstances) for minerals used or sold for use as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes; and (2) it was provided in the last sentence of paragraph (6) that the term "all other minerals" as used in that paragraph does not include soil, sod, dirt, turf, water, or mosses, or minerals from sea water, the air, or similar inexhaustible sources.

Section 302(a) of Public Law 86–564, C.B. 1960–2, 681, at 683, amended section 613(b) of the 1954 Code by dealing with refractory and fire clay in section 613(b)(3)(B), allowing the 15-percent rate to clay used or sold for use for purposes dependent on its refractory properties if paragraph (5)(B) of section 613(b), as amended, does not apply. The amendment of paragraph (5) dealt with "brick and tile clay" in a new subparagraph (B), which allows the 5-percent rate for clay used or sold for use in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots, and kindred products. Finally, paragraph (6) was amended to delete refractory and fire clay from the "all other minerals" category, such clay having been dealt with in the amended section 613(b)(3)(B).

It will be noted that both in its original form and as amended by Public Law 86–564, section 613(b) does not specifically provide a depletion rate for clay used in the manufacture of cement. Nevertheless, such clay falls within the term "all other minerals" for which the 15-percent rate is provided by section 613(b)(6) if it does not fall within either of the two exceptions referred to above. Such clay when used or sold for use as one of the constituents of the kiln feed in the manufacture of cement is used because it contributes to the setting qualities of the cement when mixed with water and does not fall within either of those exceptions. Such clay is therefore considered to be entitled to the 15-percent depletion rate provided by section 613(b)(6).

Accordingly, clay used, or sold for use, by a mineowner or operator, as one of the constituents of the kiln feed in the manufacture of cement is not to be regarded as "brick and tile clay." For taxable years to which the 1939 Code is applicable, percentage depletion is not allowable for such clay unless it is a variety for which depletion is otherwise specifically provided for by that Code.

For taxable years to which the 1954 Code is applicable, clay used, or sold for use, by a mineowner or operator, as one of the constituents of the kiln feed in the manufacture of cement falls within the category of "all other minerals" and is subject to a depletion rate of 15 percent as provided by section 613(b)(6) of that Code.

Rev. Rul. 66–51

A 15-percent depletion rate is allowable under section 613 of the Internal Revenue Code of 1954 for quartz sand and quartz pebbles used or sold by the mineowner or operator for use for sand blasting, filtration, or for foundry purposes.

Advice has been requested whether the 5-percent or the 15-percent depletion rate is allowable under section 613 of the Internal Revenue

Code of 1954 for quartz sand and quartz pebbles used or sold by the mineowner or operator for use for sand blasting, filtration, or for foundry purposes.

Section 613(a) of the Code provides that for the mines and other natural deposits named in section 613(b), the allowance for depletion under section 611 shall be a percentage (specified in section 613(b) of the Code) of the "gross income from the property" excluding rents and royalties paid by the taxpayer in respect to the property.

Quartz sand and quartz pebbles are listed in section 1.613–2(b)(4) of the Income Tax Regulations as examples of "all other minerals". Section 1.613–2(b)(4) of the regulations provides a 15-percent rate for "all other minerals" (all minerals not specifically named under one of the other rate provisions for percentage depletion) unless the mineral is used or sold for use as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes. If such mineral ("all other minerals") is, however, used for rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes, the 5-percent rate is applicable unless the mineral is sold by the mineowner or operator on a bid in direct competition with a bona fide bid to sell a mineral listed under section 613(b)(3) of the Code (in which case the 15-percent rate applies).

Quartz sand and quartz pebbles are not used as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes, when used for sand blasting, filtration, or for foundry purposes.

Accordingly, a 15-percent depletion rate is allowable under section 613 of the Code for quartz sand and quartz pebbles used or sold by the mineowner or operator for use for sand blasting, filtration, or for foundry purposes.

SECTION 616.—DEVELOPMENT EXPENDITURES

26 CFR 1.616–1: Development expenditures. Rev. Rul. 66–170

Costs incurred by a quarry operator to reimburse a power company for the relocation of power transmission facilities located on a right-of-way through the quarry property are additional capital expenditures for the acquisition of full rights to the mineral property and are not "development expenditures" under section 616 of the Internal Revenue Code of 1954.

Advice has been requested whether the costs incurred by a quarry operator to reimburse a power company for the relocation of transmission facilities located on a right-of-way through the quarry property are a "development expenditure" under section 616 of the Internal Revenue Code of 1954.

The taxpayer, a quarry operator, purchased the mineral lands subject to an easement in perpetuity and right-of-way previously granted to the power company. The taxpayer owns the mineral rights within the right-of-way but is prevented from extracting all of the minerals because he will be liable for any damages to the transmission facilities caused by or resulting from the removal of the mineral under the right-of-way. The quarry has been in the production stage for several years.

As a result of normal operations over the years the quarry has progressed to the right-of-way, and the normal plan of quarrying will

be interrupted unless the mineral can be quarried from the right-of-way. In order to continue the operations, the taxpayer has entered into an agreement with the power company under which he will grant to such company a new right-of-way and reimburse it for the costs of relocating the transmission facilities.

Under section 616(a) of the Code a deduction is allowable for all expenditures (other than for depreciable property) paid or incurred during the taxable year for the development of a mine or other natural deposit (other than an oil or gas well) after the existence of ore or minerals in commercial quantities has been disclosed. Under section 616(b) of the Code, such expenditures may be treated as deferred expenses at the election of the taxpayer. The expenditures described in section 616 of the Code are those resulting directly from the mining process or activity of making the ore or mineral in place accessible for production operations through the removal of material, by the driving of shafts, tunnels, galleries, and similar processes or activities. Expenditures for the acquisition of new rights to enable the taxpayer to extract the mineral are not within the purview of that section.

When acquired by the taxpayer, the land containing the mineral deposit here involved was subject to an easement held by the power company. This impediment to full use of the area by the taxpayer required him to incur additional costs before he possessed an unlimited right to use the land for purposes of extracting the minerals therefrom.

The expenditures made by the taxpayer in connection with the new easement were incurred for the purpose of obtaining an unlimited right to extract the mineral in lieu of the right burdened by the contingent threat of liability for damages which was previously held. Expenditures of this character, whether paid or incurred at the time of the original transaction or at a later date, are a part of the capital cost of acquiring the property involved with unlimited right to extract the mineral.

Accordingly, expenditures incurred by the taxpayer to reimburse the power company for relocation of its power transmission facilities located on the right-of-way through the quarry property are capital expenditures made to acquire full rights to the mineral deposit, recoverable through depletion, and are not development expenditures subject to section 616 of the Code.

PART III.—SALES AND EXCHANGES

SECTION 631.—GAIN OR LOSS IN THE CASE OF TIMBER, COAL, OR DOMESTIC IRON ORE

26 CFR 1.631–1: Election to consider cutting as sale or exchange. Rev. Rul. 66–6

A taxpayer who acquired timber on December 31, 1962, and still owned it at the beginning of his taxable year which began July 1, 1963, has owned such timber for a period of more than six months before the beginning of such taxable year for purposes of section 631 (a) of the Internal Revenue Code of 1954.

I.T. 3287, C.B. 1939–1 (Part 1), 138 and I.T. 3985, C.B. 1949–2, 51, amplified.

Advice has been requested whether a taxpayer who acquired timber on December 31, 1962, and still owned it at the beginning of his taxable year which began July 1, 1963, has owned such timber for a period of more than six months before the beginning of such taxable year within the meaning of section 631(a) of the Internal Revenue Code of 1954.

Section 631(a) of the Code provides, in pertinent part, that a taxpayer may elect to treat the cutting of timber for sale or use in his trade or business as a sale or exchange of timber cut during the year, providing the taxpayer has owned, or has had a contract right to cut, such timber for a period of more than six months before the beginning of such year.

When a prescribed period of months is before a designated day, date, act, or other event, it is properly computed, in the absence (as here) of a definitely evidenced different intent, by excluding the day so designated and computing the period backward to, and including the day designated as its beginning. See *Dutcher* v. *Wright*, 94 U.S. 553 (1876); *In re Warner*, 144 Fed. 987 (1906); *In re Hamilton* (*Postel* v. *Broadway Trust Co.*), 29 Fed. (2d) 281 (1928); and *In re Glenn*, 2 Fed. Supp. 579, at 594 (1932), all involving the proper computation of the statutory period of four months before the filing of a petition in bankruptcy. Thus, the general rule is the reverse of that stated in I.T. 3287, C.B. 1939–1 (Part 1), 138. Similarly, the "less one" rule of I.T. 3985, C.B. 1949–2, 51, becomes a "plus one" rule where the period to be computed is before a designated event.

For example, the first day of a period six months before June 16, 1963, would be December 16, 1962, determined by excluding June 16, and computing backward from June 15 to the corresponding date of the appropriate preceding month, i.e. December 15, plus one day, to December 16, 1962. Consequently, for timber to have been held more than six months before June 16, 1963, it must have been acquired before December 16, 1962.

Moreover, when the date before which something must have occurred is the first day of a month, the date which begins the period is determined by going backward to the last day of the appropriate preceding month, plus one.

Furthermore, when the appropriate preceding month has no date corresponding to the date before which something must have occurred, the date beginning the period will be the last day of the appropriate preceding month. For example, five months before July 31, would be February 28 or in a leap year, February 29.

Accordingly, in the instant case, the timber acquired by the taxpayer on December 31, 1962, and still owned by him at the beginning of his taxable year which began July 1, 1963, has been owned for a period of more than six months before the beginning of such taxable year since the first day of a period six months before July 1, 1963, is January 1, 1963, and December 31, 1962, is, therefore, more than six months before July 1, 1963.

When the date before which something must have occurred is the first day of a month, the date which begins a period of months before such other date will be the first day of the appropriate preceding month. Also, when the appropriate preceding month has no date corresponding to the date before which something must have occurred,

the date beginning the period will be the last day of the appropriate preceding month.

I.T. 3287, C.B. 1939–1 (Part 1), 138 and I.T. 3985, C.B. 1949–2, 51, are hereby amplified to reflect the reverse chronological computation of the general rules described therein in order to compute (as in this case) a prescribed period of months before a designated event.

SUBCHAPTER J.—ESTATES, TRUSTS, BENEFICIARIES, AND DECEDENTS

PART I.—ESTATES, TRUSTS, AND BENEFICIARIES

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 1.671–2: Applicable principles. Rev. Rul. 66–159
(Also Sections 676, 1034; 1.676(a)–1, 1.1034–1.)

> Gain will not be recognized to a trust, or to the grantor upon a sale by the trust of property used by the grantor as his principal residence, if such grantor is considered as the owner of the trust, and the trust acquires new property, which is used by the grantor as his principal residence, at a cost equal to or in excess of the selling price of the old residence.

Advice has been requested whether the gain realized from the sale by a trust of residential property, used by the grantor and his family as their principal residence, will be taxable to either the trust or grantor, in view of the provisions of section 1034 of the Internal Revenue Code of 1954.

In 1955, an individual created a trust under the terms of which he, as grantor, reserved the right to receive $3x$ dollars annually from the income or principal of the trust property. The trust agreement provides that in addition to the payment of $3x$ dollars annually to the grantor, the trustee may from time to time in its discretion pay to or apply to the use of grantor such additional part of the next income and/or principal of the trust property as it deems necessary, advisable or expedient for the care, comfort or support of the grantor and his wife and issue or for the payment of any taxes which may be assessed against the grantor, grantor's wife and their issue.

During 1960, at the request of the grantor, the trustee purchased residential property, title to which was taken in the name of a nominee of the trustee. This property was then occupied by the grantor and his family until sold by the trust. The property has never been rented and the grantor has never paid rent to the trustee.

In 1965 the trustee sold the property at a price substantially in excess of its adjusted basis. Shortly thereafter the entire proceeds of the sale were reinvested in other property which the grantor and his family immediately occupied and continued to occupy, as their principal residence.

Section 671 of the Code provides the general rule that, in cases where the grantor or another person is regarded as the owner of any portion of a trust, there shall be included in computing his taxable income and credits those items of income, deductions, and credits against 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 conditions under which a grantor is regarded as owner of a portion of a trust are set forth in sections 673 through 677, inclusive, of the Code.

Under the general rule provided in section 676(a) of the Code, the grantor is treated as the owner of any portion of a trust where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.

In this case the grantor is treated as the owner of the entire trust under section 676(a) of the Code, inasmuch as the trustee (a nonadverse party) holds a power whereby it may, in its sole discretion, pay to or apply to the use of the grantor all of the principal of the trust.

Under section 1034 of the Code, gain is not recognized where the taxpayer sells property used as his principal residence if, within a period beginning 1 year before the date of sale and ending one year after such date, the taxpayer purchases property at a price equal to or in excess of the selling price of the old property and uses it as his principal residence.

An item of income, deduction, or credit included in computing the taxable income and credits of a grantor of a trust under section 671 of the Code is treated, for Federal income tax purposes, as if it had been received or paid directly by the grantor. See section 1.671–2(c) of the Income Tax Regulations.

Accordingly, the sale of the old residence and the purchase of the new residence by the trust will be treated for Federal income tax purposes as if made by the grantor. Therefore, any gain realized will not be taxed to either the trust or the grantor, since the new residence was purchased at a cost equal to or in excess of the selling price of the old residence, and the new residence was used as the grantor's principal residence, within one year from the date of the sale.

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26 CFR 1.671–3: Attribution or inclusion of income, deductions, and credits against tax.

Inclusion, in computing grantor's taxable income, of ordinary income attributable to that portion of a ten-year trust, title to which grantor may revest in himself during the term of the trust. See Rev. Rul. 66–161, page 164.

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26 CFR 1.671–4: Method of reporting.

Eligibility of the corporate grantor for the dividends received deduction on dividends received from stock held in trust where the grantor

may revest title to the stock in itself at any time. See Rev. Rul. 66–72, page 58.

SECTION 672.—DEFINITIONS AND RULES

26 CFR 1.672(c)–1: Related or subordinate party. Rev. Rul. 66–160

A director of a corporation is not an "employee," as that term is used in section 672(c) of the Internal Revenue Code of 1954 in defining the term "related or subordinate party," merely because he is a director.

SECTION 676.—POWER TO REVOKE

26 CFR 1.676(a)–1: Power to revest title to portion of trust property in grantor; general rule.

Eligibility of the corporate grantor for the dividends received deduction on dividends received from stock held in trust where the grantor may revest title to the stock in itself at any time. See Rev. Rul. 66–72, page 58.

Applicability of section 1034 of the Code to the sale of trust property used by the grantor as a principal residence. See Rev. Rul. 66–159, page 162.

Income from that portion of a ten-year trust, title to which the grantor may revest in himself during the term of the trust. See Rev. Rul. 66–161, below.

SECTION 677.—INCOME FOR BENEFIT OF GRANTOR

26 CFR 1.677(a)–1: Income for benefit of grantor; general rule. Rev. Rul. 66–161
(Also Sections 671, 676; 1.671–3, 1.676(a)–1.)

> Where, under the terms of a trust indenture, corpus is to revert to the grantor after ten years, capital gains are to be added to corpus, and all such gains as are taxable to the grantor are, subject to his demand, payable to him, then all capital gains plus income attributable to the portion of the trust, title to which the grantor may revest in himself, must be included in the computation of the grantor's taxable income for the taxable year in which the items of income are realized.

Advice has been requested as to the taxability to the grantor of capital gains and other income realized by the trust described below.

The trust indenture provides that trust income is to be currently distributed to a named beneficiary for ten years and that upon the termination of such period, the corpus of the trust is to revert to the grantor.

The trust is irrevocable and may not be modified. The indenture further provides:

> All gains derived from the sale or exchange of capital assets shall be deemed to be corpus and any such gains as are taxable to the grantor under any Federal income tax law shall be paid to the grantor at such times and to such extent as he may request.

Section 677(a) of the Internal Revenue Code of 1954 provides, in part, that the grantor shall be treated as the owner of any portion of a trust whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be held or accumulated for future distribution to the grantor.

Section 1.677(a)-1(f) of the Income Tax Regulations provides, in part, that if income is accumulated in any taxable year for future distribution to the grantor, section 677(a)(2) of the Code treats the grantor as an owner for that taxable year. Thus, if income (including capital gains) of a trust is to be accumulated for ten years and then will be, or at the discretion of the grantor may be, distributed to the grantor, the grantor is treated as the owner of the trust from its inception.

Section 676 of the Code treats the grantor of a trust as the owner of that portion of the trust, title to which he can revest in himself at any time.

Section 1.671-3(a) of the regulations provides in part, that when a grantor is treated under sections 671 through 678 of the Code as the owner of any portion of a trust, there are included in computing his tax liability those items of income attributable to or included in that portion.

Since the terms of the trust indenture provide that capital gains are to be added to corpus which is to revert to the grantor, the grantor is treated as the owner under section 677(a) of the Code of that portion of the trust to which the capital gains are attributable.

In addition, since the accumulated capital gains lose their identity as capital gains and become merged with corpus following the year of realization, the quoted provisions of the trust indenture, in effect, give the grantor the power to revest in himself title to a portion of the corpus. Therefore, the grantor is treated as owner of such portion of the trust under section 676 of the Code.

Accordingly, all capital gains plus income attributable to the portion of the trust corpus title to which the grantor may revest in himself must be included in the computation of the grantor's taxable income for the taxable year in which the income is realized.

SUBCHAPTER K.—PARTNERS AND PARTNERSHIPS

PART I.—DETERMINATION OF TAX LIABILITY

SECTION 702.—INCOME AND CREDITS OF PARTNER

26 CFR 1.702-1: Income and credits of partner. Rev. Rul. 66-93

A and *B* were limited partners in a firm organized under a state law corresponding to the Uniform Limited Partnership Act and en-

gaged in a general brokerage business in securities. One of the general partners embezzled funds of the partnership causing the partnership to become insolvent in 1964. The partnership was placed in receivership and terminated during that same year. Each of the general partners also became insolvent during 1964 and the limited partners were unable to recover any part of their respective capital contributions to the partnership. As a result of the embezzlement the partnership sustained a loss for 1964 in an amount exceeding the combined capital contributions of all the partners.

Held, the loss incurred by the partnership in 1964 is an ordinary loss under the provisions of section 165(a) and (c)(1) of the Internal Revenue Code of 1954. Since the capital contributions of the limited partners were wiped out by this loss and there was no recoupment from the general partners, each limited partner by virtue of the provisions of sections 701, 702, and 703 of the Code has a distributive share of such ordinary loss. Therefore, the limited partners should report, on their individual returns, their distributive shares of the partnership loss, as required by section 702(a) of the Code. The loss deductible is subject to the limitation provided in section 704(d) of the Code, and section 1.704–1(d) of the Income Tax Regulations, which restricts the amount of loss allowed as a deduction to the adjusted basis (before any reduction occasioned by the current year's loss) of the partner's interest in the partnership at the end of the partnership taxable year in which the loss occurred.

Whether a partner is required to take into account separately his distributive share of the partnership's expenditures for clearing land. See Rev. Rul. 66–141, page 56.

SECTION 703.—PARTNERSHIP COMPUTATIONS

26 CFR 1.703–1: Partnership computations.

Election to deduct expenses for clearing land incurred by partnership engaged in the business of farming. See Rev. Rul. 66–141, page 56.

SECTION 704.—PARTNER'S DISTRIBUTIVE SHARE

26 CFR 1.704–1: Partner's distributive share.

Determination of distributive share of partnership losses. See Rev. Rul. 66–94, below.

SECTION 705.—DETERMINATION OF BASIS OF PARTNER'S INTEREST

26 CFR 1.705–1: Determination of basis of partner's interest. Rev. Rul. 66–94

(Also Sections 704, 731; 1.704–1, 1.731–1.)

In determining the basis of a partner's interest in a partnership under section 705(a) of the Internal Revenue Code of 1954 for purposes of determining the distributive share of partnership losses

which will be allowed as a deduction to a partner, such basis is computed without taking into account his distributive share of partnership losses for its taxable year with respect to which the loss allowable to the partner is being determined.

In determining the basis of a partner's interest in a partnership under section 705(a) of the Code for purposes of determining the gain realized by a partner upon a distribution of money to him by the partnership, such basis is computed without taking into account distributions made by the partnership during its current taxable year with respect to which the partner's gain is being determined.

Distributions are taken into consideration before losses in computing a partner's adjusted basis for his partnership interest under section 705(a) of the Code.

Advice has been requested as to the manner in which a partner should compute the basis of his partnership interest under section 705(a) of the Internal Revenue Code of 1954 for purposes of determining the extent to which his distributive share of partnership losses will be allowed as a deduction, and the extent to which gain will be realized by a partner upon the distribution of cash to him by the partnership.

During the taxable year, *A*, a member of the partnership, contributed $50x$ dollars to the partnership as his initial capital contribution, and received $30x$ dollars as a cash distribution from the partnership. *A*'s distributive share of partnership losses at the end of its taxable year was $60x$ dollars.

Section 705(a) of the Code provides, in part, that the adjusted basis of a partner's interest in a partnership shall be the basis of such interest determined under section 722 of the Code (relating to contributions to a partnership)—(1) increased by the sum of his distributive share for the taxable year and prior taxable years of taxable income of the partnership, tax exempt income of the partnership, and the excess of depletion deductions over the basis of depletable property, and (2) decreased, but not below zero, by distributions by the partnership as provided in section 733 and by the sum of his distributive share of partnership losses and nondeductible partnership expenditures not chargeable to capital account.

Section 1.704–1(d)(1) of the Income Tax Regulations provides, in part, that a partner's distributive share of partnership loss will be allowed only to the extent of the adjusted basis (before reduction by current year's losses) of such partner's interest in the partnership at the end of the partnership taxable year in which such loss occurred.

Section 1.704–1(d)(2) of the regulations provides, in part, that in computing the adjusted basis of a partner's interest for the purpose of ascertaining the extent to which a partner's distributive share of partnership loss shall be allowed as a deduction for the taxable year, the basis shall first be increased under section 705(a)(1) of the Code and decreased under section 705(a)(2) of the Code, except for losses of the taxable year and losses previously disallowed.

Section 1.731–1(a) of the regulations provides, in part, that where money is distributed by a partnership to a partner, no gain or loss shall be recognized to the partner except to the extent that the amount of money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution. For purposes of sections 731 and 705 of the Code, advances or drawings of money or property against a partner's distributive share of income

shall be treated as current distributions made on the last day of the partnership taxable year with respect to such partner.

Based on the foregoing, it is concluded that:

(1) In computing *A*'s adjusted basis for his interest in the partnership under section 705(a) of the Code, *A*'s original basis, which is determined under section 722 relating to contributions to the partnership, should be decreased by first deducting distributions made to *A* by the partnership and thereafter, by deducting his distributive share of partnership losses. However, *A*'s basis for his interest in the partnership may not be reduced below zero. Thus:

A's contribution to the partnership	50 *x* dollars
Deduct cash distributions made to *A* by the partnership	−30 *x* dollars
	20 *x* dollars
Deduct *A*'s distributive share of losses (60 *x* dollars) but only to the extent that *A*'s basis is not reduced below zero	−20 *x* dollars
A's basis for his interest in the partnership under section 705 of the Code	−0

(2) In order to determine the extent to which *A*'s distributive share of partnership losses will be allowed as a deduction, *A*'s basis for his interest in the partnership computed in accordance with section 705(a) of the Code, should be determined without taking into account his distributive share of partnership losses for the taxable year. Thus:

A's contribution to the partnership	50 *x* dollars
Deduct cash distribution made to *A* by the partnership	−30 *x* dollars
	20 *x* dollars
A's distributive share of partnership losses for the taxable year are not taken into account	−0
A's basis for determining the amount of his allowable partnership losses	20 *x* dollars

(3) In order to determine the extent to which gain will be realized by *A* upon the distribution of cash to him by the partnership, *A*'s basis for his interest in the partnership computed in accordance with section 705(a) of the Code, should be determined without taking into account cash distributions made to him by the partnership during its current taxable year. Thus:

A's contribution to the partnership	50 *x* dollars
Cash distributions made by the partnership to *A* during the taxable year are not taken into account	−0
	50 *x* dollars
Deduct *A*'s distributive share of partnership losses to the extent allowed by section 704(d) of the Code. (See examples (1) and (2).)	−20 *x* dollars
A's basis for determining the amount of gain he realized upon the distribution of cash to him by the partnership	30 *x* dollars

A may deduct his distributive share of the partnership loss to the extent of 20 *x* dollars (see example 2) and he realizes no gain from the cash distribution of 30 *x* dollars because his basis for determining the amount of gain upon such distribution is 30 *x* dollars (example 3).

SECTION 707.—TRANSACTIONS BETWEEN PARTNER AND PARTNERSHIP

26 CFR 1.707–1: Transactions between partner and partnership. (Also Section 162; 1.162–1.) Rev. Rul. 66–95

Where a partner's percentage of the partnership profits is less than his guaranteed minimum, the partner's share, computed on the percentage basis, of partnership income before deduction of the guaranteed payment is his distributive share of partnership income. The guaranteed payment, as that term is used in section 707(c) of the Internal Revenue Code of 1954, is the difference between the partner's minimum guarantee and his distributive share of partnership income determined before deduction of the guaranteed payment.

Advice has been requested whether the total amount of the minimum yearly profit participation of certain members of a partnership is a guaranteed payment under section 707(c) of the Internal Revenue Code of 1954, or whether only a portion of such amount is a guaranteed payment in the following circumstances.

The *ABC* Partnership, a limited partnership, was formed pursuant to an Agreement of Limited Partnership and consisted of both general and limited partners.

Article I of the Agreement provides that the general partners shall receive 75 percent of the net profits and the limited partners shall receive 25 percent of the net profits. Under Article II the partnership losses are borne by the general partners.

Article III of the Agreement states:

Anything hereinabove to the contrary notwithstanding, the Limited Partners shall be paid the sum of $4x$ dollars per annum for each $100x$ dollars of contributed Contract Capital as minimum yearly profit participation, and if the profit participation calculated on the percentage basis above set forth shall be less than said minimum amount, or if there shall be losses, said minimum amount shall nevertheless be paid to the Limited Partners and said payment shall in all respects be treated as if it were an expense of the Limited Partnership.

Article IV of the Agreement provides that the minimum profit participation payments to limited partners to the extent set forth in Article III shall be charged as a part of the expense of doing business in determining the partnership profits and losses, but only in the event that their respective profit participation in any one year would otherwise be less than said guaranteed payment.

In the partnership taxable year in question the limited partners' profit participation calculated on the percentage basis was less than the minimum yearly profit participation as determined by using the formula stated in Article III of the Agreement.

Section 707(c) of the Code provides that to the extent determined without regard to the income of the partnership, payments to a partner for services or use of capital shall be considered as made to one who is not a member of the partnership, but only for the purposes of section 61(a) (relating to gross income) and section 162(a) (relating to trade or business expenses).

Section 1.707–1(c) of the Income Tax Regulations provides, in part, that a partner must include such payments as ordinary income for his taxable year within or with which ends the partnership taxable year in which the partnership deducted such payments as paid or accrued

under its method of accounting. Under these regulations where a partner's percentage of profits is less than his guaranteed minimum, the partner's share, computed on the percentage basis, of partnership income before deduction of guaranteed payment is his distributive share of partnership income; and the guaranteed payment, as the term is used in section 707(c) of the Code, is the difference between the partner's minimum guarantee and his distributive share of partnership income before taking into account the guaranteed payment. See example 2 of section 1.707–1(c) of the regulations.

The fact that a partnership agreement provides that, in the event a minimum payment must be made to certain partners, the payment shall in all respects be treated as if it were an expense of the partnership, does not control as to whether the entire minimum amount will be considered an expense for Federal income tax purposes.

Accordingly, notwithstanding those provisions of Articles III and IV of the Agreement which require that the minimum profit participation payments be treated as an expense in all respects in the years the limited partners' guaranteed minimum is greater than their profit participation, when the guaranteed minimum is the greater, then only the difference between the limited partners' guaranteed minimum and their distributive share of the partnership income is a guaranteed payment for Federal tax purposes. Only the amount of the guaranteed payment (section 707(c) of the Code) as thus determined should be considered as a business expense under section 162(a) of the Code for Federal income tax purposes.

PART II.—CONTRIBUTIONS, DISTRIBUTIONS, AND TRANSFERS

SUBPART B.—DISTRIBUTIONS BY A PARTNERSHIP

SECTION 731.—EXTENT OF RECOGNITION OF GAIN OR LOSS ON DISTRIBUTION

26 CFR 1.731–1: Extent of recognition of gain or loss on distribution.

Determination of partner's gain in partnership distribution. See Rev. Rul. 66–94, page 166.

SUBCHAPTER L.—INSURANCE COMPANIES

PART I.—LIFE INSURANCE COMPANIES

Subpart B.—Investment Income

SECTION 805.—POLICY AND OTHER CONTRACT LIABILITY REQUIREMENTS

26 CFR 1.805–5: Adjusted reserves rate and earnings rates. Rev. Rul. 66–31

A life insurance company, in calculating assets under section 805(b)(4) of the Internal Revenue Code of 1954, may not reduce the asset "cash" by amounts on deposit in its bank account because of

taxes withheld from employees, escrow funds relating to mortgage loans, and standby commitment fees received from proposed mortgagors.

Advice has been requested whether a life insurance company, in calculating assets under section 805(b)(4) of the Internal Revenue Code of 1954, may reduce the asset "cash" by amounts on deposit in its bank account because of taxes withheld from employees, escrow funds relating to mortgage loans, and standby commitment fees received from proposed mortgagors (where the agreement provides for the return of the fee in the event the mortgage loan is consummated).

Section 805(b)(4) of the Code provides that the term "assets" means all assets of the company (including nonadmitted assets) other than real and personal property (excluding money) used by it in carrying on a trade or business.

Section 1.805–5(a)(4)(i) of the Income Tax Regulations specifically provides that the term "money" as used in section 805(b)(4) of the Code includes cash, currency, bank deposits (including time deposits) whether or not interest bearing, share accounts in savings and loan associations, checks (whether or not certified), drafts, money orders, and any other items of similar nature.

Section 1.805–5(a)(4)(i) of the regulations further states that only certain items (enumerated therein) may be excluded from the term "assets" as being considered used by the life insurance company in carrying on an insurance trade or business, which items do not include those involved in the instant case.

Section 1.805–5(a)(4)(iii) of the regulations provides in general that the valuation of assets under section 805(b)(4) of the Code shall not be reduced by the amount of any encumbrance, lien, mortgage, etc.

In view of the broad nonexclusive provisions of section 805(b)(4) of the Code and section 1.805–5(a)(4) of the regulations, it is apparent that all money items of a life insurance company generally are included in "assets" as that term is defined in section 805(b)(4) of the Code. It follows that such money items are included in assets whether or not their use is restricted to certain designated purposes and whether or not they are allocated to any particular account, or are held in the form of cash or bank deposits.

Accordingly, a life insurance company, in calculating assets under section 805(b)(4) of the Code, may not reduce the assets "cash" by amounts on deposit in its bank account because of taxes withheld from employees, escrow funds relating to mortgage loans, and standby commitment fees received from proposed mortgagors.

Subpart C.—Gain and Loss From Operations

SECTION 809.—IN GENERAL

26 CFR 1.809–4: Gross amount. Rev. Rul. 66–36

Where a life insurance company accepts advance payments of premiums from its policyholders in an amount less than the contract premium, only the actual amount received is taken into account as

premiums in the taxable year of receipt under section 809(c)(1) of the Internal Revenue Code of 1954. The difference, often referred to as "discount," is accrued and credited to the section 810(c)(5) reserves over the period the payment is held before the due date of the contract premium. The contract premium is included in income as an item of gross amount in the taxable year such premium is due, and the section 810(c)(5) reserve released.

The year the contract premium is due and taken into account as an item of gross amount is also the appropriate year in which said premium is taken into account in computing the allowable deduction under section 809(d)(5) or section 809(d)(6) of the Code, if applicable.

Advice has been requested concerning the treatment, for purposes of section 809(c)(1) of the Internal Revenue Code of 1954, of premiums received in advance which are in an amount less than the contract premium by a life insurance company from its policyholders.

Section 809(c)(1) of the Code provides, in part, that the gross amount of premiums and other consideration, including advance premiums and deposits, on insurance and annuity contracts is taken into account, as a part of the items grouped under the heading "gross amount," in determining the gain or loss from operations of a life insurance company under sections 809(b)(1)(C) and 809(b)(2)(C) of the Code.

Section 1.809–4(a)(1)(i) of the Income Tax Regulations provides, insofar as material here, that the term "gross amount of all premiums" means the premiums and other consideration provided on insurance and annuity contracts. Such term includes advance premiums and deposits. Thus, the amount to be taken into account is the total of the premiums and other consideration provided in the insurance or annuity contract without any reduction by reason of premiums which have been paid in advance or any other item of similar nature.

The purpose of section 1.809–4(a)(1)(i) of the regulations is to make certain that the gross contract premium is taken into account in the taxable year that the premium is due. In that taxable year, the contract premium is accounted for without reduction although the company had accepted a reduced amount in advance which, together with that portion of the interest earned on and added to such deposited amount over the period it is held by the company, will equal the gross contract premium on the due date.

For example, assume the company received $240 on December 31, 1965, as advance premium for a contract premium of $300 due January 1, 1971. In computing gross premiums on its 1965 return the company would include only $240 as advance premium. Since the premium is not yet due, the amount paid in advance represents a liability of the company to the policyholder and, therefore, the section 810(c)(5) reserve is simultaneously increased. At this point the item included in computing gross premiums is offset by a deduction under section 809(d)(2) of the Code for the increase in the reserve so that the net result is zero. The difference between the amount received and the contract premium ($60) is accrued and credited to the reserve over the 5-year period the advance premium is held before the due date. The company will be entitled to the interest paid deduction under section 805(e) of the Code and the required interest deduction under section 809(a)(2) of the Code as such amount is accrued and credited to the reserve. On January 1, 1971, the amount of the re-

serve will be $300 ($240 plus $60), which is the contract premium. The $300 will then be included in income as an item of gross amount in that taxable year when the reserve is released and applied to the payment of the contract premium due.

Accordingly, only the actual amount received by a life insurance company for a premium which is not yet due is taken into account as premiums in the taxable year of receipt under section 809(c)(1) of the Code. The difference between the amount received and the contract premium is accrued and credited to the section 810(c)(5) reserve over the period the company holds the amount paid before the due date of the contract premium. The contract premium is included in income as an item of gross amount in the taxable year such premium is due.

It should be noted that if the deductions provided by sections 809(d)(5) and 809(d)(6) of the Code are applicable, the amount received in advance ($240 in the foregoing example) should not be taken into account in computing the amount equal to the 3 percent or the 2 percent of the premiums for the taxable year 1965, since the premium under the contract is not due. However, for the taxable year 1971, the year in which the premium is due under the insurance contract, the amount of the contract premium ($300 in the example) should be taken into account in the computation of the deductions provided for in sections 809(d)(5) and 809(d)(6) of the Code, if applicable.

Subpart E.—Miscellaneous Provisions

SECTION 819.—FOREIGN LIFE INSURANCE COMPANIES

26 CFR 1.819–2: Foreign life insurance companies.

Percentage to be used by foreign life insurance companies in computing income tax for the taxable year 1965 and estimated tax for the taxable year 1966. See T.D. 6878, page 597.

SUBCHAPTER N.—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

PART I.—DETERMINATION OF SOURCES OF INCOME

SECTION 861.—INCOME FROM SOURCES WITHIN THE UNITED STATES

26 CFR 1.861–2: Interest.

Interest portion of payments on awards of the Mixed Claims Commission, United States and Germany. See Rev. Rul. 66–32, page 174.

SECTION 862.—INCOME FROM SOURCES WITHOUT THE UNITED STATES

26 CFR 1.862–1: Income specifically from sources without the United States. (Also Section 861; 1.861–2.) Rev. Rul. 66–32

On February 27, 1953, an agreement was entered into between the United States and the Federal Republic of Germany (4 U.S.T. 908) making provision for the settlement of the remaining obligations of Germany for awards made by the Mixed Claims Commission, United States and Germany, on behalf of nationals of the United States for losses and damages sustained during World War I. Payments received from Germany are deposited with the United States Treasury in the German Special Deposit Account from which distributions representing the principal amount of the awards, plus interest, are made to the holders of awards of the Mixed Claims Commission. *Held*, the awards of the Mixed Claims Commission, United States and Germany, are interest-bearing obligations of a nonresident obligor (Germany), and the interest portion of the payments on the awards is income from sources without the United States pursuant to section 862(a) of the Internal Revenue Code of 1954.

PART II.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

Subpart C.—Miscellaneous Provisions

SECTION 892.—INCOME OF FOREIGN GOVERNMENTS AND OF INTERNATIONAL ORGANIZATIONS

26 CFR 1.892–1: Income of foreign governments and international organizations. (Also Sections 893, 4382; 1.893–1, 47.4382–1.) Rev. Rul. 66–73

The Internal Revenue Service discussed the applicability of sections 892, 893, and 4382 of the Internal Revenue Code of 1954 to an organization separate in form but wholly owned by a foreign government. I.T. 3789, C.B. 1946–1, 100, modified.

Advice has been requested concerning the applicability of sections 892, 893, and 4382 of the Internal Revenue Code of 1954 to an organization separate in form but wholly owned by a foreign government.

In 1946 the Internal Revenue Service in I.T. 3789, C.B. 1946–1, 100, announced its position that the benefits of section 116(c) of the Internal Revenue Code of 1939 (predecessor of section 892 of the 1954 Code) which exempts foreign governments from income tax "cannot be extended to a corporation which is wholly owned by a foreign government inasmuch as a corporation is an entity separate and distinct from its sole stockholder." This is simply an application of a basic legal principle. However, the Tax Court of the United States in *Louis Vial*, 15 T.C. 403 (1950), acquiescence, C.B. 1952–1, 4, tempered this principle by limiting its application to a "corporation as that term is understood in the United States."

As a result of the *Vial* decision and extended reconsideration, it is now the position of the Service that an organization separate in form

and wholly owned by a foreign government, and no part of the net earnings of which inures to the benefit of any private shareholder or individual, regardless of where organized and whether with stock outstanding, is exempt under section 892 of the Code, provided it does not constitute a corporation as that term is generally understood in the United States and as explained in the following paragraph.

Whether an organization constitutes a corporation as contemplated by this rule will depend directly upon its purposes, functions, and activities. Where its purposes, functions, and activities, taken as a whole, customarily are attributable to and carried on by private enterprise for profit in this country, it will be deemed to constitute a corporation separate from its owner even though in some instances governments also are engaged in the same or a similar activity in the United States. On the other hand, where the organization does not have purposes, functions, and activities of the type which are customarily attributable to and carried on by private enterprise for profit in this country, or, to the extent it has such purposes, functions, and activities, taken as a whole they are so circumscribed and limited that the organization does not in fact substantially resemble such a private enterprise, it will not be deemed to constitute a corporation separate from its owner, and hence will be entitled to the benefits granted by section 892 of the Code.

The same test will be applied for purposes of determining what organizations will be considered to be part of a "foreign government" within the meaning of sections 893 and 4382 of the Code.

I.T. 3789, C.B. 1946–1, 100 is hereby modified.

SECTION 893.—COMPENSATION OF EMPLOYEES OF FOREIGN GOVERNMENTS OR INTERNATIONAL ORGANIZATIONS

26 CFR 1.893–1: Compensation of employees of foreign governments or international organizations.

Application of section 893 of the Code to an organization separate in form but wholly owned by a foreign government. See Rev. Rul. 66–73, page 174.

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

26 CFR 1.901–1: Allowance of credit for taxes. Rev. Rul. 66–65

The tax imposed by section 24(b) of the National Internal Revenue Code of the Republic of the Philippines (Commonwealth Act No. 466 as amended to August 1963) on interest received by a

United States corporation not engaged in a trade or business in the Philippines is creditable against United States Federal income taxes in accordance with section 901 of the Internal Revenue Code of 1954.

Advice has been requested whether the tax imposed by section 24(b) of the National Internal Revenue Code of the Republic of the Philippines (Commonwealth Act No. 466 as amended to August 1963) on interest received during 1962 and 1963 by a United States corporation not engaged in a trade or business in the Philippines is creditable against United States income taxes in accordance with section 901 of the Internal Revenue Code of 1954.

Section 901(b) of the Code provides, in part, that in the case of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States shall be allowed as a credit under section 901(a) of the Code, subject to the applicable limitation of section 904 of the Code.

In order for a tax paid or accrued to a foreign country to be allowable as a credit against United States income taxes, it must be shown that such tax is a tax on income, war profits, or excess profits within the meaning of section 901 of the Code, or is a tax imposed in lieu of such a tax within the meaning of section 903 of the Code. For a particular foreign tax to qualify as a creditable tax under section 901 of the Code it must be shown that the tax imposed by the foreign law is a tax on income within the United States concept thereof. *Biddle* v. *Commissioner*, 302 U.S. 573 (1938), Ct. D. 1303, C.B. 1938–1, 309.

Section 24(b) of the Philippine Code provides, in part, that there shall be levied, collected and paid for each taxable year upon the amount received by every foreign corporation not engaged in trade or business within the Philippines, from all sources within the Philippines, as interest, dividends, rents, etc., or other fixed or determinable annual or periodical gains, profits, and income, a tax equal to 30 percent of such amount.

The foregoing provision of the Philippine tax law relating to the income tax on nonresident foreign corporations is analogous to section 881 of the United States Internal Revenue Code relating to tax on foreign corporations not engaged in business in the United States.

Accordingly, the tax imposed under section 24(b) of the Philippine Code falls within the United States concept of an income tax and is allowable as a credit against United States income tax under section 901(a) of the Code, subject to the applicable limitation of section 904 of the Code.

Subpart B.—Earned Income of Citizens of United States

SECTION 911.—EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES

26 CFR 1.911–2: Earned income from sources without the United States attributable to services performed after 1962.

Whether "interest income" is "earned income" as that term is defined in section 911 of the Code. See Rev. Rul. 66–56, page 87.

Subpart C.—Western Hemisphere Trade Corporations

SECTION 921.—DEFINITION OF WESTERN HEMISPHERE TRADE CORPORATIONS

26 CFR 1.921–1: Definition of Western Hemisphere trade corporation. (Also Section 922; 1.922–1.) Rev. Rul. 66–4

The islands of St. Pierre, Great Miquelon, and Little Miquelon are in North America for purposes of section 921 of the Internal Revenue Code of 1954.

SECTION 922.—SPECIAL DEDUCTION

26 CFR 1.922–1: Special deduction of Western Hemisphere trade corporation.

Whether the islands of St. Pierre, Great Miquelon, and Little Miquelon are part of North America. See Rev. Rul. 66–4, above.

Subpart F.—Controlled Foreign Corporations

SECTION 952.—SUBPART F INCOME DEFINED

26 CFR 1.952–1: Subpart F income defined.

Basis of depreciable assets held by a foreign corporation on the first day of its first taxable year beginning after December 31, 1962, in which such corporation has a deficit in earnings and profits sought to be taken into account under section 952(d) of the Code; utilization of depreciation method adopted for such purpose for the additional purpose of calculating a deficit in earnings and profits sought to be taken into account under section 952(c)(1)(B) of the Code. See Rev. Rul. 66–19, page 178.

SECTION 957.—CONTROLLED FOREIGN CORPORATIONS; UNITED STATES PERSONS

26 CFR 1.957–1: Definition of controlled foreign corporation.

Basis of depreciable assets held by a foreign corporation on the first day of its first taxable year beginning after December 31, 1962, in which such corporation is a controlled foreign corporation. See Rev. Rul. 66–19, page 178.

SECTION 963.—RECEIPT OF MINIMUM DISTRIBUTIONS BY DOMESTIC CORPORATIONS

26 CFR 1.963–1: Exclusion of subpart F income upon receipt of minimum distributions.

Basis of depreciable assets held by a foreign corporation on the first day of its first taxable year beginning after December 31, 1962, in which such corporation is included in a chain or a group under section 963(c) (2)(B) or (3)(B) of the Code. See Rev. Rul. 66–19, below.

SECTION 964.—MISCELLANEOUS PROVISIONS

26 CFR 1.964–1: Determination of the earnings and profits of a foreign corporation. (Also Sections 167, 952, 957, 963; 1.167(b)–0, 1.952–1, 1.957–1, 1.963–1.)

Rev. Rul. 66–19[1]

Determination of basis of depreciable assets held by a foreign corporation on the first day of its first taxable year beginning after December 31, 1962.

The Internal Revenue Service recognizes the need for clarification of the Income Tax Regulations under section 964(a) of the Internal Revenue Code of 1954 (relating to determination of the earnings and profits of a foreign corporation) insofar as such regulations require the determination of basis of depreciable assets held by a foreign corporation on the first day of its first taxable year beginning after December 31, 1962, in which such corporation is a controlled foreign corporation (within the meaning of section 957 of the Code) or for which it is included in a chain or group under section 963(c) (2)(B) or (3)(B) of the Code or has a deficit in earnings and profits sought to be taken into account under section 952(d) of the Code (hereinafter referred to as the corporation's first post-1962 taxable year).

Paragraph (b) (1)(ii) and (2) of section 1.964–1 of the regulations provides, in effect, that depreciation shall be based on historical cost of a physical asset determined on—

(1) The first day of the corporation's first taxable year beginning after December 31, 1949, if treatment under paragraph (b) (2)(ii) of section 1.964–1 of the regulations is elected by or on behalf of the corporation,

(2) The date the corporation acquired the asset, or

(3) The date the corporation became a majority-owned subsidiary if such event occurred after December 31, 1949, but before October 27, 1964, and if treatment under paragraph (b) (2)(i) of section 1.964–1 of the regulations is elected by or on behalf of the corporation,

whichever date is latest.

Paragraph (c) of section 1.964–1 of the regulations provides that depreciation shall be computed in accordance with section 167 of the Code and the regulations thereunder and that for its first post-1962 taxable year there may be adopted by or on behalf of a foreign corpo-

[1] Based on Technical Information Release 752, dated July 28, 1965.

ration any method of accounting or election allowable under such section of the regulations notwithstanding that, in previous years, the corporation's earnings and profits were computed, or its financial statements prepared, in accordance with a different method and notwithstanding that such election is required by the Code or regulations to be made in a prior year.

Thus, although the regulations provide guidelines for determining depreciation during a foreign corporation's first post-1962 taxable year and later years, the regulations do not provide rules for the determination of basis of depreciable assets as of the first day of the corporation's first post-1962 taxable year.

For purposes of computing depreciation during the period beginning on the date historical cost is determined and ending on the day before the first day of a foreign corporation's first post-1962 taxable year, the corporation (or its controlling United States shareholders on its behalf) may—

(1) Choose to continue using the method actually utilized by such corporation on its books of account regularly maintained for the purpose of accounting to its shareholders during such period if such method is sanctioned by section 167 of the Code and the regulations thereunder,

(2) Adopt the straight-line method of depreciation, as set forth in section 1.167(b)–1 of the regulations, or

(3) Adopt the same method of depreciation that the corporation adopts for its first post-1962 taxable year.

If the method described in paragraph (1) is not sanctioned by section 167 of the Code and the regulations thereunder, a method described in paragraph (2) or (3) must be adopted. If such a method is adopted, the controlling United States shareholders of the foreign corporation must comply with the procedures set forth in paragraph (c)(3) (ii) and (iii) of section 1.964–1 of the regulations, relating to notification of the Internal Revenue Service and noncontrolling United States shareholders of the action taken.

It should be noted that adoption of the straight-line method of depreciation in accordance with this Revenue Ruling does not preclude the adoption of a different method of depreciation for the first post-1962 taxable year and later years in accordance with paragraph (c) of section 1.964–1 of the regulations so long as such method is sanctioned by section 167 of the Code and the regulations thereunder.

It should also be noted that adoption of a method of depreciation for years prior to a foreign corporation's first post-1962 taxable year in accordance with this Revenue Ruling will not authorize the filing of amended returns for those years. However, if the foreign corporation utilized a method of depreciation for those years which is not sanctioned by section 167 of the Code and the regulations thereunder, the Service may require that appropriate adjustments be made for those years. See Revenue Ruling 63–6, C.B. 1963–1, 126. Moreover, if a method of depreciation is adopted, for purposes of calculating the basis of depreciable assets held on the first day of the corporation's first post-1962 taxable year, which is different from the method actually utilized by such corporation for years ending prior to that date, the Service may require that the method so adopted be utilized in calculating—

(1) Any deficit in earnings and profits of such corporation which is sought to be taken into account under section 952(c)(1)(B) of the Code, or

(2) The earnings and profits of such corporation from such prior years when a distribution (including a liquidating distribution) made on or after such first day has United States tax consequences,

to prevent any duplication or omission of amounts which would otherwise result from the adoption of such method.

Conforming amendments to the regulations will be made.

SUBCHAPTER O.—GAIN OR LOSS ON DISPOSITION OF PROPERTY

PART II.—BASIS RULES OF GENERAL APPLICATION

SECTION 1011.—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS

26 CFR 1.1011–1: Adjusted basis.

Allocation of basis when taxpayer has acquired an upland cotton acreage allotment along with the land to which the allotment relates. See Rev. Rul. 66–58, page 186.

SECTION 1012.—BASIS OF PROPERTY—COST

26 CFR 1.1012–1: Basis of property. Rev. Rul. 66–96

A corporation owned several pieces of real property, all of which had a fair market value greatly in excess of the corporation's basis for the property. The estate of a deceased shareholder desired to have the stock it held in the corporation redeemed. In accordance with an agreement between the parties, the corporation redeemed all of its stock held by the estate by distributing in exchange for the stock real property with a fair market value equal to the value of the estate's stock and then repurchased the real property from the estate for cash.

Held, the substance rather than the form of the transaction is controlling; therefore, cash rather than real property is regarded as having been distributed by the corporation in redemption of its stock. The basis of the real property distributed and reacquired will be the same as it was in the hands of the corporation prior to the distribution.

SECTION 1016.—ADJUSTMENTS TO BASIS

26 CFR 1.1016–3: Exhaustion, wear and tear, obsolescence, amortization, and depletion for periods since February 28, 1913.

Adjusted basis of an automobile used in trade or business by employees or self-employed individuals. See Rev. Proc. 66–10, page 622.

PART III.—COMMON NONTAXABLE EXCHANGES

SECTION 1033.—INVOLUNTARY CONVERSIONS

26 CFR 1.1033(a)-1: Involuntary conversion; nonrecognition of gain.

Purchase of stock with proceeds of sale certified by F.C.C. See Rev. Rul. 66-33, page 183.

SECTION 1034.—SALE OR EXCHANGE OF RESIDENCE

26 CFR 1.1034-1: Sale or exchange of residence. Rev. Rul. 66-114

A taxpayer sold his principal residence at a gain and within 12 months thereafter reinvested the sales proceeds in a new residence in New York and a new residence in Florida. Taxpayer owned both of these residences during the remaining portion of the succeeding 12 months following the sale and occupied each of them at various times during this period.

Held, only the residence which qualifies as the principal residence of the taxpayer at the expiration of the 12-month period beginning with the date of sale of the old residence will be considered for the purpose of determining the nonrecognition of the gain on the sale under section 1034(a) of the Internal Revenue Code of 1954. Any amounts reinvested in the other residence may not be considered in determining the nonrecognition of gain on the sale of his old residence.

Sale of trust property used by grantor as a principal residence. See Rev. Rul. 66-159, page 162.

SECTION 1036.—STOCK FOR STOCK OF SAME CORPORATION

26 CFR 1.1036-1: Stock for stock of the same corporation. Rev. Rul. 66-171

(Also Sections 354, 367; 1.354-1, 1.367-1.)

> A foreign corporation amended its charter to effect a change of its name. The shareholders of the corporation exchanged all of their stock for stock identical in all respects with the stock surrendered except that the new stock reflected the change of name. *Held*, section 1036 of the Internal Revenue Code of 1954 applies to the exchange. Thus, no gain will be recognized to the corporation's shareholders. notwithstanding that the exchange is also described in sections 368(a)(1)(F) and 354 of the Code and the Commissioner has not issued a favorable ruling under section 367 of the Code.

Advice has been requested whether the transaction described below requires an advance ruling by the Commissioner that it is not in pur-

suance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

A foreign corporation amended its charter to effect a change of its name. The shareholders of the corporation then exchanged all of their old stock certificates in the corporation for new stock certificates which were identical in all respects to the stock certificates surrendered except that the new stock certificates reflected the new name of the corporation.

Under the provisions of section 1036 of the Internal Revenue Code of 1954, no gain or loss shall be recognized by the shareholders where stock in a corporation is exchanged solely for stock of the same class in the same corporation. The transaction is also described in sections 368(a)(1)(F) and 354 of the Code. Section 368(a)(1)(F) of the Code provides, in part, that a mere change in identity is a reorganization. Section 354 of the Code provides, in part, that no gain or loss shall be recognized if stock in a corporation a party to a reorganization is exchanged solely for stock in such corporation.

Section 367 of the Code provides, in effect, that gain shall be recognized in any exchange described in section 354 of the Code between a foreign corporation and its shareholders unless prior to the exchange the Commissioner has ruled that the exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes. The transaction described above involves an exchange described in section 354 of the Code. However, if the mere change in identity and the exchange take the form of a transaction described in section 1036 of the Code, no gain will be recognized to the shareholders, notwithstanding the absence of a favorable ruling under section 367 of the Code prior to the exchange since section 1036 of the Code is not one of the sections enumerated in section 367 of the Code. See Rev. Rul. 64–156, C.B. 1964–1 (Part 1), 139.

Since in this case all stock involved in the exchange was issued by the same corporate entity, the exchange is of stock in "the same corporation" within the meaning of section 1036 of the Code. Where, however, a new entity is incorporated, whether in the same country or a different country, in order to receive all of the assets and liabilities of the reorganized company, the exchange of stock of the old corporation for stock in the new corporation of the same class is not an exchange of stock in "the same corporation" within the meaning of section 1036 of the Code. Consequently, such an exchange would not qualify under section 1036 of the Code.

Accordingly, where a foreign corporation amends its charter to effect a change of its name and the shareholders of the corporation exchange all of their stock for stock identical in all respects except that the new stock reflects the change of name, section 1036 of the Code is applicable and no gain will be recognized to the corporation's shareholders, notwithstanding that the exchange is also described in sections 368(a)(1)(F) and 354 of the Code and the Commissioner has not issued a favorable ruling under section 367 of the Code.

SECTION 1038.—CERTAIN REACQUISITIONS OF REAL PROPERTY

Elections made before September 4, 1965, in accordance with proposed regulations to have the provisions of section 1038 of the Code apply to reacquisitions of real property occurring in certain taxable years beginning after December 31, 1957, and before September 3, 1964. See Rev. Proc. 66–12, page 626.

PART V.—CHANGES TO EFFECTUATE F.C.C. POLICY

SECTION 1071.—GAIN FROM SALE OR EXCHANGE TO EFFECTUATE POLICIES OF F.C.C.

26 CFR 1.1071–1: Gain from sale or exchange to effectuate policies of Federal Communications Commission.
(Also Section 1033; 1.1033(a)–1.)

Rev. Rul. 66–33

The purchase by a taxpayer of stock of a corporation which does not operate broadcasting stations, but which owns all the stock of a subsidiary corporation which owns and operates such stations, is not a purchase of stock of a corporation "operating a radio broadcasting station" within the meaning of section 1071 of the Internal Revenue Code of 1954. Consequently, the transaction cannot be treated as a replacement of the property involuntarily converted which qualifies for nonrecognition of gain under sections 1033 and 1071 of the Code.

Advice has been requested whether the purchase by a taxpayer of the stock of a corporation owning all of the stock of a subsidiary corporation which operates radio broadcasting stations qualifies as a purchase of stock of a corporation "operating a radio broadcasting station" within the meaning of section 1071 of the Internal Revenue Code of 1954.

A taxpayer sold his stock of a corporation which owned and operated a radio station. The sale was certified by the Federal Communications Commission for purposes of section 1071 of the Code. The taxpayer elected to treat such sale as an involuntary conversion under section 1033 of the Code, and, within the prescribed time under section 1033(a)(3)(A) of the Code, he purchased stock of another corporation which, although it does not directly operate radio broadcasting stations, owns all of the stock of a subsidiary corporation which does operate radio stations.

Section 1071 of the Code, relating to gain from a sale or exchange to effectuate policies of the Federal Communications Commission, provides, in part, as follows:

(a) NONRECOGNITION OF GAIN OR LOSS.—If the sale or exchange of property (including stock in a corporation) is certified by the Federal Communications Commission to be necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the Commission with respect to the ownership and control of radio broadcasting stations, such sale or exchange shall, if the taxpayer so elects, be treated as an involuntary conversion of such property within the meaning of section 1033. For purposes of such section as made applicable by the provisions of this section, *stock of a corporation operating*

a radio broadcasting station, whether or not representing control of such corporation, shall be treated as property similar or related in service or use to the property so converted. * * * [Emphasis added.]

Section 1.1071-2(b)(1) of the Income Tax Regulations states, in part, that for the purposes of section 1071 of the Code and the regulations thereunder, stock of a corporation operating a radio broadcasting station shall be treated as property similar or related in service or use to the property sold or exchanged. However, securities of such a corporation other than stock, or securities of a corporation not operating a radio broadcasting station, do not constitute property similar or related in service or use to the property sold or exchanged.

Section 1033 of the Code requires, in order that stock qualify as a replacement for business property, that such stock constitute a controlling interest in a corporation owning property which is similar or related in service or use to the property involuntarily converted. However, section 1071 of the Code permits any stock interest, whether or not controlling, in a corporation operating a radio station to so qualify. But, where the stock acquired is not in a corporation which, itself, operates a radio station, the taxpayer has replaced business properties with unrelated property.

Accordingly, the purchase by the taxpayer of stock of a corporation which does not operate broadcasting stations, but which owns all the stock of a subsidiary corporation which owns and operates such stations, is not a purchase of stock of a corporation "operating a radio broadcasting station" within the meaning of section 1071 of the Code. Consequently, the transaction cannot be treated as a replacement of the property involuntarily converted which qualifies for nonrecognition of gain under sections 1033 and 1071 of the Code.

SUBCHAPTER P.—CAPITAL GAINS AND LOSSES

PART III.—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1221.—CAPITAL ASSET DEFINED

26 CFR 1.1221-1: Meaning of terms. Ct. D. 1906

INCOME TAX—INTERNAL REVENUE CODE OF 1954—DECISION OF SUPREME COURT OF THE UNITED STATES

1. CAPITAL ASSET—PROPERTY HELD "PRIMARILY" FOR SALE.

Section 1221 of the Internal Revenue Code of 1954 denies capital gain treatment to profits which result from the sale of "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." The term "primarily" as used in this section means "of first importance" or "principally."

The courts below applied an incorrect legal standard in determining that gain on sale of real estate which had been acquired with intent either to develop it for rental purposes or to sell it whichever would be more profitable was ordinary income. The case is remanded to the District Court for fresh fact-finding in accordance with the statute as now construed.

2. JUDGMENT VACATED AND REMANDED.

Judgment of the United States Court of Appeals for the Ninth Circuit, 347 Fed. (2d) 23, vacated and remanded.

SUPREME COURT OF THE UNITED STATES

No. 487.—OCTOBER TERM, 1965

William Malat et ux., petitioners, v. *Robert A. Riddell, District Director of Internal Revenue*

[383 U.S. 569]

On writ of certiorari to the United States Court of Appeals for the Ninth Circuit

[March 21, 1966]

OPINION

PER CURIAM.

Petitioner was a participant in a joint venture which acquired a 45-acre parcel of land, the intended use for which is somewhat in dispute. Petitioner contends that the venturers' intention was to develop and operate an apartment project on the land; the Commissioner's position is that there was a "dual purpose" of developing the property for rental purposes or selling, whichever proved to be the more profitable. In any event, difficulties in obtaining the necessary financing were encountered, and the interior lots of the tract were subdivided and sold. The profit from those sales was reported and taxed as ordinary income.

The joint venturers continued to explore the possibility of commercially developing the remaining exterior parcels. Additional frustrations in the form of zoning restrictions were encountered. These difficulties persuaded petitioner and another of the joint venturers of the desirability of terminating the venture; accordingly, they sold out their interests in the remaining property. Petitioner contends that he is entitled to treat the profits from this last sale as capital gains; the Commissioner takes the position that this was "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business,"[1] and thus subject to taxation as ordinary income.

The District Court made the following finding:

> "The members of [the joint venture], as of the date the 44.901 acres were acquired, intended either to sell the property or develop it for rental, depending upon which course appeared to be most profitable. The venturers realized that they had made a good purchase price-wise and, if they were unable to obtain acceptable construction financing or rezoning . . . which would be prerequisite to commercial development, they would sell the property in bulk so they wouldn't get hurt. The purpose of either selling or developing the property continued during the period in which [the joint venture] held the property."

The District Court ruled that petitioner had failed to establish that the property was not held *primarily* for sale to customers in the ordinary course of business, and thus rejected petitioner's claim to capital gain treatment for the profits derived from the property's resale. The Court of Appeals affirmed, 347 F. 2d 23. We granted certiorari (382 U.S. 900) to resolve a conflict among the Courts of Appeals[2] with regard to the meaning of the term "primarily" as it is used in Section 1221(1) of the Internal Revenue Code of 1954.

The statute denies capital gain treatment to profits reaped from the sale of "property held by the taxpayer *primarily* for the sale to customers in the ordinary course of his trade or business." (Emphasis added.) The Commissioner urges upon us a construction of "primarily" as meaning that a purpose may be "primary" if it is a "substantial" one.

As we have often said, "the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses." *Crane* v. *Commissioner*, 331 U.S. 1, 6 [Ct. D. 1684, C.B. 1947–1, 97]. And see *Hanover Bank* v.

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[1] Internal Revenue Code of 1954, Sec. 1221(1), 26 U.S.C. § 1221(1):
"For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—
"(1) . . . property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

[2] Compare *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263, 266 (C.A. 9th Cir.); *American Can Co.* v. *Commissioner*, 317 F. 2d 604, 605 (C.A. 2d Cir.), with *United States* v. *Bennett*, 186 F. 2d 407, 410–411 (C.A. 5th Cir.); *Municipal Bond Corp.* v. *Commissioner*, 341 F. 2d 683, 688–689 (C.A. 8th Cir.). Cf. *Recordak Corp.* v. *United States*, 325 F. 2d 460, 463–464 (Ct. Cl.).

Commissioner, 369 U.S. 672, 687–688 [Ct. D. 1870, C.B. 1962–1, 321]; *Commissioner* v. *Korell*, 339 U.S. 619, 627–628 [Ct. D. 1732, C.B. 1950–2, 44]. Departure from a literal reading of statutory language may, on occasion, be indicated by relevant internal evidence of the statute itself and necessary in order to effect the legislative purpose. See, *e.g.*, *Board of Governors* v. *Agnew*, 329 U.S. 441, 446–448. But this is not such an occasion. The purpose of the statutory provision with which we deal is to differentiate between the "profits and losses arising from the everyday operation of a business" on the one hand (*Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 52 [Ct. D. 1787, C.B. 1955–2, 511]) and "a realization of appreciation in value accrued over a substantial period of time" on the others. "*Commissioner* v. *Gillette Motor Co.*, 364 U.S. 130, 134 [Ct. D. 1853, C.B. 1960–2, 466]). A literal reading of the statute is consistent with this legislative purpose. We hold that, as used in Section 1221(1), "primarily" means "of first importance" or "principally."

Since the courts below applied an incorrect legal standard, we do not consider whether the result would be supportable on the facts of this case had the correct one been applied. We believe, moreover, that the appropriate disposition is to remand the case to the District Court for fresh fact-findings, addressed to the statute as we have now construed it.

Vacated and remanded.

MR. JUSTICE BLACK would affirm the judgments of the District Court and the Court of Appeals.

MR. JUSTICE WHITE took no part in the decision of this case.

(Also Sections 162, 167, 1011; 1.162–12, 1.167(a)–3, 1.1011–1.) Rev. Rul. 66–58 [1]

An upland cotton acreage allotment may qualify as a capital asset having an indeterminate useful life. The basis of an allotment is usually its cost. Where land and allotment are acquired as a unit the cost should be allocated between the land and the allotment in accordance with the relative fair market values of such properties. Payments therefore are not deductible but should be capitalized. The cost of the allotment is not subject to depreciation or amortization.

Advice has been requested (1) whether the proceeds received from the sale of an upland cotton acreage allotment will be treated for Federal income tax purposes as proceeds from the sale or exchange of a capital asset; and (2) whether the cost of purchasing such an allotment by a cotton producer is deductible as an ordinary and necessary business expense.

The national acreage allotment for cotton was established by the Agricultural Adjustment Act of 1938. This law, as amended, authorizes the Secretary of Agriculture to determine and proclaim a national acreage allotment for each calendar year's crop of cotton and to apportion such allotment among the states. Each state's acreage allotment is then apportioned among the counties therein and thence through local committees to individual farms.

At present, an upland cotton acreage allotment entitles the owner thereof to (1) price support payments for cotton grown on allotted acreage; (2) acreage diversion payments for allotted acreage diverted from cotton production to approved conservation practices; and (3) price support loans. Penalties for producing upland cotton in excess of allotted acreage are substantial to the extent that such production is not profitable. Thus, it would generally be necessary for a tax-

[1] Also released as Technical Information Release 800, dated Feb. 17, 1966.

payer engaging in the business of growing and selling upland cotton to have an upland cotton acreage allotment.

For upland cotton only, section 405 of the Food and Agriculture Act of 1965, Public Law 89–321, Eighty-ninth Congress, H.R. 9811, November 3, 1965, 79 Stat. 1187, amended the Agricultural Adjustment Act of 1938, as amended, by permitting,

> * * * the owner and operator of any farm for which a cotton acreage allotment is established to sell or lease all or any part or the right to all or any part of such allotment * * * to any other owner or operator of a farm for transfer to such farm * * *.

From the above, it is concluded that an upland cotton acreage allotment is an intangible property right which qualifies as a capital asset under section 1221 of the Internal Revenue Code of 1954, if held by a taxpayer who is not a dealer in such allotments. Therefore, gains or losses from the separate sale of such upland cotton acreage allotments will be treated as gains or losses from the sale of capital assets. Of course, amounts received by the lessor of upland cotton acreage allotments from the lease thereof are ordinary income.

For the purpose of determining gain or loss from the separate sale of a cotton allotment, the basis of the allotment is usually its cost. Where a taxpayer has acquired such an allotment along with the land to which it relates, as a unit, the cost or other basis of the entire unit should be allocated between the land and the allotment in accordance with the relative fair market values of such properties on the date of acquisition. Of course, no portion of the basis of land, acquired prior to the issuance of the cotton allotment, can be allocated to such allotment.

Since cotton acreage allotments can be expected to continue as income producing assets for a period longer than one year, the amount expended by a cotton producer to purchase such an allotment is not deductible for Federal income tax purposes. Accordingly, the amount must be capitalized. Since these upland cotton acreage allotments have an indeterminate useful life, they are not subject to depreciation or amortization.

SECTION 1222.—OTHER TERMS RELATING TO CAPITAL GAINS AND LOSSES

26 CFR 1.1222–1: Other terms relating to capital gains and losses. Rev. Rul. 66–153 [1]

> The Supreme Court's decision in *Commissioner* v. *Clay B. Brown*, 380 U.S. 563, Ct. D. 1904, C.B. 1965–2, 282, does not extend to cases where the amount payable by an exempt foundation for the stock of a commercial business is in excess of the fair market value of the stock.
>
> Rev. Rul. 54–420, C.B. 1954–2, 128, modified.

In the light of the Supreme Court's decision in *Commissioner* v. *Clay B. Brown*, 380 U.S. 563, Ct. D. 1904, C.B. 1965–2, 282, the Internal Revenue Service has reexamined its position set forth in the last para-

[1] Based on Technical Information Release 768, dated Oct. 5, 1965.

graph of Revenue Ruling 54–420, C.B. 1954–2, 128, in the exempt foundation-bootstrap purchase area.

Generally, the factual pattern of these cases involves a "sale" of all the stock of a going commercial business to a foundation claiming exemption under section 501 of the Internal Revenue Code of 1954. Pursuant to plan, the corporation is liquidated and its assets are "leased" to a new operating company which will manage and operate the business. The operating company then pays a major portion of the business' profits to the foundation as "rent." The foundation pays the "purchase price" due the original "sellers" out of these payments received from the operating company.

In a series of cases culminating in the *Clay Brown* decision by the Supreme Court, the Government contested the right of the "sellers" to treat the transaction as a sale for capital gains purposes. Noting that in the case before it there was no finding that the purchase price payable by the foundation was excessive, the Supreme Court in *Clay Brown* held that there was a sale of stock, entitling the sellers to capital gains treatment.

The *Clay Brown* decision does not extend to cases where the amount payable to the "sellers" for their stock is in excess of the fair market value of the stock. In cases of this type the Service will continue to resist what is in substance an attempt to convert future business profits to capital gains.

This Revenue Ruling is applicable only to the "sellers." The position of the Service as to the tax consequences to other participants in these transactions remains unchanged and will be further developed to the extent necessary.

The last paragraph of Revenue Ruling 54–420 is modified to make the conclusion denying capital gains treatment applicable only to those cases where the consideration for the stock "sold" is in excess of the fair market value of the stock.

Method of computing the period during which a capital asset must be held in order to have been "held for more than 6 months." See Rev. Rul. 66–7, below.

Holding period of debentures and other securities. See Rev. Rul. 66–97, page 190.

SECTION 1223.—HOLDING PERIOD OF PROPERTY

26 CFR 1.1223–1: Determination of period for which capital assets are held. (Also Sections 1222, 1231, 7805; 1.1222–1, 1.1231–1, 301.7805–1.) Rev. Rul. 66–7

A capital asset which is acquired on the last day of any calendar month, regardless of whether the month has 31 days, must not be disposed of until on or after the first day of the seventh succeeding month of the calendar in order to have been "held for more than 6 months," within the meaning of sections 1222 (3) and (4) of the Internal Revenue Code of 1954.

The same rule applies in determining holding periods of property for purposes of section 1231 of the Code.
I.T. 3985, C.B. 1949–2, 51, amplified.

Advice has been requested as to when a capital asset will have been held for more than 6 months within the meaning of sections 1222 (3) and (4) of the Internal Revenue Code of 1954, particularly where the asset was acquired on the last day of a calendar month which has less than 31 days.

Section 1222(3) of the Code provides, in part, that the term "long-term capital gain" means gain from the sale or exchange of a capital asset *held for more than 6 months* and section 1222(4) of the Code provides, in part, that the "long-term capital loss" means loss from the sale or exchange of a capital asset *held for more than 6 months.*

It is well and long established that, in computing a period of "years" or "months" prescribed, in a contract or statute, "from" or "after" a designated day, date, act, or other event, the day thus designated is excluded and the last day of the prescribed period is included, unless a different intent is definitely evidenced. See I.T. 3287, C.B. 1939–1 (Part 1), 138.

I.T. 3985, C.B. 1949–2, 51, states the position of the Internal Revenue Service that the determination of the holding period of "capital assets" under sections 117 (a) (2), (3), (4), (5), and (h) (4), of the Internal Revenue Code of 1939, must be made with reference to calendar months and fractions thereof, rather than with reference to days. The ruling was concerned primarily with the determination of the total holding period of securities purchased and sold where the provisions of section 117(h) (4) of the 1939 Code, relating to "wash sales," were applicable. Although similar provisions are not involved in the instant case, the principles enunciated in that ruling apply here. Furthermore, although I.T. 3287 was not cited in I.T. 3985 the rule stated in the former was actually applied in all the appropriate illustrative examples of the latter, that is, in examples 1 through 6.

In view of the foregoing, it is concluded that the holding period of a capital asset begins to run on the day following the date of acquisition of the asset involved. Accordingly, a capital asset acquired on the last day of any calendar month, regardless of whether the month has 31 days or less, must not be disposed of until on or after the first day of the seventh succeeding month of the calendar in order to have been "held for more than 6 months" within the meaning of sections 1222 (3) and (4) of the Code. For example, an asset acquired on April 30, 1963, must not have been disposed of before November 1, 1963, in order to have been held for more than 6 months.

I.T. 3985, C.B. 1949–2, 51, is hereby amplified for the purpose of determining when a capital asset has been held for more than 6 months where the asset was acquired on the last day of a month having less than 31 days.

The same rule applies in determining holding periods of property for purposes of section 1231 of the Code.

Pursuant to authority contained in section 7805(b) of the Code the provisions of this Revenue Ruling will be applicable with respect to dispositions of property after April 10, 1966.

(Also Section 1222; 1.1222–1.) Rev. Rul. 66–97

The holding period for debentures acquired by purchase, whether on a registered securities exchange or in the "over-the-counter" market, is to be determined by excluding the "trade date" on which the debentures are acquired and including the "trade date" on which the debentures are sold.

The same rule applies generally in determining holding periods of stocks and securities acquired by purchase.

Advice has been requested regarding the holding period of debentures and as to whether there is a distinction between a trade effected on a registered securities exchange and a trade made in the "over-the-counter" market.

The taxpayer purchased for investment certain debentures on the same day in an "over-the-counter" trade and a trade effected on a registered securities exchange. There are two relevant dates in connection with such security transactions: (1) the "trade date"—the date on which the contract to buy or sell the security is made and (2) the "settlement date"—the date on which the security is delivered and payment is tendered. In many cases settlement takes place a fixed number of days after the trade. In transactions involving bonds, notes or other evidences of indebtedness, the buyer pays the interest accrued on the security to the date of settlement as a part of the consideration for the transfer. However, bonds as well as stocks are considered acquired or sold on the respective "trade dates." See I.T. 3442, C.B. 1941–1, 212. I.T. 3287, C.B. 1939–1, 138, states that the period during which an asset was held is to be computed by excluding the day on which the asset was acquired and including the day upon which it was sold. See also I.T. 3705, C.B. 1945, 174, and Revenue Ruling 66–7, page 188, this Bulletin. This rule applies whether the trade is made on a registered securities exchange or in the "over-the-counter" market.

Accordingly, the holding period for debentures acquired by purchase, whether on a registered securities exchange or in the "over-the-counter" market, is to be determined by excluding the "trade date" on which the debentures are acquired and including the "trade date" on which the debentures are sold.

The same rule applies generally in determining the holding periods of stocks and securities acquired by purchase.

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 the sale or exchange of certain property used in the trade or business.

Method of computing the period during which section 1231 property must be held in order to have been "held for more than 6 months." See Rev. Rul. 66–7, page 188.

SECTION 1244.—LOSSES ON SMALL BUSINESS STOCK

26 CFR 1.1244(c)-1: Section 1244 stock defined. Rev. Rul. 66-67

The minutes of a board of directors' meeting can qualify as a "plan" within the meaning of section 1244(c)(1)(A) of the Internal Revenue Code of 1954 if they contain all of the required elements of a "plan" as specified in that section of the Code and the regulations thereunder.

However, the minutes of a corporation's board of directors' meeting, which merely authorized the issuance of common stock and failed to specify the maximum amount to be received or the particular period of time during which the stock would be offered, do not qualify as a "plan" within the meaning of section 1244(c)(1)(A) of the Code.

Advice has been requested whether the minutes of a corporation's board of directors' meeting can ever qualify as a "plan" within the meaning of section 1244(c)(1)(A) of the Internal Revenue Code of 1954 and, if so, whether the minutes described below so qualify.

A corporation was organized on January 1, 1964. The minutes of the initial board of directors' meeting show that a resolution was passed which authorized the board of directors to issue a certain amount of unsubscribed capital common stock in the corporation, in such amounts, at such times and for such terms as the board of directors may deem necessary for the business of the corporation.

Between January 1, 1964, and March 31, 1964, the board of directors caused one hundred shares of common stock in the corporation to be issued pursuant to the above-mentioned resolution.

Section 1244 of the Code provides that in certain cases a loss on "section 1244 stock" may be treated as an ordinary loss. Section 1244(c)(1)(A) of the Code provides, in part, that the term "section 1244 stock" means common stock in a domestic corporation if such corporation adopted a plan after June 30, 1958, to offer such stock for a period (ending not later than 2 years after the date such plan was adopted) specified in the plan.

Section 1.1244(c)-1(c) of the Income Tax Regulations provides, in part, as follows:

Written plan.—(1) The common stock must be issued pursuant to a written plan adopted by the corporation after June 30, 1958, to offer only such stock during a period specified in the plan ending not later than two years after the date the plan is adopted. * * * The plan must specifically state, in terms of dollars, the maximum amount to be received by the corporation in consideration for the stock to be issued pursuant thereto.

The minutes of a board of directors' meeting can qualify as a "plan" within the meaning of section 1244(c)(1)(A) of the Code if they contain all of the required elements of a "plan" as specified in that section of the Code and the regulations thereunder.

The minutes of the board of directors' meeting in this case contained merely a resolution which authorized the directors to issue, at their discretion, a certain amount of capital common stock. The resolution failed to establish a period of time during which the stock would be offered for sale, which period would expire not later than 2 years from the date of the resolution. Further, it did not specify, in terms of dollars, the maximum amount to be received as consideration for the stock.

Accordingly, the minutes of the corporation's board of directors in this case do not qualify as a "plan" within the meaning of section 1244(c)(1)(A) of the Code and section 1.1244(c)-1(c) of the regulations.

SUBCHAPTER Q.—READJUSTMENT OF TAX BETWEEN YEARS AND SPECIAL LIMITATIONS

PART IV.—WAR LOSS RECOVERIES

SECTION 1332.—INCLUSION IN GROSS INCOME OF WAR LOSS RECOVERIES

26 CFR 1.1332-1: Inclusion in gross income of war loss recoveries. Rev. Rul. 66-115

(Also Part II, Section 127(c); Regulations 118, Section 39.127(a)-1.)

A series of questions is answered by the Internal Revenue Service relative to the tax treatment of awards received by corporations from the Foreign Claims Settlement Commission under the War Claims Act of 1948, as amended.

Advice has been requested with respect to the tax consequences of awards received by claimants from the Foreign Claims Settlement Commission, under the circumstances described below, as the result of the enactment of Public Law 87-846, approved October 22, 1962 (76 Stat. 1107), C.B. 1962-3, 205.

Public Law 87-846 amended the War Claims Act of 1948 (62 Stat. 1240) to authorize the Foreign Claims Settlement Commission of the United States to determine certain claims of nationals for payments of losses arising out of World War II for loss, destruction, or physical damage to real property and items of identifiable tangible personal property located in certain countries of Europe and the Far East. The Foreign Claims Settlement Commission is the primary agency concerned in the administration of the act and is charged with the responsibility of reducing a gross award by the amount of related tax benefits. Assistance has been requested of the Internal Revenue Service in the determination of prior tax benefits and the tax consequences of awards made in certain situations.

Section 206(a) of the act provides, in effect, that the Commission, in determining the amount of any award, shall deduct all amounts the claimant has previously received on account of the same loss (or losses) for which an award is sought under the act.

Section 206(b) of the act provides that each claim in excess of $10,000 filed under title II of the act by a corporation shall include a statement under oath disclosing the aggregate amount of Federal tax benefits derived by such corporation in any prior taxable year or years resulting from any deduction or deductions claimed for the loss or losses with respect to which the claim is filed. The subsection further provides that in determining the amount of any award where the allowable loss exceeeds $10,000 there shall be deducted an amount equal to the aggregate of the amounts by which the claimant's taxes for such year or years under chapters 1, 2A, 2B, 2D, and 2E of the Internal

Revenue Code of 1939 or subtitle A of the Internal Revenue Code of 1954 were decreased with respect to such loss or losses. Section 206(b) of the act concludes with a provision that any payments made on an award reduced by reason of the foregoing requirements are to be exempt from Federal income taxes.

It is presumed that the Federal tax benefits described in section 206(b) of the act refer primarily to reductions of the amount of prior Federal taxes which were obtained by reason of the provisions of section 127 of the 1939 Code, relating to war losses. Thus, the question is principally directed to the ultimate effect of prior tax benefits based on such losses which were obtained under section 127 of the 1939 Code since these benefits are to be taken into account by the Foreign Claims Settlement Commission under section 206(b) of the act in determining the amount of an award to a claimant.

Under section 127(a)(2) of the 1939 Code, property located in a country against which the United States has declared war or in a country under enemy control on the date of declaration of war is deemed destroyed or seized. A loss deduction resulting from this provision which produced a tax reduction in the taxable year in which the loss was sustained or in any other taxable year affected by such loss, such as one affected by a net operating loss carryback from such year, is considered to be a tax benefit, to the extent of the tax reduction, within the meaning of section 206(b) of the act, the amount of which tax reduction is to be deducted from the otherwise allowable loss found by reducing the amount of the gross loss by the amount of prior loss recoveries, if any, pursuant to section 206(a) of the act.

However, an additional adjustment is necessary where the taxpayer has had a prior war loss recovery which was taxable in accordance with the provisions of section 1331 and section 1332 or section 1333 (as the result of an election under section 1335) of the 1954 Code (or corresponding provisions of the 1939 Code). In such a case, the amount of tax benefit attributable to the war loss for purposes of section 206(b) of the act is confined to the tax benefit remaining after taking into account the tax consequences resulting from the prior war loss recovery. Thus, the net amount of the tax benefit (for purposes of the deduction required by section 206(b) of the act) is to be found by subtracting from the amount which would otherwise constitute the tax benefit attributable to the war loss in question the amount of any additional tax resulting from the applicability, for example, of section 1332 of the 1954 Code to a prior recovery.

The following situations and resulting Federal income tax consequences, while not all inclusive, are generally representative of the cases which have been or may be encountered in connection with the application of the War Claims Act, as amended. As used in these situations, the term "Federal income tax" refers to all applicable taxes under the above-cited chapters of the 1939 Code and under subtitle A of the 1954 Code.

SITUATION (1). *W* Corporation sustained a war loss within the meaning of section 127(a)(2) of the 1939 Code of a single piece of property. However, the loss did not result in a deduction which reduced the amount of tax due as shown on the taxpayer's return. A

cash award was made by the Foreign Claims Settlement Commission to the taxpayer.

Answer. Since the war loss did not result in any Federal income tax reduction, *W* Corporation received no tax benefit within the meaning of section 206(b) of the act and there was no reduction in the amount of the award from the Foreign Claims Settlement Commission by reason of that section. No portion of the award is excludable from gross income under section 206(b) of the act. However, the award is a recovery within the meaning of section 1332 of the 1954 Code and its taxability is determined in accordance with the provisions contained therein.

SITUATION (2). *X* Corporation sustained a war loss within the meaning of section 127(a)(2) of the 1939 Code of a single piece of property. The amount of the loss was $5x$ dollars. The portion of the loss which resulted in a deduction which reduced taxpayer's Federal income tax for the year of the loss amounted to $4x$ dollars and taxpayer's income tax was reduced by $2x$ dollars. Prior to applying the provisions of section 206(b) of the act, the Foreign Claims Settlement Commission determined that the gross award to the taxpayer for his claim should be in the amount of $5x$ dollars.

Answer. The gross award approved by the Foreign Claims Settlement Commission in the amount of $5x$ dollars was reduced by the amount of Federal income tax benefits previously received, an income tax reduction here of $2x$ dollars which resulted from the deduction of $4x$ dollars of the loss. Consequently *X* Corporation's net award determined by the Foreign Claims Settlement Commission of $3x$ dollars ($5x$ dollars less $2x$ dollars) is exempt from tax under section 206(b) of the act.

SITUATION (3). *Y* Corporation sustained a war loss within the meaning of section 127(a)(2) of the 1939 Code of a single piece of property in the amount of $12x$ dollars. A reduction of income tax of *Y* Corporation of $4x$ dollars resulted from the deduction of $10x$ dollars of the war loss, the remaining $2x$ dollars of the war loss not resulting in any tax benefit to *Y* Corporation. In a subsequent taxable year prior to its present claim with the Foreign Claims Settlement Commission, *Y* Corporation experienced a recovery with respect to the war loss in the amount of $5x$ dollars, $2x$ dollars of which was excluded from its taxable income for that taxable year ($12x$ dollars less $10x$ dollars being $2x$ dollars) and $3x$ dollars of which resulted in an increase of Federal income tax of $1x$ dollars for that year pursuant to section 1332 of the 1954 Code.

Answer. Since the taxpayer received a prior recovery of $5x$ dollars on account of the same loss, the Foreign Claims Settlement Commission first reduced the gross award of $12x$ dollars determined by it with respect to the loss by the amount of such $5x$ dollars pursuant to the provisions of section 206(a) of the act, leaving an amount of $7x$ dollars. Under section 206(b) of the act, the Commission determined that the prior tax benefit of $4x$ dollars had been reduced by the increase of tax of $1x$ dollars in the taxable year of the prior recovery of $5x$ dollars, resulting in a net tax benefit of $3x$ dollars by which the gross award of $7x$ dollars was to be reduced. Hence, the net award determined by the Commission of $4x$ dollars ($7x$ dollars less $3x$ dollars) is exempt from Federal income taxes under section 206(b) of the act. It will

be noted that a similar computation would have been made by the Foreign Claims Settlement Commission if the prior recovery had resulted in an increase in Federal income tax in the taxable year of recovery as the result of the provisions of section 1333 of the 1954 Code (if an election had been made by the taxpayer in accordance with the provisions of section 1335 of the 1954 Code) except that the amount of the reduction of the prior tax benefit might have been different. This would depend on whether the increase of the Federal income tax of the taxpayer for the taxable year of recovery under section 1333 of the 1954 Code was other than the amount of $1x$ dollars actually found in connection with the application of section 1332 of the 1954 Code to the recovery.

SITUATION (4). Z Corporation sustained a war loss within the meaning of section 127(a)(2) of the 1939 Code of two properties in the amount of $8x$ dollars and $4x$ dollars, respectively. The total amount of the loss was deducted by Z Corporation on its return and its tax was reduced $6x$ dollars thereby. Z Corporation's claim in the amount of $4x$ dollars covering the loss of the second property was approved by the Foreign Claims Settlement Commission in an amount of $3x$ dollars. There was no award with respect to the first property.

Answer. Where a war loss deduction is taken with respect to two or more properties and an award is made for only one property, the amount of the reduction in the award of the Foreign Claims Settlement Commission for any prior tax benefit is determined by the Commission by reference to the portion of the prior tax benefit attributable to the deduction taken for the loss on the property for which the award is to be made. Thus, Z Corporation is considered to have a tax benefit of $2x$ dollars attributable to the loss on the property for which the Foreign Claims Settlement Commission has made an award since $4x$ dollars bears the same ratio to the total loss of $12x$ dollars as $2x$ dollars bears to the total prior tax benefit of $6x$ dollars. The gross award of $3x$ dollars was therefore reduced by $2x$ dollars and the balance of $1x$ dollars is excludable from gross income under section 206(b) of the act.

SUBCHAPTER R.—ELECTION OF CERTAIN PARTNERSHIPS AND PROPRIETORSHIPS AS TO TAXABLE STATUS

SECTION 1361.—UNINCORPORATED BUSINESS ENTERPRISES ELECTING TO BE TAXED AS DOMESTIC CORPORATIONS

26 CFR 1.1361–5: Election irrevocable. Rev. Rul. 66–25
(Also Sections 331, 351; 1.331–1, 1.351–1.)

Federal income tax consequences of a transfer of the assets of a partnership, which had elected to be taxed as a corporation under section 1361 of the Internal Revenue Code of 1954, to an actual corporation.

Advice has been requested regarding the Federal income tax consequences of a transfer of the assets of a partnership, which had elected to be taxed as a corporation under section 1361 of the Internal Revenue Code of 1954, to an actual corporation under the circumstances described below.

In 1960, a partnership, consisting of individuals *A* and *B*, made an election under section 1361 of the Code to be taxed as a domestic corporation.

In 1964, the enterprise ceased doing business as a partnership and all of its assets were transferred to an actual corporation, organized by *A* and *B*, in exchange for stock sufficient to give *A* and *B* control of the new corporation within the meaning of section 368(c) of the Code. Thereafter, the business formerly conducted by the partnership was carried on by the corporation.

Section 1361(a) of the Code provides, in effect, that, if certain qualifications are met, the proprietor or the partners of an unincorporated enterprise engaged in the operation of a trade or business may elect to have the enterprise treated as a domestic corporation for Federal income tax purposes. However, section 1361(m) of the Code provides, in part, that, with certain exceptions not here pertinent, a "section 1361 corporation" shall not be considered a corporation for purposes of parts III and IV of subchapter C of the Code, relating to corporate organizations and reorganizations.

Section 1.1361–5(b) of the Income Tax Regulations provides, in part, that if the owners of a section 1361 corporation "* * * cease conducting the business of the enterprise in an unincorporated form the election terminates and the assets of the enterprise are deemed to have been distributed to the owners in a complete liquidation of the section 1361 corporation. The effect of the liquidation on the owners shall be determined under the provisions of section 331, 334(a), and, in appropriate cases, 341. Therefore, if a substantial part of the business is transferred to an actual corporation, the transaction shall be treated as if immediately before the transfer all of the assets of the enterprise had been distributed to the owners in a complete liquidation. Accordingly, the transfer of the assets to the actual corporation shall be treated as a transfer made by the owners in their individual capacities immediately after the liquidation."

Section 331(a)(1) of the Code provides that amounts distributed in partial or complete liquidation of a corporation will be treated as in full payment in exchange for the stock of the corporation.

Section 1.331–1(b) of the regulations provides, in part, that the gain or loss recognized to a shareholder from a distribution in partial or complete liquidation will be subject to the provisions of sections 1201 through 1223 of the Code, relating to capital gains and losses.

Section 334(a) of the Code provides the general rule that if property is received in a distribution in partial or complete liquidation (other than a distribution to which section 333 of the Code applies), and if gain or loss is recognized on receipt of such property, then the basis of the property in the hands of the distributee shall be the fair market value of such property at the time of the distribution.

Section 351 of the Code, which is in part III of subchapter C of the Code, provides, in part, as follows:

> (a) GENERAL RULE.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation. * * *
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> * * * * * * *
>
> (d) CROSS REFERENCES.
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> * * * * * * *

(2) For the basis of stock, securities, or property received in an exchange to which this section applies, see sections 358 and 362.

In view of the specific language of section 1.1361–5(b) of the regulations, the partnership's election under section 1361 of the Code terminated, and the assets of the enterprise are deemed to have been distributed to *A* and *B* in a complete liquidation, on the date that the assets of the enterprise were transferred to the actual corporation.

It is assumed that there are no facts which would require taxing the distribution in liquidation under section 341(a) of the Code.

In accordance with the provisions of section 1.1361–5(b) of the regulations, the effect of the liquidation on *A* and *B* will be determined under sections 331 and 334(a) of the Code and the transfer of the assets to the actual corporation is treated as a transfer made by *A* and *B* in their individual capacities immediately after the liquidation. See *Estate of David Wein*, 40 T.C. 454 (1963), affirmed per curiam 330 Fed. (2d) 957 (1964) and *Estate of J. O. Willett*, T.C. Memo. 1964–125.

Based on the foregoing, it is held as follows: (1) Under section 331 of the Code, the gain or loss recognized to *A* and *B* from the distribution in liquidation is subject to the provisions of section 1201 through 1223 of the Code, relating to capital gains and losses; (2) under section 334(a) of the Code, the basis of the property of the partnership in the hands of *A* and *B* is its fair market value at the time of the distribution; (3) under section 351(a) of the Code no gain or loss will be recognized to *A* and *B* upon the transfer of the property received in the liquidation of the partnership to the corporation in exchange for its stock; (4) under section 362(a) of the Code, the basis of the property transferred to the corporation will be the same in its hands as the basis of the property in the hands of *A* and *B* immediately prior to the transfer; and (5) under section 358(a)(1) of the Code, the basis of the stock of the corporation received by *A* and *B* will be the same as the basis of the property transferred in exchange therefor.

Any earned but unreported income of the unincorporated enterprise at the time of the liquidation (incorporation), is includible in the gross income of the unincorporated enterprise in its final return. See *Estate of David Wein, supra*, *Henry A. Kuckenberg, Transferee, et al.* v. *Commissioner*, 35 T.C. 473 (1960), affirmed in part, 309 Fed. (2d) 202 (1962), certiorari denied, 373 U.S. 909 (1963), and *Jud Plumbing & Heating, Inc.* v. *Commissioner*, 5 T.C. 127 (1945), affirmed, 153 Fed. (2d) 681 (1946).

SUBCHAPTER S.—ELECTION OF CERTAIN SMALL BUSINESS CORPORATIONS AS TO TAXABLE STATUS

SECTION 1372.—ELECTION BY SMALL BUSINESS CORPORATION

26 CFR 1.1372–2: Manner and time for making election and filing shareholders' consent. (Also Section 441; 1.441–1.) Rev. Rul. 66–68

X, a newly organized corporation, made a timely election under section 1372(a) of the Internal Revenue Code of 1954 for its first taxable year by filing Form 2553, Election by Small Business Corporation,

and a statement of consent of each shareholder of the corporation. *X* indicated on the Form 2553 that its first taxable year would be a fiscal year ending January 31, 1966. However, on December 15, 1965, *X* filed a return for a taxable year ending on September 30, 1965.

Held, the election under section 1372(a) of the Code is not affected by the adoption of an initial annual accounting period different from that specified on the Form 2553. *Held further*, the statement on Form 2553 that *X*'s first taxable year was to end on January 31, 1966, did not constitute the adoption of a taxable year ending on that date, but the adoption of *X*'s first taxable year was effected through the filing of a timely return for the period covered by such return.

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26 CFR 1.1372–3: Shareholders' consent. Rev. Rul. 66–116

The custodian holding stock for a minor under the Uniform Gifts to Minors Act or the Model Gifts of Securities to Minors Act cannot consent, in that capacity, to an election under subchapter S of the Internal Revenue Code of 1954. However, the consent of a minor to a corporation's election as a subchapter S corporation under section 1372 of the Code may be made by the minor's legal guardian, or his natural guardian if no legal guardian has been appointed. Therefore, if the custodian is also the minor's guardian, the consent may be made by him in the capacity of legal guardian or natural guardian, as the case may be.

SECTION 1375.—SPECIAL RULES APPLICABLE TO DISTRIBUTIONS OF ELECTING SMALL BUSINESS CORPORATIONS

26 CFR 1.1375–4: Distributions of previously taxed income. Rev. Rul. 66–172

> Where stock in an electing small business corporation is owned by spouses as tenants by the entirety, each spouse's net share of the corporation's undistributed taxable income is determined in accordance with the applicable state law, and upon the death of a spouse, the decedent's right to receive distributions not considered dividends under section 1375(d) of the Internal Revenue Code of 1954 lapses and is not available to the survivor. The same reasoning is applicable where the stock is held in a joint tenancy and in community property states where the surviving spouse acquires exclusive ownership of the stock.

Advice has been requested concerning the amount of a surviving spouse's net share of undistributed taxable income as defined in section 1375(d) of the Internal Revenue Code of 1954 under the following facts.

Decedent, *H*, and his wife, *W*, owned all of the outstanding stock of *X* corporation as tenants by the entirety. *X* corporation, which reports its income on a calendar year basis, has qualified as an electing small business corporation subject to the same election since January 1, 1962. As of December 31, 1961, *X* corporation had accumulated earnings and profits of $100x$ dollars. In each of the years 1962, 1963, and 1964 *X* corporation had undistributed taxable income, as defined in section 1373(c) of the Code, of $20x$ dollars. Under the laws of

the State of *Y* where the taxpayers are domiciled, income from property held in a tenancy by the entirety is required to be divided equally between the spouses. *H* and *W* each reported their respective $10x$ dollars share of undistributed taxable income, as required by section 1373(a) of the Code, on joint returns filed for each of the calendar years involved. *H* died on June 30, 1965, and *W* became the exclusive owner of the stock in *X* corporation by reason of her right of survivorship. *X* corporation had no net earnings or losses for 1965 and made a cash distribution of $60x$ dollars to *W* on December 31, 1965. Under these facts it has been asked whether the entire $60x$ dollars distributed to *W* on December 31, 1965, may be treated as her net share of *X* corporation's undistributed taxable income previously taxed to shareholders and hence will be considered a distribution which is not a dividend under section 1375(d) of the Code.

Section 1.1371–1(d)(2) of the Income Tax Regulations provides, in part, that where a husband and wife are joint owners of stock in an electing small business corporation, each will be considered a shareholder for purposes of section 1373(a) of the Code, relating to the inclusion in the shareholder's gross income of the corporation's undistributed taxable income.

Section 1373(b) of the Code, provides, in part, that a shareholder of an electing small business corporation on the last day of a taxable year of such corporation shall include in his gross income, for his taxable year in which or with which the taxable year of the corporation ends, the amount he would have received as a dividend, if on such last day there had been distributed pro rata to its shareholders by such corporation an amount equal to the corporation's undistributed taxable income for the corporation's taxable year.

Section 1375(d)(1) of the Code, provides, in part, that an electing small business corporation may distribute to any shareholder all, or any portion, of the shareholder's net share of previously taxed income and that any such distribution shall, for income tax purposes, be considered a distribution which is not a dividend.

Section 1375(d)(2) of the Code, provides, in part, that a shareholder's net share of the undistributed taxable income of an electing small business corporation is determined, with certain adjustments, by reference to the sum of the amounts included in the gross income of the shareholder under section 1373(b) of the Code for all prior taxable years in which the corporation was subject to the same election.

Section 1.1375–4(e) of the regulations provides that a shareholder's right to nondividend distributions is personal and cannot in any manner be transferred to another. If a shareholder transfers part, but not all, of his stock in an electing small business corporation, his net share of previously taxed income is not reduced by reason of the transfer, and the transferee does not acquire any part of such net share. If a shareholder transfers all of his stock in an electing small business corporation, any right which he may have had to nondividend treatment upon the receipt of distributions lapses entirely unless he again becomes a shareholder in the corporation while it is subject to the same election. This result is applicable in all cases, notwithstanding that the transfer was by sale, gift, bequest or operation of law.

Since a shareholder's net share of an electing small business corporation's undistributed taxable income previously taxed to him is

determined by reference to the amounts required to be included in the gross income of the shareholder for his prior taxable years under section 1373(b) of the Code, and since, under the applicable state law, *W*, as co-owner of the stock in *X* corporation, was entitled to one-half of the dividends on the stock, it follows that on December 31, 1965, her net share of undistributed taxable income available for distribution as a distribution not treated as a dividend under section 1375 (d)(1) of the Code is limited to 30*x* dollars. *H*'s right to receive distributions not treated as dividends (30*x* dollars), which was personal to him, lapsed at his death and does not pass to his surviving spouse, *W*, who acquired exclusive ownership of the stock by reason of her right of survivorship. That *H* and *W* filed joint returns does not affect the foregoing result, since a joint return is the return of two separate taxpayers. See section 1.6013–4(b) of the regulations.

Accordingly, 30*x* dollars of the 60*x* dollars distributed to *W* is considered a distribution which is not a dividend, and 30*x* dollars is a distribution from accumulated earnings and profits taxable as a dividend.

Furthermore, the same result would be applicable if *W* had acquired absolute ownership of the *X* corporation stock as a surviving joint tenant with right of survivorship, or as a surviving spouse in a community property state, and if prior to her acquisition of absolute ownership one-half of the corporation's undistributed taxable income had been included in her gross income pursuant to section 1373 of the Code.

SUBCHAPTER T.—COOPERATIVES AND THEIR PATRONS

PART I.—TAX TREATMENT OF COOPERATIVES

SECTION 1381.—ORGANIZATIONS TO WHICH PART APPLIES

26 CFR 1.1381–1: Organizations to which part applies. Rev. Rul. 66–98

(Also Sections 1382, 1388; 1.1382–2, 1.1388–1.)

A financing corporation which purchases accounts receivable with recourse from all its department store members at face value (of which an amount is deducted as a holdback and credited to a reserve account); charges all members the same discount rate based on the net dollars actually paid for the accounts receivable (face amount minus holdback); charges its members approximately the same discount rate they would have to pay if they discounted their accounts receivable on an independent basis with independent factors; distributes its net savings ratably to its members on the basis of the discounts charged them pursuant to a preexisting obligation; and otherwise operates on a cooperative basis, is an organization described in section 1381(a) of the Internal Revenue Code of 1954. Furthermore, cash distributions made to the member-patrons by the corporation, which are based on the discounts charged each member as compared with the total discounts charged all members, are patronage dividends as defined in section 1388(a)(1) of the Code and thus are deductible from the corporation's gross income to the extent provided in section 1382 of the Code.

The Internal Revenue Service has been asked whether a corporation which conducts a financing activity in the manner described below is operating on a cooperative basis and whether annual cash distributions paid to its members are patronage dividends.

A financing corporation was created by certain department stores to purchase their accounts receivable, thus supplying its member-patrons with working capital. The corporation purchases the accounts receivable with recourse and charges a so-called "discount" equal to a specified rate of interest on the monthly unpaid balance of such accounts. This "discount" is paid by each member monthly on a "settlement date."

All members sell their accounts receivable to the financing corporation at face value. However, an amount designated as a holdback is deducted from the face amount of the receivables and credited to a reserve account. The holdback is based on the loss experience of each individual store and thus varies from member to member. However, the "discount" charged is the same to all members and is based on the net dollars—the face amount of the receivables minus the holdback—actually paid to the members at the time the receivables are purchased. The "discount" charged is approximately the same as the member stores would have to pay if they discounted their receivables on an independent basis with independent factors.

The corporation's articles obligate it to distribute in cash a proportionate part of its annual net savings to each of its members in the ratio that the "discounts" charged such member bear to the total "discounts" charged all of the members.

Section 1381(a)(2) of the Internal Revenue Code of 1954 provides, with exceptions not material here, that any corporation operating on a cooperative basis shall be subject to the tax treatment provided in part I of subchapter T, chapter 1 of the Code, which includes among its provisions section 1382 of the Code.

Section 1382(b)(1) of the Code provides, in part, that in determining the taxable income of a cooperative there shall not be taken into account amounts paid during the payment period for the taxable year as patronage dividends with respect to patronage occurring during such taxable year. Such amounts are treated as deductions in the Income Tax Regulations. See section 1.1382–1 of the regulations.

Section 1388(a)(1) of the Code provides that the term "patronage dividend" means an amount paid to a patron by a cooperative on the basis of quantity or value of business done with or for such patron.

The corporation in the instant case is supplying its members with needed working capital at cost. The discount rate charged is the same to all members and is based on the net dollars actually paid to the members at the time the accounts receivable are purchased. While the discount rate may vary, depending upon the cost to the corporation of borrowing funds, each participating member is treated on an equal basis at any given time.

That each member will bear all losses attributable to its accounts receivable sold with recourse to the corporation does not prevent this corporation from being considered cooperative in character. Cooperative operation of a financing corporation does not necessitate acquisition of accounts receivable on a basis different from that on which

such receivables would customarily be acquired by a comparable commercial institution.

The amount of the cash distribution paid to each member following the close of each taxable year is based on the "discounts" charged such member as compared with the total "discounts" charged all of the members. This fulfills the requirement of section 1388(a)(1) of the Code that, to be considered patronage dividends, distributions must be paid to a patron "on the basis of the quantity or value of business done with or for such patron."

Accordingly, the corporation is operating on a cooperative basis within the meaning of section 1381(a)(2) of the Code. The required annual distributions to the member-patrons by the corporation are patronage dividends as defined in section 1388(a)(1) of the Code and are deductible from the gross income of the corporation to the extent provided in section 1382 of the Code.

SECTION 1382.—TAXABLE INCOME OF COOPERATIVES

26 CFR 1.1382-2: Taxable income of cooperatives; treatment of patronage dividends.

Whether distributions based on discounts charged to member-patrons of a corporation offering a finance service constitute patronage dividends. See Rev. Rul 66-98, page 200.

PART II.—TAX TREATMENT BY PATRONS OF PATRONAGE DIVIDENDS

SECTION 1385.—AMOUNTS INCLUDIBLE IN PATRON'S GROSS INCOME

26 CFR 1.1385-1: Amounts includible in patron's gross income.

Whether withholding of tax is required on patronage dividends paid to nonresident alien patrons, substantially all of which are foreign cooperative corporations not doing business in the United States. See Rev. Rul. 66-53, page 206.

PART III.—DEFINITIONS; SPECIAL RULES

SECTION 1388.—DEFINITIONS; SPECIAL RULES

26 CFR 1.1388-1: Definitions and special rules.

Whether withholding of tax is required on patronage dividends paid to nonresident alien patrons, substantially all of which are foreign cooperative corporations not doing business in the United States. See Rev. Rul. 66-53, page 206.

Whether distributions based on discounts charged to member-patrons of a corporation offering a finance service constitute patronage dividends. See Rev. Rul. 66-98, page 200.

CHAPTER 2.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 1402.—DEFINITIONS

26 CFR 1.1402(c)–1: Trade or business. Rev. Rul. 66–52

A is a constable appointed by a city pursuant to statutory authority. *A*'s services in his capacity as constable in serving summonses and other legal process are excluded from the term "trade or business", as defined in the Self-Employment Contributions Act of 1954, as the performance of the functions of a public office.

However, *A* is engaged in a "trade or business" for purposes of the Self-Employment Contributions Act of 1954, where he serves summonses and other legal process in a nonofficial capacity.

Advice has been requested as to the status, under the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), of an individual who performs services in his official capacity as a constable, and who also performs similar services in a nonofficial capacity.

A is a constable appointed by the city of *X* in the state of *Y*. Constables, sheriffs, deputy sheriffs and other officers are required under the laws of the state of *Y* to serve all lawful process issued by a court, judge, judicial officer or county commissioners legally directed to them. Demands, notices and citations may be served by constables as well as "by other persons". Constables are also authorized to serve summonses for witnesses, but the statute further provides that a "disinterested person" may also serve such process. Except in a few cases for which special provisions are made by the statute, official action of a constable is generally limited to the city or town in which he holds office.

A also serves summonses, demands, notices and citations not in his capacity as constable but as a "disinterested person". Individual attorneys engage him to serve a particular item, within or without his town, and the attorney, not the city or state, pays the bill for service. The attorney is then reimbursed by his client. In serving any such item for an attorney, *A* strikes the word "Constable" from the "return of service" to make it clear that he is acting solely as a "disinterested person". *A* derives the bulk of his income from the fees of those persons who engage him to serve summonses or other notices in his nonofficial capacity.

Section 1402(c) of the Self-Employment Contributions Act of 1954 provides, in part, 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 Internal Revenue Code of 1954 (relating to trade or business expenses), except that such term shall not include (1) the performance of the functions of a public office.

Section 1.1402(c)–2 of the Income Tax Regulations relating to the Self-Employment Contributions Act provides, in part, that the term "public office" includes any elective or appointive office of a state or its political subdivisions. The functions of a public office include those performed by a marshal, a sheriff or a constable.

Under the laws of the state of *Y*, demands, notices, citations and summonses are legal process which may be served by a constable in the

performance of the functions of his office, but they may also be served by one who is not the incumbent of the office of constable, that is, "by other persons" or by a "disinterested person". Although certain services are those which would be within the purview of the official duties of an office, where they may also be performed by any person, and where the incumbent of the office in fact performs them in a capacity other than his official capacity, they would not be excluded from a trade or business under section 1402(c) of the Self-Employment Contributions Act of 1954.

Accordingly, the services performed by *A* in his capacity as constable under appointment by the city of *X* pursuant to statutory authority are excluded from the term "trade or business" under section 1402(c) of the Self-Employment Contributions Act of 1954 as the performance of the functions of a public office. The tax imposed by that Act is not applicable to his remuneration for such services.

However, in serving demands, notices, citations and summonses, not in his official capacity as constable, but in a nonofficial capacity, *A* is engaged in a "trade or business" for purposes of the Self-Employment Contributions Act of 1954, and the income derived therefrom is includible in computing net earnings from self-employment for purposes of the tax on self-employment income.

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26 CFR 1.1402(c)–3: Employees. Rev. Rul. 66–69
(Also Section 3121; 31.3121(b)(15)–1.)

Services performed in the United States in the employ of an international organization by an individual who is a citizen of the United States are included in the term "trade or business," and salary for such services is included in net earnings for purposes of the tax imposed by the Self-Employment Contributions Act, even though the individual is covered concurrently by the Civil Service Retirement Act.

Advice has been requested whether the tax imposed by the Self-Employment Contributions Act (chapter 2, subtitle A, Internal Revenue Code of 1954) applies to salary received from an international organization by an individual, who is a citizen of the United States, for services performed in the United States for the international organization, notwithstanding the employee's election to have the same services covered by the Civil Service Retirement Act.

Under section 1402(c) of the Code the term "trade or business", for purposes of the Self-Employment Contributions Act, includes several types of service performed as an employee. One of the types is service performed in the United States in the employ of an international organization as described in section 3121(b)(15) of the Federal Insurance Contributions Act (chapter 21, subtitle C, of the Code). This is the type of service performed by the individual in the instant case, and the question presented is whether concurrent coverage under the Civil Service Retirement Act prevents the service from being a "trade or business" for purposes of the Self-Employment Contributions Act.

The individual entered the employ of and was paid a salary by the international organization. He transferred from an agency of the United States Government, pursuant to the Federal Employees Inter-

national Organization Service Act (Public Law 85-795, 72 Stat. 959). The regulations under that Act, promulgated by the Civil Service Commission, provide that upon written request by an international organization for the services of an employee, the Federal agency may authorize the transfer of the employee to the organization for any period not to exceed 3 years.

Section 4 of the Federal Employees International Organization Service Act provides, in part, that any employee serving under a Federal appointment not limited to 1 year or less who transfers to an international organization shall have certain rights if the transfer is made with the consent of the head of his agency. Among other things he is entitled to retain "coverage and all rights and benefits under any system established by law for the retirement of civilian employees of the United States, if all necessary employee deductions and agency contributions in payment for such coverage, rights, and benefits for the period of employment with the international organization are currently deposited in the system's fund or depository, and for such purpose service as an officer or employee of the international organization shall be considered to be creditable service under any such system." The individual here involved elected to participate concurrently in the Civil Service Retirement program and accordingly contributed to the Civil Service Retirement Fund.

Although the individual is considered to remain an employee of the Federal agency for certain purposes specified in the Federal Employees International Organization Service Act, he is an employee of the international organization with respect to the services performed in its employ following his transfer. Accordingly, since services performed within the United States by a citizen thereof in the employ of an international organization, which are excepted from "employment" under section 3121(b)(15) of the Federal Insurance Contributions Act, are included in the term "trade or business", as used in the Self-Employment Contributions Act, the salary received by the individual for services performed for the international organization should be taken into consideration in computing his net earnings from self-employment for purposes of the tax imposed by the latter Act even though he is covered concurrently under the Civil Service Retirement Act.

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.

Exemption from withholding of tax at source on industrial royalties in the case of residents, corporations, or other entities of Finland,

as affected by the income tax convention between the United States and Finland. See Rev. Rul. 66–55, page 360.

Status of foreign citizens in the United States who perform services for a United States corporation in connection with a training program conducted by the company. See Rev. Rul. 66–76, page 238.

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26 CFR 1.1441–2: Income subject to withholding. Rev. Rul. 66–53
(Also Sections 1442, 1388, 1385; 1.1442–1, 1.1388–1, 1.1385–1.)

A domestic cooperative is engaged in the purchase of lubricating oils and allied products and in the sale of them in the United States to its member patrons on a cooperative basis. The savings resulting from purchasing on a cooperative basis are distributed as patronage dividends to its member patrons, some of whom are nonresident aliens and foreign corporations or foreign cooperatives not doing business in the United States.

Held, under sections 1441 and 1442 of the Internal Revenue Code of 1954, the domestic cooperative is required to withhold tax on these patronage dividends distributed to the nonresident patrons since these amounts are fixed or determinable annual or periodical income from sources within the United States.

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26 CFR 1.1441–3: Exceptions and rules of special application.

Status of foreign citizens in the United States who perform services for a United States corporation in connection with a training program conducted by the company. See Rev. Rul. 66–76, page 238.

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26 CFR 1.1441–4: Exemptions from withholding.

Services performed in the United States by residents of Canada. See Rev. Rul. 66–77, page 242.

SECTION 1442.—WITHHOLDING OF TAX ON FOREIGN CORPORATIONS

26 CFR 1.1442–1: Withholding of tax on foreign corporations.

Whether withholding of tax is required on patronage dividends paid to nonresident alien patrons, substantially all of which are foreign cooperative corporations not doing business in the United States. See Rev. Rul. 66–53, above.

Exemption from withholding of tax at source on industrial royalties in the case of residents, corporations, or other entities of Finland, as affected by the income tax convention between the United States and Finland. See Rev. Rul. 65–55, page 360.

CHAPTER 6.—CONSOLIDATED RETURNS

SUBCHAPTER A.—RETURNS AND PAYMENT OF TAX

SECTION 1502.—REGULATIONS

26 CFR 1.1502–31: Basis of tax computation. T.D. 6874[1]

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

Net operating loss carryovers and carrybacks from separate return years to consolidated return years

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

The Income Tax Regulations (26 CFR Part 1) under subchapter A of chapter 6 of the Internal Revenue Code of 1954, relating to consolidated returns, are amended as follows:

Section 1.1502–31 is amended by revising paragraph (b)(3)(i) and by revising paragraph (b)(21) (i) and (ii). These revised provisions read as follows:

§ 1.1502–31 BASIS OF TAX COMPUTATION.

* * * * * * *

(b) *Computations.* * * *

(3) *Limitation on net operating loss carryovers and carrybacks from separate return years.*—(i) In no case shall there be included in the consolidated net operating loss deduction for the taxable year as consolidated net operating loss carryovers or carrybacks under paragraph (a)(3)(i)(*b*), (4) (i) (*f*), (*g*), (*h*), (*j*), and (*k*), and (ii) (*c*) and (*d*) of this section (relating to net operating losses sustained by a corporation in years for which separate returns were filed, or for which such corporation joined in a consolidated return filed by another affiliated group) an amount exceeding the taxable income of such corporation included in the computation of the consolidated taxable income for the taxable year, adjusted as provided in subdivision (ii) of this subparagraph. This subdivision shall not be applicable to a carryover under paragraph (a)(3)(i)(*b*) of this section of a net operating loss of a corporation—

(*a*) Attributable to a period for which it was included in a consolidated return filed by another affiliated group for a taxable year be-

[1] 31 F.R. 1271.

ginning prior to January 1, 1954, all of whose members are included in the consolidated return filed for the taxable year if all of the members of such other affiliated group would have been members of the affiliated group if the law applicable to the taxable year had been applicable to such prior taxable year,

(*b*) To taxable years beginning after December 31, 1963, attributable to a taxable year beginning before January 1, 1964, in which such corporation was (on each day of such year) a member of the affiliated group, or

(*c*) Attributable to a taxable year beginning after December 31, 1963, in which such corporation was (on each day of such year) a member of the affiliated group, provided that an election under section 1562 (relating to privilege of groups to elect multiple surtax exemptions) was not effective for such year.

* * * * * * *

(21) *Rules with respect to net operating losses under sections 381 and 382.*—(i) If, in the computation of the consolidated net operating loss carryover, there is included an amount with respect to a net operating loss of a corporation, sustained in a taxable year for which it filed a separate return or for which such corporation joined in a consolidated return filed for another affiliated group, which is a transferor or distributor of assets to a member of the affiliated group within the meaning of section 381(a), the amount allowable as a carryover with respect to such transferor or distributor shall not exceed the amount of the taxable income of the acquiring corporation included in the computation of the consolidated taxable income for the taxable year, adjusted as provided in subparagraph (3)(ii) of this paragraph. The preceding sentence shall not apply to a carryover—

(*a*) To taxable years beginning after December 31, 1963, attributable to a net operating loss or losses sustained by a corporation in a taxable year or years beginning before January 1, 1964, in which such corporation was (on each day of any such year) a member of the affiliated group, or

(*b*) Attributable to a taxable year beginning after December 31, 1963, in which the corporation sustaining the loss was (on each day of such year) a member of the affiliated group, provided that an election under section 1562 (relating to privilege of groups to elect multiple surtax exemptions) was not effective for such year.

(ii) If, in addition to the amount described in subdivision (i) of this subparagraph, there is included an amount with respect to a net operating loss sustained by the acquiring corporation in a year for which it filed separate returns or for which it joined in a consolidated return filed by another affiliated group, the losses sustained by both the acquiring corporation and the transferor or distributor corporation which may be taken into account as a net operating loss deduction in determining the consolidated taxable income may not exceed the taxable income of the acquiring corporation included in the computation of the consolidated taxable income for the taxable year, adjusted as provided in subparagraph (3)(ii) of this paragraph. The preceding sentence shall not apply to a carryover—

(*a*) To taxable years beginning after December 31, 1963, attributable to a net operating loss or losses sustained by the acquiring corporation in a taxable year or years beginning before January 1, 1964,

in which such corporation was (on each day of any such year) a member of the affiliated group, or

(*b*) Attributable to a net operating loss sustained by the acquiring corporation in a taxable year beginning after December 31, 1963, in which such corporation was (on each day of such year) a member of the affiliated group, provided that an election under section 1562 (relating to privilege of groups to elect multiple surtax exemptions) was not effective for such year.

* * * * * * *

Because this Treasury Decision amends existing regulations merely to liberalize the consolidated net operating loss deduction by narrowing the limitation imposed by § 1.1502-31(b)(3) on such deduction, it is 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 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.C. 7805).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved January 27, 1966.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on Feb. 1, 1966, 8:47 a.m., and published in the issue of the Federal Register for Feb. 2, 1966, 31 F.R. 1271)

(Also Sections 301, 302, 316, 317; 1.301-1, 1.302-2, 1.316-1, 1.317-1.) Rev. Rul. 66-37

The redemption by a subsidiary of all of its preferred stock all of which is held by its common parent corporation is a taxable dividend to the common parent to the extent of the subsidiary's earnings and profits. If a consolidated income tax return is filed for the taxable year in which the redemption occurs, the distribution represents an intercompany dividend to be eliminated under section 1.1502-31(b)(1) of the Income Tax Regulations in computing the consolidated taxable income. Under section 1.302-2(c) of the regulations, the parent's adjusted basis for the subsidiary's preferred stock will be transferred to and allocated ratably among the shares of the subsidiary's common stock owned by the parent at the time of redemption.

Advice has been requested as to whether the receipt of cash by a common parent corporation from its subsidiary, during a consolidated return period, in redemption by the subsidiary of all of its preferred stock, all of which is held by the parent corporation, constitutes an intercompany dividend to be eliminated, under section 1.1502-31(b)(1) of the Income Tax Regulations, in computing the consolidated taxable income.

Corporation *X* is the common parent of an affiliated group of corporations which filed consolidated income tax returns for the years 1958

through 1964. During 1958, corporation Y became a member of the affiliated group of which X was the common parent and Y joined in the filing of consolidated returns with X and its other subsidiaries from the time it became a member of the group.

As of July 30, 1964, Y had outstanding $240y$ shares of 4 percent voting noncumulative preferred stock having a par and liquidating value of $100 per share and $400y$ shares of voting common stock having a par value of $100 per share. As of such date, X owned all of Y's preferred stock and $320y$ shares or 80 percent of Y's common stock.

Y's directors at their June 1964 meeting voted to redeem all of Y's outstanding preferred stock at par for cash which was done in October 1964.

X's tax basis for the Y preferred stock redeemed in 1964 was $14x$ dollars and the profit to X on the redemption was $10x$ dollars. The Y preferred stock was retired at the time of the redemption. Y's earnings and profits accumulated since February 28, 1913, as of December 31, 1963, exceeded the $24x$ dollars cash distributed to X in the redemption.

Section 301 of the Internal Revenue Code of 1954 provides the general rule for treatment of distributions on or after June 22, 1954, of property by a corporation to a shareholder with respect to its stock. Under section 301(c)(1) of the Code that portion of the distribution which is a dividend (as defined in section 316 of the Code) shall be included in gross income.

Under section 302(a) of the Code, if a corporation redeems its stock (within the meaning of section 317(b) of the Code) and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock. Section 302(b)(1) of the Code provides that if the redemption is not essentially equivalent to a dividend, section 302(a) of the Code shall apply. Under section 302(d) of the Code, unless otherwise provided, a distribution in redemption of stock shall be treated as a distribution of property to which section 301 of the Code applies if the distribution is not within any of the provisions of section 302(b) of the Code.

Section 1.302–2(c) of the regulations provides that in any case in which an amount received in redemption of stock is treated as a distribution of a dividend, proper adjustment of the basis of the remaining stock will be made with respect to the stock redeemed.

Section 316 of the Code defines the term "dividend" as any distribution of property made by a corporation to its shareholders (1) out of its earnings and profits accumulated after February 28, 1913, or (2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Under section 317(b) of the Code, stock shall be treated as redeemed by a corporation if the corporation acquires it from a shareholder in exchange for property, including money, whether or not the stock is cancelled, retired, or held as treasury stock.

Section 1.1502–31(b)(1) of the regulations, pertaining to consolidated returns, provides, in part, that the taxable income of each corporation shall be computed in accordance with the provisions covering the determination of taxable income of separate corporations except that unrealized profits and losses in transactions between members of the affiliated group and dividend distributions from one member of the group to another member of the group (referred to in the regulations under section 1502 of the Code as intercompany transactions) are to be eliminated.

The acquisition by *Y* of all of its preferred stock in exchange for cash was a redemption of stock as defined in section 317(b) of the Code. Under the facts, subsections (2), (3), and (4) of section 302(b) of the Code clearly did not apply to the redemption. The redemption did not qualify as being not essentially equivalent to a dividend under section 302(b)(1) of the Code, the only other section 302 provision which would prevent dividend treatment for the redemption, because it did not change the essential relationship of *X* as the principal shareholder of *Y*. *X*'s position as the holder of the majority of the common stock of *Y* was not affected by the redemption of *Y*'s preferred stock. The net effect of the transaction was a distribution of *Y*'s earnings to its controlling shareholder without any appreciable change in the position of the *Y* shareholders.

Therefore, if separate returns had been filed for the year 1964, the redemption by *Y* of its preferred stock held by *X* would be treated as a distribution of property to which section 301 of the Code applies, under the provisions of section 302(d) of the Code. Under sections 301(c)(1) and 316 of the Code, this cash distribution would have been treated as a dividend to *X* to the extent of *Y*'s earnings and profits. The same rule would apply to a redemption during a consolidated return period.

Accordingly, under the facts in this case, if the affiliated group of which *X* is the common parent filed a consolidated income tax return for the year 1964, the receipt by *X* of the $24x$ dollars in cash from *Y* in redemption of all of *Y*'s outstanding preferred stock, represented an intercompany dividend to be eliminated under the provisions of section 1.1502–31(b) of the regulations in computing the taxable income of *X*. Under section 1.302–2(c) of the regulations, *X*'s adjusted basis for *Y*'s preferred stock will be transferred to and allocated ratably among the shares of *Y*'s common stock owned by *X* at the time of the redemption.

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26 CFR 1.1502–31: Bases of tax computation.

Carryback of net operating loss of corporation filing separate return to a consolidated return year. See Rev. Rul. 66–91, page 54.

225–638°—66——15

SUBTITLE B.—ESTATE AND GIFT TAXES

CHAPTER 11.—ESTATE TAX

SUBCHAPTER A.—ESTATES OF CITIZENS OR RESIDENTS

PART II.—CREDITS AGAINST TAX

SECTION 2013.—CREDIT FOR TAX ON PRIOR TRANSFERS

26 CFR 20.2013–1: Credit for tax on prior transfers. Rev. Rul. 66–38

(Also Section 2041; 20.2041–1.)

There is a transfer of a beneficial interest in property, as defined under section 2013(e) of the Internal Revenue Code of 1954, to a decedent-transferee if that property interest meets the requirements of a general power of appointment within the meaning of section 2041 of the Code at the time of the transferor's death.

Advice has been requested whether, under the circumstances described below, a prior decedent transferred to a decedent a power of appointment representing a beneficial interest in property in computing the credit for tax on prior transfers under section 2013 of the Internal Revenue Code of 1954.

The gross estate, for Federal estate tax purposes, of the transferor included an annuity contract wherein the insurance company agreed to retain the proceeds of the contract and to pay the income to the decedent's surviving spouse for life, and upon her death to pay the proceeds of the contract then held to their son. The settlement plan provided that during the first contractual year the original payee, the surviving spouse, had the right to withdraw all or any part of the amount retained under the settlement option. Since this power was exercisable only during the first contractual year it was not exercisable in all events within the meaning of section 2056(b)(5) of the Code. Accordingly, no marital deduction was allowed in respect of the property in determining the estate tax liability of the estate of the transferor-decedent.

Section 2013(a) of the Code provides that the Federal estate tax imposed upon a decedent's estate shall be credited with all or 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 nonexercise of a power of appointment) to the decedent by or from a person who died within 10 years before, or within 2 years after the decedent's death.

Section 2013(d) of the Code provides further that the value of the property transferred is "* * * the value used for the purpose of determining the Federal estate tax liability of the estate of the transferor * * *." Such value of the property is determined as of the date of the transferor-decedent's death. See Revenue Ruling 59–9, C.B. 1959–1, 232.

Section 2013(e) of the Code defines the term "property" to include "any beneficial interest in property, including a general power of appointment (as defined in section 2041)."

Since the decedent-transferee had the power, on the date of death of the transferor, to withdraw in her favor the entire amount retained by the insurance company unlimited by an ascertainable standard, she had a general power of appointment within the meaning of section 2041 of the Code. For purposes of the credit for tax on prior transfers, it is not required that a general power of appointment be exercisable "in all events" as is provided under section 2056(b)(5) of the Code with respect to the allowance of the marital deduction.

Accordingly, it is held that regardless of the date of death of the decedent-transferee, the value of the entire amount retained by the insurance company under the settlement plan of the annuity contract represents a transfer of a beneficial interest in property, as defined in section 2013(e) of the Code, passing to the decedent-transferee from the transferor.

PART III.—GROSS ESTATE

SECTION 2031.—DEFINITION OF GROSS ESTATE

26 CFR 20.2031–1: Definition of gross estate; valuation of property. Rev. Rul. 66–85

> Where a decedent a citizen of the United States dies in one time zone while domiciled in the United States in another zone, the time of decedent's death for Federal estate tax purposes is the point of time (standard time) at the place where the estate tax return is to be filed.

Advice has been requested with respect to the determination of the date of death for Federal estate tax purposes where the decedent a citizen of the United States dies in one time zone, while domiciled in the United States in another zone.

In the instant case, the decedent died while vacationing in Germany. The date of death was June 16, 1964, at 2 a.m., German time, or June 15, 1964, at 9 p.m., United States eastern standard time, in the State of New York, the decedent's domicile.

Section 2031 of the Internal Revenue Code of 1954 provides, in pertinent part, that the value of the decedent's gross estate shall be determined by including to the extent provided for in that section, the value at the *time* of his death of all property wherever situated. Section 20.2031–1(b) of the Estate Tax Regulations provides that the value of the decedent's gross estate is its fair market value at the *time* of his death (unless the executor elects to value the estate under the alternate valuation method provided by section 2032 of the Code). Section 6091(b) of the Code provides that returns of estate tax required under section 6018 of the Code shall be made to the Secretary or his delegate in the internal revenue district in which was the domicile of the decedent at the time of his death or, if there was no such domicile in an internal revenue district, then at such place as the Secretary or his delegate may by regulations prescribe.

Since the domicile of the decedent determines the place from which the estate tax return is to be filed and liability for the Federal estate tax arises in the United States at the time of death prevailing at the same instant throughout the world, it is held that the time and date

of death of the decedent for Federal estate tax purposes is the time and date prevailing in the decedent's domicile in the United States at the instant of death. The standard of time is United States time as prescribed by United States law. See sections 261 and 262 of Title 15, United States Code, providing for the establishment of standard time zones for the United States and applying that time to acts to be performed by officers, departments, and persons subject to the jurisdiction of the United States, and relating to the time within which any rights shall accrue or determine.

In the instant case, therefore, the date of the decedent's death is June 15, 1964, the time of his death in the State of New York, his domicile and the place where the estate tax return is to be filed. This is also the time to be used in valuing his estate, if the date of death valuation is chosen, and for determining the due date of the estate tax return.

SECTION 2033.—PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST

26 CFR 20.2033–1: Property in which the decedent had an interest. Rev. Rul. 66–20

> Where pursuant to a partnership agreement, a deceased partner's estate is to receive a share of the partnership profits for a definite period after the partner's death, such contractual right is property in which the decedent had an interest at the time of his death within the meaning of section 2033 of the Internal Revenue Code of 1954. Accordingly, the value of this right must be included in decedent's gross estate for Federal estate tax purposes.

Advice has been requested whether the value of the right of decedent's estate to receive for a period of years after decedent's death a share of the income of the partnership of which he was a member is includible in his gross estate for Federal estate tax purposes under the circumstances described below.

At the time of his death, decedent, aged 55, was a general partner in a public accounting firm. The business of the firm consists entirely of the performance of personal services by its partners and staff members and there are no income-producing investments or properties.

The partnership agreement provides that in the event of the death of a partner there shall be paid to the representatives of his estate his share of the capital of the firm, his unwithdrawn share of the net earnings, and his share of the net earnings for the fiscal year ending with the date of his death. The agreement further provides that in the event of the death of a partner before attaining the age of 60 years, in addition to the payments mentioned above, there shall be paid to his estate each year for 10 years a portion of the net earnings of the partnership for each such year equal to one-tenth of the decedent's percentage of such earnings for either the first or second fiscal year next preceding his death, subject to a prescribed minimum annual payment.

Section 2033 of the Internal Revenue Code of 1954 provides that the value of the gross estate shall include the value of all property to the extent of the decedent's interest therein at the time of his death.

The leading case dealing with agreements between business asso-

ciates as to payments of post-mortem profits to the estate of a deceased associate is *Bull, Executor* v. *United States*, 295 U.S. 247 (1935), Ct. D. 969, C.B. XIV–1, 310 (1935). In this case, the enterprise required no capital and none was ever invested by the partners. In the partnership agreement it was provided that in the event a partner died, the survivors might continue the business for one year thereafter and his estate should "receive the same interests, or participate in the losses to the same extent" as the deceased partner would, if living. The agreement further provided that the estate should have the option of withdrawing from the firm but the representative of the estate did not exercise the option, and the business was continued as contemplated by the agreement. The Supreme Court of the United States held that the payments of partnership income earned after the death of the deceased partner were income to the estate; however, there was nothing which could be taxed to the decedent's estate under the estate tax.

The partnership agreement in the instant case, unlike the agreement in the *Bull* case, does not contemplate that the estate of the deceased partner shall continue as a partner and maintain precisely the same status with respect to the firm as decedent had in respect of profits and losses. Instead, as in the case of *Charles F. Coates, et al.* v. *Commissioner*, 7 T.C. 125 (1946), acquiescence, C.B. 1946–2, 2, the instant agreement provides that a deceased partner's estate is to receive decedent's share of the capital and the income earned and accrued to the date of death and, in addition thereto, that his estate is to receive a share of the profits earned for the specified period of years after his death. In the *Coates* case, the Tax Court of the United States pointed out that provisions of this kind are "intended to be in the nature of a mutual insurance plan, the disadvantage of which each partner was willing to accept in consideration of a similar commitment for his benefit on the part of all other partners, and, in part, as further compensation for the past services of the deceased partner payable after his death." See Senate Report No. 1622; Eighty-third Congress, Second Session, at page 405, pertaining to section 753 of the Code, where it is stated:

> * * * Thus, while a successor in interest of a decedent partner will be required to include in gross income amounts received from the partnership which are attributable to the value of the decedent's interest in unrealized fees or *mutual insurance, the recipient will at the same time receive a deduction for the estate tax paid with respect to the inclusion of such rights to income in the decedent's estate.* [Emphasis added.]

In view of the foregoing, it is clear that under the terms of the instant partnership agreement, the deceased partner acquired, among other things, a contractual right to have a share of partnership income earned after his death paid to his estate for a specified period which right at the time of his death passed to the executors of his estate.

The conclusion in this case is consistent with the decisions in the cases of *Estate of Charles A. Riegelman, et al.* v. *Commissioner*, 27 T.C. 833 (1957), affirmed 253 Fed. (2d) 315 (1958); *Alice B. Winkle, Executrix*, v. *United States*, 160 Fed. Supp. 348 (1958). Accordingly, it is held that such right is property in which the decedent had an interest at the time of his death within the meaning of section 2033 of the Code, the value of which must be included in his gross estate for Federal estate tax purposes.

(Also Section 2036; 20.2036–1.) Rev. Rul. 66–86

Where pursuant to the laws of Descent and Distribution of Switzerland entitling the decedent to the usufruct for life in three-fourths of the estate of her husband, a trust consisting of that portion of her husband's estate was established by the decedent and the remaindermen, and the indenture of trust provides that the net trust income be distributed to the decedent during her lifetime, no portion of the corpus of the trust is includible in the gross estate of the decedent under section 2033 or 2036 of the Internal Revenue Code of 1954.

Advice has been requested whether the value of the corpus of a trust established in the manner set forth below is to be included in the decedent's gross estate for Federal estate tax purposes.

The decedent's former husband died intestate in 1930, a citizen and resident of Switzerland. At the time of his death, his estate in the United States consisted of shares of stock in a United States corporation. The husband was survived by the decedent, his mother, and a sister. Under the laws of Descent and Distribution of Switzerland, a surviving spouse receives ownership in one-fourth and the usufruct for life in three-fourths of her husband's estate if he, as here, leaves no descendants but does leave legal heirs designated as "the group of his parents." A usufruct is comparable to the life estate of the common law.

To effect the distribution of the assets of the estate of decedent's husband in accordance with the laws of Descent and Distribution of Switzerland, one-fourth of the shares of stock were distributed to the decedent outright. The remaining three-fourths of the shares were placed in trust by the decedent and the remaindermen acting together. The trust indenture provided that the net trust income was to be distributed to the decedent during her lifetime. After her death, the trust assets were to be divided into two equal shares. One such share was to be distributed to the mother of the decedent's husband. The other share was to be distributed to the sister of the decedent's husband.

Section 2033 of the Internal Revenue Code of 1954 provides:

The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

It was held in *Williams* v. *United States*, 41 Fed. (2d) 895 (1930), that where a decedent had only a life estate in property transferred by another, no portion of the property was includible in the decedent's gross estate under section 402(c) of the Revenue Act of 1921, a predecessor of section 2033 of the 1954 Code. Similarly, the decedent in the instant case had no interest in the trust corpus which is includible under section 2033 of the Code.

Section 2036(a) of the Code provides:

General rule.—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(1) the possession or enjoyment of, or the right to the income from, the property * * *

The value of the property subject to a decedent's life estate is includible under section 2036 of the Code only where the decedent, in legal effect, made a transfer of the property and retained the life estate. Here, although the decedent was one of the settlors of the trust, she was never entitled to more than a usufruct for life in the trust property. Thus, she did not have a sufficient interest in the trust property to make a transfer thereof within the meaning of section 2036 of the Code.

Accordingly, it is held that no part of the value of the assets of the trust involved is includible as a part of the present decedent's estate for Federal estate tax purposes, under section 2033 or 2036 of the Code.

Wife's interest in property held in tenancy by the entirety in a simultaneous death situation. See Rev. Rul. 66-60, page 221.

SECTION 2036.—TRANSFERS WITH RETAINED LIFE ESTATE

26 CFR 20.2036-1: Transfers with retained life estate.

Exclusion of property from gross estate in cases where transferor did not have the requisite interest in property. See Rev. Rul. 66-86, page 216.

SECTION 2040.—JOINT INTERESTS

26 CFR 20.2040-1: Joint interests.

Husband's interest in property held in tenancy by the entirety in a simultaneous death situation. See Rev. Rul. 66-60, page 221.

SECTION 2041.—POWERS OF APPOINTMENT

26 CFR 20.2041-1: Powers of appointment; in general.

Credit for tax on prior transfers. See Rev. Rul. 66-38, page 212.

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26 CFR 20.2041-3: Powers of appointment created after October 21, 1942. Rev. Rul. 66-87

A decedent was the lifetime beneficiary of a testamentary trust established under the will of her husband, who died in 1953. As beneficiary, she had the noncumulative right to withdraw the income from the trust each year, a right which she did not exercise during her lifetime. It has been determined that the failure to exercise the right constitutes the lapse of a power taxable for estate tax purposes under section 2041(b)(2) of the Internal Revenue Code of 1954. *Held*, in applying the provisions of section 2041(b)(2)(B) of the Code, the 5-percent limitation on the lapsed power exclusion is based on the income the decedent could have withdrawn from the trust rather than on the corpus of the trust.

Advice has been requested whether, for purposes of the Federal estate tax, the 5-percent lapsed power exclusion from gross estate provided in section 2041(b)(2)(B) of the Internal Revenue Code of 1954 is based on trust income or the value of the trust corpus, under the circumstances described below.

The decedent was the lifetime beneficiary of a testamentary trust established under the will of her husband, who died in 1953. As the beneficiary, she had the noncumulative right to withdraw the income from the trust each year. Any income not so withdrawn was to be accumulated and added to corpus. The decedent did not exercise her right during her lifetime. Each annual failure to exercise such right has been determined to constitute a lapse of a power for purposes of section 2041(b)(2) of the Code.

The issue is whether the 5-percent limitation on the lapsed power exclusion from decedent's gross estate provided by section 2041(b)(2)(B) of the Code applies to the income the decedent could have withdrawn from the trust or to the trust corpus from which the income was derived.

Section 2041(b)(2) of the Code provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. However, section 2041(b)(2) of the Code further provides that the lapse of the power during any calendar year shall be considered a release for purposes of inclusion of property in the gross estate of the individual only to the extent that the property, which could have been appointed by exercise of such lapsed power, exceeded in value the greater of $5,000 or 5 percent of the aggregate value, at the time of such lapse, "of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied."

Example (2) of section 20.2041–3(f) of the Estate Tax Regulations illustrates the application of section 2041(b)(2) of the Code in a situation substantially similar in certain important respects to that under consideration in the instant case. In that example, the donee of the power, the decedent, had the noncumulative power to distribute $10,000 of each year's income to himself, which otherwise was accumulated. The trust income for the year was $20,000. Thus, where the donee did not distribute any income to himself, there was a lapse as to $5,000 (i.e., the amount by which $10,000 exceeds $5,000).

The fact that the 5-percent exclusion is not discussed in the above example is attributable to the reason that it does not apply in the described factual situation. Five percent of $20,000 is $1,000 and, therefore, the greater exclusion of $5,000 provided for in section 2041(b)(2)(A) of the Code is the applicable exclusion in the circumstances of the example.

The 5-percent exclusion provided for in section 2041(b)(2)(B) of the Code logically relates to the "assets out of which" the property in question could have been withdrawn. The value of the fund so described is the quantity against which the exclusion is computed. This is consistent with the underlying objective of this section, which is to provide a limited exclusion from the general rule of taxability of the property over which the decedent had command by his general power of appointment. It is considered significant that the Code uses the

phrase "assets out of which" rather than more commonly used terms, as principal, corpus, etc.

In the instant case, the annual trust income earned by the testamentary trust created by the decedent's husband is "the assets out of which * * * the exercise of the lapsed powers could have been satisfied" within the meaning of section 2041(b)(2)(B) of the Code. Accordingly, it is held that the 5-percent exclusion from decedent's gross estate provided for in section 2041(b)(2)(B) of the Code is based on the value of the trust income rather than on the trust corpus from which the income was derived.

PART IV.—TAXABLE ESTATE

SECTION 2053.—EXPENSES, INDEBTEDNESS, AND TAXES

26 CFR 20.2053–1: Deductions for expenses, indebtedness, and taxes; in general. Rev. Rul. 66–21

Under Texas community property law, only one-half of the administration expenses are generally allowable as a deduction under section 2053(a) of the Internal Revenue Code of 1954 in determining the taxable estate of a decedent who is either husband or wife. Expenses incurred solely in determining estate tax liability, however, are allowable in full to the decedent's estate. A deduction for only one-half of the amount of unpaid ad valorem taxes on decedent's separate property is allowable in all cases, except where it can be shown by an adversary proceeding in a court of competent jurisdiction that the nonowner spouse has a right of equitable reimbursement for taxes already paid with his or her funds. A deduction of one-half of the funeral expenses incurred by the estate of the first community partner to die is allowable based on applicable local law.

Advice has been requested regarding the deductibility, for Federal estate tax purposes under Texas community property law, of legal and accounting fees incurred in determining estate tax liability, ad valorem taxes assessed against separate property of the decedent, and funeral expenses.

The specific questions involved are whether all, or one-half, of each of the above-mentioned items is deductible, and whether the result is the same regardless of whether the decedent is the husband or the wife.

Section 2053(a) of the Internal Revenue Code of 1954 provides, in part, that the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts for funeral and administration expenses and for claims against the estate as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

It appears that under Texas community property law the entire community estate is liable for necessary and reasonable administration expenses of the decedent's estate, and that the surviving spouse's share of the community is thus chargeable with one-half of the administration expenses of the community. See *Norwood* v. *Farmers & Merchants National Bank of Abilene, et al.*, 145 S.W. (2d) 1100 (1940), *Velma E. Goggans* v. *Enloe Simmons, et al.*, 319 S.W. (2d) 442 (1958). Where the separate estate of the decedent and the community estate

are both involved in the administration, the administration expenses are to be charged proportionately to the community estate and, in such case, less than one-half are chargeable to the surviving spouse's share of the community. See *Goggans*, above.

Accordingly, it is held that only one-half of the administration expenses are allowable as a deduction under section 2053(a) of the Code in the estate of a decedent subject to Texas community property law, except where separate property is also administered in the estate, in which case the deduction is allowable proportionately. However, expenses which can be specifically allocated to the decedent's share of the community property, such as attorney's fees incurred in the determination or litigation of estate and inheritance taxes in connection with his share of the property, are fully deductible. Expenses incurred solely in determining estate tax liability are allowable in full to the decedent's estate. The deduction for all other ordinary expenses in any way connected with the management or division of the community should be limited to fifty percent of the expenses. See *Estate of Julius C. Lang* v. *Commissioner*, 97 Fed. (2d) 867 (1938), with opinion on other issues in 304 U.S. 264 (1938), Ct. D. 1342, C.B. 1938–1, 507.

The solution to the problem relating to unpaid ad valorem taxes assessed against the separate property of the decedent depends upon whether a Texas Probate Court would charge the surviving spouse's share of the community with one-half the amount owed at the decedent's death. Under Texas community property law, there are community debts and separate debts. For instance, if community funds are expended to improve separate property or to pay off antenuptial debts, then on dissolution of the marriage the nonowner spouse has a right of reimbursement against that separate property to the extent that his or her share of the property was expended. Debts other than those for which there is a right of reimbursement are community debts, and insofar as they are in existence at the time of the decedent's death, the surviving spouse's share of the community may be charged with one-half of them.

Although the cases in Texas are not wholly in accord on the question of taxes on separate property paid for with community funds, the general rule is that expenditures for taxes on separate property create no equitable claim for reimbursement unless the expenditures by the community are greater than the benefits resulting to it. See *Colden* v. *Alexander*, et al., 171 S.W. (2d) 328 (1943). Thus, unless it can be shown that a right of reimbursement exists as to the taxes already paid, the surviving spouse's share of the community should be charged with one-half of the amount of unpaid taxes at the decedent's death regardless of whether a lien has attached or not.

Therefore, a deduction will be allowed for only one-half of the amount of unpaid ad valorem taxes on decedent's separate property in all cases, except where it can be shown by a proceeding in a court of competent jurisdiction that the nonowner spouse has a right of equitable reimbursement for taxes already paid with his or her funds. In the latter case, a pro rata deduction will be allowed in accordance with the terms of the reimbursement allowed by the court in the adversary proceeding.

Generally, funeral expenses are community debts in Texas. In the *Goggans* case, above, it was held that funeral expenses of a deceased spouse in a reasonable amount are primarily chargeable to the community estate. Also, Speer's *Marital Rights in Texas*, Fourth Edition, Volume I, at pages 539 and 540, points out, "Ordinarily debts created after the dissolution of the marriage are not community debts, yet the estate (community) is liable for all such things as funeral expenses, tombstones and the like."

In *Commissioner* v. *Stewart*, 49 Fed. (2d) 257 (1931), certiorari denied 284 U.S. 658 (1931), Ct. D. 423, C.B. X-2, 425 (1931), funeral expenses were held to be chargeable against the Texas decedent's half of the community property. However, no recent Texas cases have so held and, in the *Norwood* case, above, funeral expenses were held to be a legitimate charge against the community estate and deductible before partition. In that case, the Court of Civil Appeals of Texas stated at page 1103: "Further, if there be anything in the opinion in *Blair* v. *Stewart*, 5 Cir., 49 F. 2d 257, implying a different application of the rules of law employed in the disposition of this appeal, then we are of the opinion that the authority cannot be given any effect here in view of the opinions of our Supreme Court above cited, as well as those of other appellate courts of this State."

Accordingly, only one-half of the funeral expenses incurred by the estate of the first community partner to die are allowable based on applicable local law.

SECTION 2056.—BEQUESTS, ETC., TO SURVIVING SPOUSE

26 CFR 20.2056(a)-1: Marital deduction; in general. Rev. Rul. 66-60

(Also Sections 2033, 2040; 20.2033-1, 20.2040-1.)

> Where a husband and wife hold property as tenants by the entirety and it cannot be determined that they have died other than simultaneously, the full value of the property (purchased entirely with consideration furnished by the husband) is includible in the husband's gross estate. However, under section 3 of the Uniform Simultaneous Death Act, a presumption of survivorship in the wife is created with respect to half of the property held by the entirety. With respect to this property she has survived and the property passes to and is includible in her estate. Therefore, the husband's estate is entitled to a marital deduction to the extent of the one-half interest passing to the wife.

Advice has been requested as to (1) the extent to which the value of property is includible in each decedent's gross estate in a situation where there is simultaneous death and the property involved is held in tenancy by the entirety, and (2) whether a marital deduction is allowable under section 2056 of the Internal Revenue Code of 1954.

A husband and wife were killed in an automobile accident under circumstances wherein there was not sufficient evidence as to which spouse may have died first. The husband furnished the entire consideration for the purchase of certain realty which was held by them as tenants by the entirety. The husband's will contained no statement as to which should be considered to have survived the other in case they died in a common disaster. The decedents resided and per-

ished in a state which has adopted the Uniform Simultaneous Death Act, and the property in question was located in that state.

The purpose of the Uniform Simultaneous Death Act is to provide for the devolution of property where there is insufficient evidence that persons have died otherwise than simultaneously. Section 3 of the Act is pertinent to this case and it states:

> Joint Tenants or Tenants by the Entirety—Where there is no sufficient evidence that two joint tenants or tenants by the entirety have died otherwise than simultaneously the property so held shall be distributed one-half as if one had survived and one-half as if the other had survived.

With regard to the amount includible in the husband's gross estate as to the tenancy by the entirety property, section 2040 of the Code and section 20.2040–1(a)(2) of the Estate Tax Regulations require that the value of all property in which the decedent at the time of his death held an interest either as joint tenant or as a tenant by the entirety be included in his gross estate, except to the extent that it can be shown that a part of such property originally belonged to the spouse or other joint tenant or was received or acquired by him or her from the decedent for an adequate and full consideration.

Inasmuch as the property in question was held in tenancy by the entirety at the time of the husband's death and since there is no evidence to indicate that the wife furnished any consideration for the property, it is held that the full value of the property is includible in the husband's gross estate.

With respect to the wife's interest in the entirety property, section 2033 of the Code provides that the gross estate of a decedent includes the value of all property in which he had an interest at the time of his death. Inasmuch as the estate of the wife is entitled to a half interest in the property under the courts' construction of the Uniform Simultaneous Death Act, as discussed hereinafter, one-half of the value of the property held in tenancy by the entirety is includible in the wife's estate under section 2033 of the Code.

With regard to the allowable marital deduction, section 2056 of the Code states that a deduction is allowed with respect to the value of any property which passes from the decedent to his surviving spouse, but only to the extent that such property is included in determining the value of the decedent's gross estate.

Section 20.2056(a)–1(b) of the regulations sets forth five conditions which an executor must establish in order to obtain the marital deduction. Two of these are:

> (1) That the decedent was survived by his spouse, and
> (2) That the property interest passed from the decedent to his spouse.

Where the order of deaths of the decedent and his spouse cannot be established by proof, a presumption (whether supplied by local law, the decedent's will or otherwise) that the decedent "was survived by his spouse" will be recognized as satisfying requirement (1) only to the extent that it has the effect of giving to such spouse an interest in property includible in her gross estate. Under such circumstances, if an estate tax return is required to be filed for the estate of the decedent's spouse, the marital deduction will not be allowed in the final audit of the estate tax return of the decedent's estate with respect to any property interest which has not been finally determined to be includible

in the gross estate of his spouse. Section 20.2056(e)-2(e) of the regulations.

The crux of the matter, therefore, is whether under the Uniform Simultaneous Death Act there is a presumption that the husband's spouse survived him since the husband's will contained no such presumption.

Section 3 of the Uniform Simultaneous Death Act does not include the word "presumption." However, section 20.2056(e)-2(e) of the regulations is not interpreted as requiring the existence of an express "presumption" in a statement of the state law if the effect on the administration of each one-half of the joint tenancy property is the same as if there were an express presumption of survivorship. The Internal Revenue Service interprets section 3 of the Uniform Act as providing a formula for the devolution of the decedent's property and creating a presumption of survivorship in each person as to his own property. This view is expressed by the courts in various states where cases have arisen under the Act.

In *Miami Beach First National Bank* v. *Miami Beach First National Bank*, 52 So. 2d 893 (1951), the Supreme Court of Florida, in deciding that the estate of the remainderman was entitled to her share pursuant to the provisions of the will, said at page 896:

> The Simultaneous Death Act discards the idea of proving survivorship and proceeds on the presumption that each person is the survivor as to the property alloted [sic] to him and administers the estate accordingly.

Here the court interpreted the Act as creating a presumption of survivorship of a person with respect to the property received by the estate of that person.

In *Mayor and City Council of Baltimore* v. *White*, 189 Md. 571, 56 A. 2d 824 (1948), the Court of Appeals of Maryland in arriving at its conclusion held, in effect, that the Act creates a presumption of survivorship in each as to his own property, and there is, therefore, survivorship within the meaning of the lapsed legacy statute.

Therefore, it is held that where a husband and wife hold property as tenants by the entirety and it cannot be determined that they have died other than simultaneously, section 3 of the Uniform Simultaneous Death Act creates a presumption of survivorship in the wife with respect to a one-half interest in the property sufficient to satisfy the requirements of section 2056(a) of the Code to the extent recognized under section 20.2056(e)-2(e) of the regulations, thereby entitling the husband's estate to a marital deduction of the value of the one-half interest passing to the wife.

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26 CFR 20.2056(b)-5: Marital deduction; life estate with power of appointment in surviving spouse. — Rev. Rul. 66-39

> An interest passing in trust may qualify for the marital deduction under section 2056 of the Internal Revenue Code of 1954, notwithstanding provisions granting to the trustees administrative powers, including the power to determine the allocation or apportionment of receipts and disbursements between income and corpus, if under the local law applicable to the administration of the trust, reasonable limitations are placed upon the exercise of the powers.

Advice has been requested whether a marital deduction may be allowed under section 2056 of the Internal Revenue Code of 1954 for the value of a bequest in trust, where the trustees were granted certain powers to determine investment and disbursement policy.

The decedent bequeathed to trustees property valued at an amount equal to 50 percent of his adjusted gross estate as defined in section 2056 of the Code, less the value of any other property included in his gross taxable estate, for Federal tax purposes, with respect to which a deduction is allowable under section 2056 of the Code. The trustees were directed to hold and administer the trust and pay the entire net income therefrom to or for the benefit of the decedent's surviving spouse for life, in annual or more frequent installments. The surviving spouse was given the power to appoint by will any part or all of the principal of the trust to her estate.

The trustees of the trust were specifically authorized and empowered, in their sole discretion:

* * * * * * *

(e) to retain cash included in any trust fund without investment thereof for such period of time as they shall deem advisable, whenever the trustees shall determine that it is inadvisable to invest such cash because of market conditions or for any other reason;

* * * * * * *

(n) to determine whether receipts and disbursements shall be credited to or charged against principal or income, or partly to or against principal and partly to or against income, which determination shall be conclusive upon all persons and corporations interested therein; * * *

Under the State law applicable to the administration of the trust, all exercises of discretion by the trustees are to be made solely in a fiduciary capacity in accordance with the general standards of trust administration imposed upon trustees. In making allocations of receipts and disbursements between principal and income, State law also requires that the trustees apply reasonable accounting principles. Thus, the courts of the State afford a remedy in the case of an allocation by trustees which is contrary to reasonable accounting principles, notwithstanding the authority given to the trustees to make determinations in this regard.

The State law imposes upon the trustees the duty of making good faith investments in the fiduciary capacities. It requires the trustees to invest as prudent men and also to exercise such prudent investment discretion at reasonable intervals. This duty affords the surviving spouse a remedy in the event that the trustees, relying on their authority under paragraph (e) of the will, unreasonably retain assets in the form of uninvested cash.

Section 2056(b)(5) of the Code provides, in part, that, in the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, no part of the interest so passing shall, for purposes of the marital deduction, be considered as passing to anyone other than the surviving spouse.

Section 20.2056(b)-5(f)(4) of the Estate Tax Regulations provides, in part, as follows:

(4) Provisions granting administrative powers to the trustees will not have the effect of disqualifying an interest passing in trust unless the grant of powers

evidences the intention to deprive the surviving spouse of the beneficial enjoyment required by the statute. Such an intention will not be considered to exist if the entire terms of the instrument are such that the local courts will impose reasonable limitations upon the exercise of the powers. Among the powers which if subject to reasonable limitations will not disqualify the interest passing in trust are the power to determine the allocation or apportionment of receipts and disbursements between income and corpus, the power to apply the income or corpus for the benefit of the spouse, and the power to retain the assets passing to the trust.

The administrative powers granted to the trustees under paragraphs (e) and (n) of the will do not evidence an intention to deprive the surviving spouse of the beneficial enjoyment required by the statute. The power of the trustees under paragraph (e) to retain cash without investment is subject to the right of the spouse, under State law, to require that the trustees either make the property productive or convert it within a reasonable time. The powers of the trustees under paragraph (n) to allocate receipts and disbursements between principal and income are subject to reasonable limitations under the applicable State law.

Accordingly, it is held that a marital deduction may be allowed, under section 2056 of the Code, for the value of the bequest in trust in the instant case.

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26 CFR 20.2056(e)–2: Marital deduction; definition of "passed from the decedent to his surviving spouse." Rev. Rul. 66–139

A settlement payment made by the executor of a decedent's estate to decedent's surviving spouse in compromise of a claim made by her in good faith for an absolute dower interest under State law, following arm's-length negotiations, qualifies for the marital deduction for Federal estate tax purposes.

Advice is requested whether an amount paid to a surviving spouse pursuant to a compromise agreement qualifies for the marital deduction for Federal estate tax purposes under the circumstances described below.

The decedent bequeathed to his surviving spouse an income interest in his estate during her lifetime or until her remarriage. The widow renounced under the will and instead claimed and elected to take her dower interest in the estate. A widow's dower interest under the law of the local jurisdiction is a one-third part absolutely in the realty and personalty owned by her husband at the time of his death. However, because of an antenuptial agreement entered into by the decedent and his wife whereby each renounced all rights, present and future, in and to any and all property of the other, the executor of decedent's estate denied her claim of dower. The widow contended that the agreement was invalid on the grounds that it was entered into by her without consideration, without disclosure, and without legal advice. Prior to a hearing on her claim, the controversy between the interested parties was settled by their entering into a compromise agreement whereby the widow was paid $3x$ dollars in settlement of all her rights and interests in the estate. This amount was $1x$ dollars in excess of the value of the interest she would have received under the will. The value of the gross probate estate was approximately $11x$ dollars.

Section 2056(a) of the Internal Revenue Code of 1954 provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse. For purposes of this section, an interest in property shall be considered as passing from the decedent to his surviving spouse if such interest is the dower or curtesy interest, or statutory interest in lieu thereof, of such person. Section 2056(e)(3) of the Code. Where a surviving spouse elects dower or her statutory share in her husband's estate instead of the interest which he left her in his will, the interest which she takes, rather than the interest which she renounces, is regarded as passing to her from the decedent. Section 20.2056(e)-2(c) of the Estate Tax Regulations.

The Supreme Court of the United States in *Munro L. Lyeth* v. *Hoey*, 305 U.S. 188 (1938), Ct. D. 1370, C.B. 1938-2, 208, held that an amount paid to an heir from the estate of a decedent in compromise of a will contest should be treated as acquired by inheritance for the reason that it was possible for him to receive it only because of his standing as an heir and of his claim in that capacity. While the issue there presented was the income tax liability of such heir, the rationale has long been followed in Federal estate tax cases. *Estate of John Sage* v. *Commissioner*, 122 Fed. (2d) 480 (1941), affirming 42 B.T.A. 1304, certiorari denied, 314 U.S. 699 (1942); *Estate of Mary Clare Milner* v. *Commissioner*, 6 T.C. 874 (1946), acquiescence, C.B. 1946-2, 4.

However, where there is a will contest and a property interest is assigned or surrendered to the surviving spouse, the interest so acquired is regarded as having passed from the decedent to his surviving spouse only where the assignment or surrender was a bona fide recognition of the surviving spouse's rights in the decedent's estate. Section 20.2056(e)-2(d) of the regulations. The regulations further provide that "such a bona fide recognition will be presumed where the assignment or surrender was pursuant to a decision of a local court upon the merits in an adversary proceeding following a genuine and active contest. However, such a decree will be accepted only to the extent that the court passed upon the facts upon which deductibility of the property interests depends. If the assignment or surrender was pursuant to a decree rendered by consent, or pursuant to an agreement not to contest the will or not to probate the will, it will not necessarily be accepted as a bona fide evaluation of the rights of the spouse." On the other hand, a valid claim to a share in decedent's estate made in good faith and settled as a result of arm's-length negotiations without any court contest will qualify as a bona fide claim within the meaning of the regulations. *Estate of Gertrude P. Barrett* v. *Commissioner*, 22 T.C. 606 (1954), acquiescence, C.B. 1954-2, 3; *Estate of Leo J. Dutcher* v. *Commissioner*, 34 T.C. 918 (1960), acquiescence, C.B. 1961-1, 4.

Following the rationale of the *Lyeth* and *Barrett* decisions, the amount paid to a surviving spouse pursuant to a bona fide compromise agreement in recognition of her alleged rights in her deceased husband's estate qualifies for the marital deduction to the extent that the interest which would have passed to her as a result of the completed exercise of such rights would have been a deductible interest.

With respect to the effect of an antenuptial agreement, the Supreme Court of Florida in the case of *Del Vecchio* v. *Del Vecchio*, 143 So. (2d) 17 (1962) stated:

> Inadequacy of provision for the wife does not in itself vitiate an antenuptial agreement. If, when she signed the contract freely and voluntarily, she had some understanding of her rights and had been fully informed by the husband as to his property or if, notwithstanding the husband's failure to disclose, she had or reasonably should have had a general and approximate knowledge of the character and extent of his property she will be bound.

In remanding the case to the trial court, however, the court said:

> The questions of whether she had some understanding of her rights and had or reasonably should have had a general and approximate knowledge of her future husband's property are matters of fact to be determined by the chancellor upon the evidence and his finding thereon will not lightly be disturbed.

Accordingly, it is held that the settlement payment made by the executor of decedent's estate to the surviving spouse following arm's-length negotiations, in compromise of a claim made by her in good faith for a one-third, absolute, dower interest under State law, qualifies for the marital deduction for Federal estate tax purposes.

CHAPTER 12.—GIFT TAX

SUBCHAPTER A.—DETERMINATION OF TAX LIABILITY

SECTION 2501.—IMPOSITION OF TAX

26 CFR 25.2501–1: Imposition of tax.

Waiver of commissions by an executor of a decedent's estate. See Rev. Rul. 66–167, page 20.

SUBCHAPTER B.—TRANSFERS

SECTION 2515.—TENANCIES BY THE ENTIRETY

26 CFR 25.2515–1: Tenancies by the entirety; in general. Rev. Rul. 66–40

> The interest held by a taxpayer in a New York cooperative apartment as a tenant-stockholder is not considered "real property" for the purposes of the exception provided in section 2515(a) of the Internal Revenue Code of 1954 to the general rules for taxing the creation of a tenancy by the entirety under the gift tax provisions.

Advice has been requested whether the transfer of a taxpayer's interest in a cooperative apartment to her husband and herself as joint tenants must be treated as a taxable gift under the circumstances described below.

Taxpayer was the tenant-owner of an interest in a cooperative apartment in New York City in which she and her husband reside. As

such, she held a specified number of shares of the common stock of the corporation which owns the building and a 25-year lease of the dwelling unit. After several years of occupancy under the lease, she transferred the stock and lease to herself and her husband as joint tenants with right of survivorship so that, in accordance with New York law, her interest in the apartment would pass to her husband by operation of law in the event of her death.

Under the provisions of section 2515(a) of the Internal Revenue Code of 1954, the creation of a tenancy by the entirety in real property either by one spouse alone or by both spouses shall not be deemed a transfer for purposes of the gift tax unless the donor elects to have such creation of a tenancy by the entirety so treated. In section 2515(d) of the Code, the term "tenancy by the entirety" is defined to include a joint tenancy between husband and wife with right of survivorship.

During calendar years prior to 1955, the contribution made by a husband or wife in the creation of a tenancy by the entirety was a taxable gift to the extent that the consideration furnished by either spouse exceeded the value of the rights retained by that spouse, such retained rights depending upon the law of the State in which the property is located. As pointed out in House Report No. 1337, 83d Congress, 2d session, at page 480, many couples who elect this method of buying a home have no intent ion of making a gift, includible for Federal gift tax purposes, at the time of the creation of the tenancy by the entirety, or any knowledge that they are considered as having done so. In order to alleviate this situation, Congress created an exception to the general rules for taxing tenancies by the entirety and joint tenancies under the gift tax by enacting section 2515 of the Code. This exception, however, is limited to the creation of tenancies by the entirety in real estate between the spouses after 1954. It does not extend to the creation of joint estates between spouses in personal property at any time.

In the field of cooperative apartment dwellings, the form of organization most commonly employed is the corporate-proprietary lease form, as typified by the instant case. Under this plan, a corporation is organized and the land and buildings conveyed to it. The corporation then leases specific apartments to its shareholders. The ownership of corporate stock, in itself, confers no right of occupancy to an apartment although the execution and continuance of a lease is dependent upon the lessee being the owner of a specified quantity of shares of the owning corporation.

Under New York law, an interest in a cooperative apartment is classed as personal property. *In re Estate of Kurt Schlesinger*, 22 Misc. (2d) 810 (N.Y. 1959) and *In re Miller's Estate*, 205 Misc. 770, (N.Y. 1954). In the case of *Miller's Estate*, the Surrogate's Court for New York County held that incorporated cooperative apartment organization stock and proprietary apartment lease, for the procurement of which stock ownership was a prerequisite, constituted personalty and did not pass by devise of "all the real estate owned by me." The court stated, "Considered separately the shares of stock and the lease each would be considered personalty for purposes of estate distribution * * *, and the fact that the stock ownership is prerequisite to the procurement of the lease would not seem to affect the legal classification of these assets."

A long line of New York decisions has consistently held that the interest of a tenant of realty under a real estate lease is not realty but is a chattel real which is personal property and not subject to tax upon real property. *Ampco Printing-Advertisers' Offset Corp., et al.* v. *City of New York*, 14 N.Y. (2d) 11 (1964); *In the Matter of Fort Hamilton Manor, Inc.* v. *Boyland, et al.*, 4 N.Y. (2d) 192 (1958); *Grumman Aircraft Engineering Corporation* v. *Board of Assessors of the Town of Riverhead, et al.*, 2 N.Y. (2d) 500 (1957); *First Trust & Deposit Co.* v. *Syrdelco, Inc., et al.*, 249 App. Div. 238 (N.Y. 1936). In the *Grumman Aircraft Engineering Corporation* case, the New York Court of Appeals stated:

> It is significant to note that nowhere in the Tax Law has the Legislature characterized a leasehold as taxable real property. Such omission is understandable, as a lease for years is deemed personalty.

In providing in section 2515(a) of the Code an exception from the gift tax provisions of the creation of tenancies by the entirety in "real property," Congress indicated in no way a modification of the concept of that term as used at common law. No special meaning is shown by the context or the history of the enactment and the regulations have not undertaken to define that term. Furthermore, as pointed out above, the New York courts have consistently held that a lease or a chattel real, although considered an interest in real property, is personalty and not within the meaning of real property as used in the statutes. A leasehold interest in a cooperative apartment is no exception to this general rule.

Accordingly, it is held that the taxpayer's interest in a cooperative apartment does not qualify under New York law as real property for purposes of the exception created under section 2515(a) of the Code to the general rules for taxing tenancies by the entirety under the gift tax provisions.

SUBTITLE C.—EMPLOYMENT TAXES

CHAPTER 21.—FEDERAL INSURANCE CONTRIBUTIONS ACT

SUBCHAPTER C.—GENERAL PROVISIONS

SECTION 3121.—DEFINITIONS

Rev. Rul. 66–74

> So-called "gratuities" collected by a club through mandatory charges added to its members' bills are service charges, rather than tips, for Federal employment tax purposes.

Advice has been requested whether amounts which a club collects through mandatory charges added to its members' bills and which it subsequently disburses to its employees with their wages may be treated by the club as tips for purposes of the Federal Insurance Contributions Act and the Collection of Income Tax at Source on Wages

(chapters 21 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The club in the instant case operates on a charge basis only and does not permit direct tipping. Its members are billed for services, and mandatory "gratuities" are added. The "gratuities" are then disbursed with the employees' wages. The club has in the past treated the "gratuities" as service charges subject to all the Federal employment taxes, including income tax withholding. The question presented requires a determination under the provisions of the Internal Revenue Code as amended by section 313 of the Social Security Amendments of 1965, Public Law 89-97, July 30, 1965, C.B. 1965-2, 601, at page 606, whether the club may now treat the "gratuities" as tips, and whether the club is thus relieved from liability for the employer taxes imposed by the Federal Insurance Contributions Act.

The Internal Revenue Service has consistently differentiated tips or gratuities paid directly and voluntarily to an employee by a customer of the employer from so-called "gratuities" which actually are mandatory charges added to a customer's bill. Under rulings heretofore published, a mandatory charge added to a bill is not a tip or gratuity.

In S.S.T. 145, C.B. 1937-1, 443, the Service held that where a club does not permit the tipping of employees but in lieu thereof adds 10 percent to the cafe charges against its members' accounts and disburses the added amounts monthly to the club's waiters, the sums so disbursed are wages. The addition of the 10 percent is an arbitrary charge set by the club which the member must pay. The amount is clearly, therefore, not a gratuity.

In Revenue Ruling 57-397, C.B. 1957-2, 628, the Service held that amounts which customers are required to pay to a hotel as service charges for using the hotel's dining facilities and which the hotel later disburses to its waiters and other employees are wages for Federal employment tax purposes. The customer has no choice in the matter, and for that reason the amount is not a tip or gratuity.

In Revenue Ruling 59-252, C.B. 1959-2, 215, the Service amplified Revenue Ruling 57-397 to state that where negotiations between a hotel and a customer for the use of the hotel's banquet facilities are not restricted to the cost of meals and beverages but also include or contemplate additional amounts for distribution to employees of the hotel, then the amounts so distributed are not tips or gratuities but are wages for Federal employment tax purposes, including income tax withholding. The Revenue Ruling stated further:

> To constitute a "tip" in the commonly accepted meaning of the term, it is inherent in the nature thereof that certain fundamental characteristics be present. It must be presented by the customer free from compulsion; he must have the unrestricted right to determine the amount thereof; and such amount should not be the subject of negotiation or dictated by employer policy. Generally, the customer has the right to determine precisely who shall be the recipient of his generosity. The absence of any of these factors creates a serious doubt as to whether the payment is really a tip and indicates that it is in fact a service charge for the use of certain facilities.

Tips or gratuities paid before 1966 directly to an employee by a customer of an employer and not accounted for by the employee to the employer, although includible in the employee's gross income, were not wages subject to the Federal employment taxes. Under section

6053(a) of the Code, an employee who receives cash tips amounting to $20 or more in any calendar month after 1965, in the course of his employment by an employer, must report the tips to the employer by furnishing one or more written statements not later than the 10th day following the month of receipt. The employer must withhold the employee taxes under the Federal Insurance Contributions Act and the income tax on the reported tips from wages of the employee (other than tips) under the employer's control or from other funds made available for this purpose by the employee. Tips received after 1965 are not subject to the employer taxes imposed by the Federal Insurance Contributions Act.

The congressional intent with respect to the treatment on and after January 1, 1966, of so-called "gratuities" which actually are service charges of the type the Service has consistently held to be wages is expressed in the Conference Report on Public Law 89–97 (H. Rept. 682, 89th Cong., C.B. 1965–2, 771, at page 778) as follows:

> Under the conference agreement, the provisions of section 313 of the bill are to apply with respect to all tips received by employees after 1965 including those which under existing law would have been covered for social security tax purposes by reason of being accounted for by the employee to the employer. The provisions of section 313 of the bill, of course, do not apply to amounts which, although denominated tips, constitute wages under present law irrespective of whether accounted for by the employee to his employer.

Under the "present law" referred to in the Conference Report (that is, the law in effect before 1966), service charges collected from members or customers and distributed before 1966 to employees are wages, and not tips, under the rulings published in S.S.T. 145 and Revenue Rulings 57–397 and 59–252, referred to above. The charges continue to be wages, and not tips, under the Code as amended by the 1965 amendments. Accordingly, the club in the instant case may not treat the "gratuities" it collects, through mandatory charges, as tips for Federal employment tax purposes, and the club is not relieved from liability for the employer taxes. The club should continue to treat these amounts as service charges which are wages subject to both the employee and employer taxes under the Federal Insurance Contributions Act, to the employer tax under the Federal Unemployment Tax Act, and to income tax withholding.

The additions and amendments made to the Code by the provisions of section 313 of the Social Security Amendments of 1965 have no effect on S.S.T. 145, Revenue Ruling 57–397 or Revenue Ruling 59–252, referred to above.

Rev. Rul. 66–75

> The Internal Revenue Service answers various questions concerning the treatment and reporting of tips under the Federal Insurance Contributions Act.

Various questions have been presented to the Internal Revenue Service relative to the treatment and reporting of tips under the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), as amended by section 313 of the Social Security Amendments of 1965, Public Law 89–97, C.B. 1965–2, 601. The questions presented and answers thereto follow:

Questions 1 and 2.—Assume that during 1966 and before the end of that year an employee has received "wages" paid by his employer

in the amount of $5,000 and has received cash tips (from customers of his employer) in the amount of $1,600. If the employer continues to pay additional wages to the employee in 1966, is the employer liable for the employer taxes on the additional payments to the employee over and above the $5,000 and up to the annual wage limitation of $6,600 during 1966? Is the employee liable for the employee taxes on these additional payments?

Answers to Questions 1 and 2.—After 1965 the term "wages", as defined in the Act, includes certain tips for purposes of the employee taxes but not for purposes of the employer taxes. Under these facts the employer incurs liability for employer taxes on the first $6,600 of wages he pays to the employee in 1966, but the tips received by the employee are not subject to the employer taxes. The employee taxes apply to the first $6,600 of wages, including tips, received by the employee (that is, the first $5,000 received from the employer and the $1,600 tips). The additional payments made by the employer are not subject to employee taxes. Stated differently, tips count against the $6,600 annual limitation of wages subject to the employee taxes, but the employer's liability for employer taxes on wages continues until wages other than tips total $6,600 for the year.

Questions 3 and 4.—3. If an employee receives $40 in cash tips directly from customers of his employer during March 1966 and reports the $40 to his employer during the first 10 days of April, should the $40 be reported by the employer in his return on Form 941, Employer's Quarterly Federal Tax Return, for the first quarter of 1966 or for the second quarter of 1966? *4.* If an employee receives $80 in tips during March 1966 and reports $50 of this amount to his employer on March 25 and reports the balance of $30 to his employer on April 9, when should the employer report these tips?

Answers to Questions 3 and 4.—Tips reported by an employee to his employer in a written statement as required by section 6053(a) of the Internal Revenue Code of 1954 are deemed to be paid to the employee at the time the written statement is furnished to the employer. (If a written statement is not furnished, the tips are deemed to be paid at the time the tips are actually received by the employee.) Under section 6053(a) of the Code, an employee who receives cash tips amounting to $20 or more in any calendar month after 1965, in the course of his employment by an employer, must report the tips to the employer by furnishing one or more written statements not later than the 10th day following the month of receipt.

In question 3 the tips received in March and reported during the first 10 days of April should be treated as paid to the employee in April. These tips should be included in the return of the employer for the second quarter of 1966.

In question 4 the $50 reported on March 25 should be treated as if paid on that date and should be included in the return of the employer for the first quarter. The balance of $30 should be treated as if paid when reported, on April 9, and should be included in the return for the second quarter.

Question 5.—This question relates to section 3121(a)(12)(B) of the Act, under which cash tips actually received by an employee in any calendar month in the course of his employment are not taxable wages unless the amount is $20 or more. Assume that in March 1966 an

employee actually receives $31 in cash tips from his employer's customers, and that in making written reports thereof to his employer as required by section 6053(a) of the Code, the employee reports $20 on March 31 and $11 on April 5. To what amount do the employee taxes apply?

Answer to Question 5.—Under these facts the employee taxes apply to the entire $31. The exclusion provided by section 3121(a)(12)(B) of the Act does not apply, because the amount of cash tips actually received in March was $31. Assuming that these were the only tips received by the employee in the course of his employment, the employer would report $20 in his return for the first quarter of 1966 and $11 in his return for the second quarter of 1966.

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26 CFR 31.3121(a)–1: Wages. Rev. Rul. 66–41
(Also Sections 61, 3306, 3401; 1.61–1, 31.3306 (b)–1, 31.3401(a)–1.)

An amount equal to an employment agency fee previously paid by an employee which is reimbursed by the employer to the employee after he has completed a specified period of satisfactory service is additional wages to the employee subject to the Federal employment taxes and is includible in gross income for Federal income tax purposes.

Advice has been requested whether an amount equal to an employment agency fee previously paid by an employee which is reimbursed by the employer to the employee after he has completed a specified period of satisfactory service is wages subject to the taxes imposed by 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), and whether the amount of the reimbursement is includible in the employee's gross income for Federal income tax purposes.

An employer recruits employees through an employment agency which charges the prospective employee a fee. The agency, on behalf of the employer, advises the prospective employee that if he satisfactorily completes a specified period of employment, the employer will reimburse him for the employment agency fee. The employee in the instant case satisfactorily completed the required period of employment and was reimbursed by his employer for the fee he had paid the agency.

The contention is made that the amount paid by the employer to the employee is reimbursement for an expense of the employer incurred by the employee in carrying on the employer's business and, therefore, excluded from wages and not subject to the Federal employment taxes.

Sections 31.3121(a)–1(h) (Federal Insurance Contributions Act), 31.3306(b)–1(h) (Federal Unemployment Tax Act), and 31.3401(a)–1(b)(2) (Collection of Income Tax at Source on Wages) of the Employment Tax Regulations provide that amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages. Reimbursement for the employment fee in the instant case, however, cannot

be considered a reimbursement within the purview of these sections. The employee incurred the expense represented by the fee before he entered upon any duties of his employment. The fee was never itself a business expense of the employer, who incurred an expense only when he reimbursed the employee.

The offer of reimbursement made by the employer through the employment agency was an offer of a special payment to be made to the employee conditioned on and in consideration for the employee continuing in employment and performing satisfactory services for a specified period of time. Reimbursing the employee for the employment agency fee was in the nature of giving him a special bonus which he earned by fulfilling those conditions. The reimbursement offer was a part of the wage structure of the contract of employment.

Accordingly, under the above circumstances, the amount equal to an employment agency fee previously paid by an employee which is reimbursed by the employer to the employee is wages subject to the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, and to the Collection of Income Tax at Source on Wages. Since this amount was paid in consideration for services rendered, it is includible in the employee's gross income as compensation for Federal income tax purposes.

The employee's liability for payment of the fee arises from a contract between the employee and the employment agency, and is independent of the conditions of employment. The fee is deductible for Federal income tax purposes by the employee from his adjusted gross income provided he itemizes his deductions. See Revenue Ruling 60–223, C.B. 1960–1, 57.

(Also Sections 3306, 3401; 31.3306(b)–1, 31.3401(a)–1.) Rev. Rul. 66–162

A concessionaire operates a leased department in a store as an independent contractor. The store considers the sales clerks in the department to be its employees and pays their salaries to them. The concessionaire also directs and controls the clerks and pays them commissions on their sales. The sales clerks are employees of both the store and the concessionaire. Therefore, the commissions paid the clerks by the concessionaire are wages for employment. The concessionaire is liable for the taxes imposed by the Federal Insurance Contributions Act, the Federal Unemployment Tax Act and the income tax withholding with respect to these "wages".

S.S.T. 154, C.B. 1937–1, 391, and S.S.T. 206, C.B. 1937–2, 451, distinguished.

Advice has been requested as to whether commissions paid by a concessionaire of a leased department in a department store to certain employees of the store are wages for purposes of the taxes imposed under the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

Under a written agreement renewed annually, a concessionaire, in consideration of his payment of a specified fee, operates a department in a department store as an independent contractor. The concessionaire directly hires, supervises, pays, and discharges all executive personnel in the department and such personnel are considered by the concessionaire and the store to be employees of the concessionaire.

The store considers the sales clerks in the leased department to be its employees. It retains the right to hire and discharge the sales clerks, and it requires them to comply with its regular procedures. The store initially pays the wages to the sales clerks, provides them with employee benefits, and reports and pays the Federal taxes with respect to these wages. The costs of all of these items are charged as expenses to the concessionaire.

In implementing the agreement, the store obtains the concessionaire's approval before engaging any individual to work in the department. Also, departmental reductions in force are within the discretion of the concessionaire and are effectuated by the store at his request.

At all times the concessionaire exercises full control in operating the department, including day-to-day direction and supervision of all employees in the department, subject to general store rules. The concessionaire instructs the sales clerks as to the qualities of the product and as to the selling methods. He pays directly to each sales clerk in the department a percentage of the clerk's total sales.

In general under the Federal Insurance Contributions Act, all remuneration for services performed by an employee for his employer is wages for employment, with exceptions not here pertinent. Since the name by which the remuneration for employment is designated is immaterial, salaries and commissions on sales are wages if paid as compensation for employment.

Thus, whether the commissions paid by the concessionaire to the sales clerks in the department are wages for employment depends upon whether the sales clerks are employees of the concessionaire.

Section 3121(d) of the Federal Insurance Contributions Act 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 whether, under such rules, an employer-employee relationship exists are found in section 31.3121 (d)-1(c) of the Employment Tax Regulations.

A person may be the servant of two masters, not joint employers, at one time and as to one act, if the service to one does not involve abandonment of the service to the other (Restatement of the Law of Agency, 2d Ed., section 226, which has been cited with approval in court cases deciding common law employer liability in the area of tort law).

The sales clerks in the leased department, whether they are employees of the store or the concessionaire, or both, are clearly employees. The store directs and controls them as to its general rules and procedures. At the same time, the concessionaire exercises the right to control and direct the activities of the sales clerks with respect to matters peculiarly pertinent to the sale of the product in order to insure the operation of the department in a manner profitable to the concessionaire. Thus, the sales clerks' services to one employer do not involve abandonment of services to the other. The store and the concessionaire act in conjunction in exercising the right of discharge.

Accordingly, the sales clerks in the leased department are employees of both the store and the concessionaire.

The commissions paid by the concessionaire to the sales clerks are directly related to the performance of services for him by his em-

ployees and are wages for employment. The concessionaire is liable for the taxes imposed by the Federal Insurance Contributions Act with respect to these "wages."

These conclusions are equally applicable for purposes of the tax imposed under the Federal Unemployment Tax Act, and for the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C of the Code).

The facts in this case are distinguishable from the facts and circumstances in both S.S.T. 154, C.B. 1937–1, 391, and S.S.T. 206, C.B. 1937–2, 451. In each of the two groups described (other than the executive officers) in S.S.T. 154, direction and control over the individuals involved were exercised solely by one company, the subsidiary in the first group, the parent corporation in the second group. In S.S.T. 206, bonuses paid by a manufacturer to the salesmen-employees of a retail dealer were not wages for employment since the usual attributes of direction and control found in an employer-employee relationship did not exist between the manufacturer and the dealer's salesmen-employees.

S.S.T. 154, C.B. 1937–1, 391, and S.S.T. 206, C.B. 1937–2, 451, distinguished.

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26 CFR 31.3121(a)(5): Statutory provisions; definitions; wages; payments from or to certain tax-exempt trusts, or under or to certain annuity plans or bond purchase plans. T.D. 6876[1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON AND AFTER JANUARY 1, 1955

Regulations relating to the Federal Insurance Contributions Act

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

In order to conform the Employment Tax Regulations (26 CFR Part 31) to section 220(c)(2) of the Revenue Act of 1964 (78 Stat. 62) [P.L. 88–272, C.B. 1964–1 (Part 2), 6] and to section 103(r)(1) of the Social Security Amendments of 1960 (74 Stat. 940) [P.L. 86–778, C.B. 1960–2, 693], relating to the taxes under the Federal Insurance Contributions Act, such regulations are amended as follows:

PARAGRAPH 1. Section 31.3121(a)(5) is amended by revising section 3121(a)(5) and by adding a historical note. These amended and added provisions read as follows:

§ 31.3121(a)(5) STATUTORY PROVISIONS; DEFINITIONS; WAGES; PAYMENTS FROM OR TO CERTAIN TAX-EXEMPT TRUSTS, OR UNDER OR TO CERTAIN ANNUITY PLANS OR BOND PURCHASE PLANS.

SEC. 3121. DEFINITIONS.

(a) WAGES.—For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include—

* * * * * * *

[1] 31 F.R. 2596.

(5) Any payment made to, or on behalf of, an employee or his beneficiary—

(A) From or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust,

(B) Under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a), or

(C) Under or to a bond purchase plan which, at the time of such payment, is a qualified bond purchase plan described in section 405(a);

[Sec. 3121(a)(5) as amended by sec. 220(c)(2), Rev. Act 1964 (78 Stat. 62) [P.L. 88-272, C.B. 1964-1 (Part 2), 6]]

PAR. 2. Section 31.3121(a)(5)-1 is amended to read as follows:

§ 31.3121(a)(5)-1 PAYMENTS FROM OR TO CERTAIN TAX-EXEMPT TRUSTS, OR UNDER OR TO CERTAIN ANNUITY PLANS OR BOND PURCHASE PLANS.—(a) *Payments from or to certain tax-exempt trusts.* The term "wages" does not include any payment made—

(1) By an employer, on behalf of an employee or his beneficiary, into a trust, or

(2) To, or on behalf of, an employee or his beneficiary from a trust, if at the time of such payment the trust is exempt from tax under section 501(a) as an organization described in section 401(a). A payment made to an employee of such a trust for services rendered as an employee of the trust and not as a beneficiary thereof is not within this exclusion from wages.

(b) *Payments under or to certain annuity plans.*—(1) The term "wages" does not include any payment made after December 31, 1962—

(i) By an employer, on behalf of an employee or his beneficiary, into an annuity plan, or

(ii) To, or on behalf of, an employee or his beneficiary under an annuity plan,

if at the time of such payment the annuity plan is a plan described in section 403(a).

(2) The term "wages" does not include any payment made before January 1, 1963—

(i) By an employer, on behalf of an employee or his beneficiary, into an annuity plan, or

(ii) To, or on behalf of, an employee or his beneficiary under an annuity plan,

if at the time of such payment the annuity plan meets the requirements of section 401(a)(3), (4), (5) and (6).

(c) *Payments under or to certain bond purchase plans.* The term "wages" does not include any payment made after December 31, 1962—

(1) By an employer, on behalf of an employee or his beneficiary, into a bond purchase plan, or

(2) To, or on behalf of, an employee or his beneficiary under a bond purchase plan,

if at the time of such payment the plan is a qualified bond purchase plan described in section 405(a).

PAR. 3. Section 31.6205 is amended by adding a paragraph (3) to section 6205(a) and by adding a historical note. These added provisions read as follows:

§ 31.6205 STATUTORY PROVISIONS; SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES.

SEC. 6205. SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES.

(a) ADJUSTMENT OF TAX. * * *

(3) GUAM OR AMERICAN SAMOA AS EMPLOYER.—For purposes of this subsection, in the case of remuneration received during any calendar year from the Government of Guam, the Government of Ameri-

can Samoa, a political subdivision of either or any instrumentality of any one or more of the foregoing which is wholly owned thereby, the Governor of Guam, the Governor of American Samoa, and each agent designated by either who makes a return pursuant to section 3125 shall be deemed a separate employer.

* * * * * * *

[Sec. 6205 as amended by sec. 103(r)(1), Social Security Amendments 1960 (74 Stat. 940) [P.L. 86-778, C.B. 1960-2, 693]]

Because the amendment made by section 220(c)(2) of the Revenue Act of 1964 merely conforms section 3121(a)(5) of the Code to sections 3306(b)(5) and 3401(a)(12) of the Code (which exclude certain payments from the definition of wages for purposes of the Federal unemployment tax and the collection of income tax at source on wages) and the amendment made by section 103(r)(1) of the Social Security Amendments of 1960 is merely supplemental to the amendment made by section 103 (n) and (q) of such Act, and does not require regulatory provisions of an interpretative nature, it is 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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved February 4, 1966.
STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on Feb. 9, 1966, 8:48 a.m., and published in the issue of the Federal Register for Feb. 10, 1966, 31 F.R. 2596)

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26 CFR 31.3121(b)-3: Employment; services performed after 1954.

Services performed in the United States by residents of Canada. See Rev. Rul. 66-77, page 242.

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26 CFR 31.3121(b)(15)-1: Services in employ of international organization.

Services performed by a United States citizen in the United States for an international organization. See Rev. Rul. 66-69, page 204.

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26 CFR 31.3121(d)-1: Who are employees. (Also Sections 1441, 3306, 3401; 1.1441-1, 1.1441-3, 31.3306(i)-1, 31.3401(c)-1.) Rev. Rul. 66-76

A and *B*, citizens of India, are in the United States receiving training under a program conducted by a United States corporation. The training covers most phases of the company's work at its plant in India at which both *A* and *B* expect to be employed after their training. It includes performing services of the same type and

under the same conditions as regular employees in the company's United States plant. *A*'s training program will last more than 2 years and *B*'s will last about 8 months. *Held*, *A* and *B* are employees of the company under the Federal Insurance Contributions Act and Federal Unemployment Tax Act with respect to these services. *A*'s wages are subject to withholding under section 3402 of the Internal Revenue Code of 1954 whereas *B*'s wages are subject to withholding under section 1441 of the Code.

Advice has been requested whether the individuals described below are employees 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, 24, respectively, subtitle C, Internal Revenue Code of 1954).

A and *B* are citizens of India who are in the United States for the purpose of receiving training under a program conducted by a United States corporation. In connection with their training, both *A* and *B* perform services at the company's plant in the United States. They are both apprentice engineers and perform the same type of services as any of the other apprentice engineers in the company's plant. They work regular hours and follow the same routine as the other engineers. The company exercises the same control and guidance over them as it does over regular employees doing the same type of work.

A is paid a monthly salary for his services. His training in the United States is expected to last at least 2 years. *B* is paid at an hourly rate for his services. His training program in the United States is expected to be of approximately 8 months duration. Before coming to the United States, *B* was employed at the company's plant in India.

Although *A* and *B* are not obligated to work at the company's plant in India following completion of their training, the fact that their training programs are directed to that end and cover most phases of the company's work at that plant indicates that they expect to do so. Neither *A* nor *B* is in the United States under an "F" or "J" visa within the meaning of section 101(a)(15) of the Immigration and Nationality Act, as amended.

Whether or not the individuals described above are employees for Federal employment tax purposes depends upon whether they have the status of employees under the usual common law rules. Guides for determining that status are found in three substantially similar sections of the Employment Tax Regulations, sections 31.3121(d)–1(c), 31.3306(i)–1, and 31.3401(c)–1.

The facts presented in this case establish that the company exercises, or has the right to exercise, such direction and control over both *A* and *B* in the performance of their services as is necessary to establish the relationship of employer and employee under the usual common law rules. Accordingly, *A* and *B* are employees of the company for purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

Considering the length and nature of *A*'s stay in the United States, in the light of the applicable regulations and the principle set forth in Revenue Ruling 54–87, C.B. 1954–1, 155, *A* is treated as a resident alien whose wages are subject to withholding under section 3402 of the Code.

On the other hand, in view of the fact that *B* intends to remain in the United States for only about 8 months, *B*'s status will be that of a nonresident alien engaged in trade or business within the United States through the performance of personal services in this country. His compensation for services performed will be fixed or determinable annual or periodical income from sources within the United States and, therefore, will be subject to withholding under section 1441 of the Code at the rate of 30 percent on the gross amount thereof. However, in computing the amount of tax to be withheld at the source, the benefit of the personal exemption of $600 may be allowed, prorated upon the basis of $1.70 per day for the period of employment during any portion of which labor or personal services are performed within the United States by such alien. See section 1.1441–3(e)(2) of the Income Tax Regulations.

CHAPTER 22.—RAILROAD RETIREMENT TAX ACT

SUBCHAPTER A.—TAX ON EMPLOYEES

SECTION 3201.—RATE OF TAX

26 CFR 31.3201–1: Measure of employee tax.

Employment tax imposed under the Railroad Retirement Tax Act with respect to compensation paid during 1966 for services rendered after 1936 and before October 1, 1965. See Rev. Proc. 66–8, page 618.

SUBCHAPTER B.—TAX ON EMPLOYEE REPRESENTATIVES

SECTION 3211.—RATE OF TAX

26 CFR 31.3211–1: Measure of employee representative tax.

Employment tax imposed under the Railroad Retirement Tax Act with respect to compensation paid during 1966 for services rendered after 1936 and before October 1, 1965. See Rev. Proc. 66–8, page 618.

SUBCHAPTER C.—TAX ON EMPLOYERS

SECTION 3221.—RATE OF TAX

26 CFR 31.3221–1: Measure of employer tax.

Employment tax imposed under the Railroad Retirement Tax Act with respect to compensation paid during 1966 for services rendered after 1936 and before October 1, 1965. See Rev. Proc. 66–8, page 618.

CHAPTER 23.—FEDERAL UNEMPLOYMENT TAX ACT

SECTION 3302.—CREDITS AGAINST TAX

26 CFR 31.3302(a)-1: Credit against tax for contributions paid.

Extension of time for filing Federal unemployment tax returns for the calendar year 1965 with certain districts. See Rev. Proc. 66-19, page 647.

SECTION 3306.—DEFINITIONS

26 CFR 31.3306(b)-1: Wages. Rev. Rul. 66-54

Tips reported after 1965 by an employee to his employer, as required by section 6053(a) of the Internal Revenue Code of 1954, are not "wages" for purposes of the tax imposed by the Federal Unemployment Tax Act unless the tips are otherwise "accounted for."

Advice has been requested whether tips reported after 1965 by an employee to his employer, as required by section 6053(a) of the Internal Revenue Code of 1954, are "accounted for" within the meaning of paragraph (j)(3) of section 31.3306(b)-1 of the Employment Tax Regulations under the Federal Unemployment Tax Act (chapter 23, subtitle C, of the Code).

Under section 6053(a) of the Code, written statements must be furnished by an employee to his employer to report tips received after 1965, if the tips are "wages" for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, of the Code) or of the Collection of Income Tax at Source on Wages (chapter 24, subtitle C, of the Code). Paragraph (j)(3) of section 31.3306(b)-1 of the regulations excludes from "wages" for purposes of the Federal unemployment tax, tips or gratuities paid directly to an employee by a customer of an employer, and not accounted for by the employee to the employer.

The mere reporting of tips by an employee to his employer pursuant to the requirements of section 6053(a) of the Code does not mean that the tips are "accounted for" as contemplated by paragraph (j)(3) of section 31.3306(b)-1 of the regulations. Accordingly, such tips are not "wages" for purposes of the Federal Unemployment Tax Act solely as a result of that reporting. For a prior ruling as to the meaning of the term "accounted for", see S.S.T. 301, C.B. 1938-1, 455.

An amount equal to an employment agency fee previously paid by an employee which is reimbursed by the employer to the employee after he has completed a specified period of satisfactory service. See Rev. Rul. 66-41, page 233.

Commissions paid by a concessionaire to sales clerks, who are employees of both the concessionaire and a department store. See Rev. Rul. 66-162, page 234.

26 CFR 31.3306(i)-1: Who are employees.

Status of foreign citizens in the United States who perform services for a United States corporation in connection with a training program conducted by the company. See Rev. Rul. 66-76, page 238.

CHAPTER 24.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 3401.—DEFINITIONS

26 CFR 31.3401(a)-1: Wages.

An amount equal to an employment agency fee previously paid by an employee which is reimbursed by the employer to the employee after he has completed a specified period of satisfactory service. See Rev. Rul. 66-41, page 233.

Commissions paid by a concessionaire to sales clerks, who are employees of both the concessionaire and a department store. See Rev. Rul. 66-162, page 234.

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26 CFR 31.3401(a)(7)-1: Remuneration for services performed by nonresident alien individuals who are residents of a contiguous country and who enter and leave the United States at frequent intervals. (Also Sections 1441, 3121; 1.1441-4, 31.3121 (b)-3.) Rev. Rul. 66-77

Remuneration paid to residents of Canada who are not citizens of the United States and who, in performing services as truck drivers, enter and leave the United States at frequent intervals, is not subject to income tax withholding under section 1441 or section 3402 of the Internal Revenue Code of 1954. Such remuneration is subject to the taxes under the Federal Insurance Contributions Act.

Advice has been requested whether the remuneration paid by a Canadian employer to its truck driver employees who are not citizens of the United States and who are residents of Canada, for services performed in the United States, is subject to Federal income tax withholding under either section 1441 or section 3402 of the Internal Revenue Code of 1954 and to the taxes under the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

In performing services as truck drivers for the Canadian employer, the employees enter and leave the United States at frequent intervals. Consequently, income tax withholding from their remuneration is not required under section 1441 of the Code, in view of the provisions of section 1441(c)(4)(A) of the Code and section 1.1441-4(b)(1) of the Income Tax Regulations. Under this section of the regulations, the salary or other compensation for personal services of a nonresident

alien individual who is a resident of Canada or Mexico and who enters and leaves the United States at frequent intervals is not subject to income tax withholding under section 1441 of the Code.

Section 3401(a)(6) of the Code excepts from "wages," for purposes of income tax withholding under section 3402 of the Code, remuneration paid for services performed by a nonresident alien individual, other than a resident of a contiguous country who enters and leaves the United States at frequent intervals. Section 3401(a)(7) of the Code excludes from "wages" remuneration paid for such services, performed by a nonresident alien individual who is a resident of a contiguous country and who enters and leaves the United States at frequent intervals, as may be designated by regulations.

Section 31.3401(a)(7)-1(a) of the Employment Tax Regulations provides, in part, as follows:

> * * * Remuneration paid to nonresident aliens who are residents of a contiguous country (Canada or Mexico) and who, in the performance of their duties in transportation service between points in the United States and points in a contiguous country, enter and leave the United States at frequent intervals, is excepted from wages and hence is not subject to withholding. This exception applies to personnel engaged in railroad, bus, ferry, steamboat, and aircraft services and applies whether the employer is a domestic or foreign entity. * * *

Although section 31.3401(a)(7)-1(a) of the regulations states that the exception from wages applies to personnel engaged in railroad, bus, ferry, steamboat, and aircraft services, and does not specifically mention truck services, the reference to the specified services is merely illustrative of the types of transportation services included in the exception and does not exclude truck services.

Accordingly, remuneration paid to residents of Canada who are not citizens of the United States and who, in performing services as truck drivers, enter and leave the United States at frequent intervals, is not subject to withholding of income tax under section 3402 of the Code. This conclusion does not mean that such aliens are never subject to United States income tax or to a duty to file United States income tax returns, as to which see section 871(c) of the Code and Article VII of the Tax Convention between the United States and Canada as amended by Supplementary Convention signed August 8, 1956, C.B. 1957-2, 1014.

The taxes under the Federal Insurance Contributions Act apply to "wages" for "employment," as those terms are defined in the Act. Under section 3121(b) of the Act the term "employment," with certain exceptions not here material, includes services performed within the United States by an employee for the person employing him, irrespective of the citizenship or residence of either. Accordingly, the remuneration paid to residents of Canada who are not citizens of the United States, for the services which they perform as truck drivers in the United States is subject to the taxes under the Act.

See also Revenue Ruling 56-609, C.B. 1956-2, 1066, concerning Federal Insurance Contributions Act tax liability of other Canadian employees performing services in the United States.

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26 CFR 31.3401(c)–1: Employee.

Status of foreign citizens in the United States who perform services for a United States corporation in connection with a training program conducted by the company. See Rev. Rul. 66–76, page 238.

SECTION 3402.—INCOME TAX COLLECTED AT SOURCE

26 CFR 31.3402(d)–1: Failure to withhold. Rev. Rul. 66–113
(Also Section 6651; 301.6651–1.)

Revenue Ruling 58–577, C.B. 1958–2, 744, dealt primarily with the assessment of interest against an employer, who fails to deduct and withhold tax from the wages of an employee as required under section 3402 of the Internal Revenue Code of 1954, where the employee subsequently files an income tax return and satisfies his income tax liability. Though the factual situation with respect to which the ruling was issued did not involve the possible application of section 6651 of the Code pertaining to delinquency penalties, the Revenue Ruling was expanded to state a general rule for computation of such a penalty. Since the question was not involved and the rule stated was erroneous, Revenue Ruling 58–577 is hereby modified to eliminate all reference to penalties except that contained in the paragraph quoting the provisions of section 3402(d) of the Code.

Where a delinquency penalty is to be assessed against an employer under section 6651 of the Code for failure to file the required return, Form 941, Employer's Quarterly Federal Tax Return, and the provisions of section 3402(d) of the Code are applicable, such penalty should be computed from the due date of the return to the date it is filed.

Revenue Ruling 58–577 is hereby modified.

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26 CFR 31.3402(g)–1: Supplemental wage payments. T.D. 6882[1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON AND AFTER JANUARY 1, 1955

Amendment of employment tax regulations relating to the withholding of income tax from supplemental wage payments

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

In order to prescribe a flat percentage rate which, under certain circumstances, may be used by employers in determining the amount of

[1] 31 F.R. 5661.

income tax to be withheld under section 3402(a) of the Internal Revenue Code of 1954, as amended by section 101(a) of the Tax Adjustment Act of 1966 (80 Stat. 38) [P.L. 89-368, page 379, this Bulletin], from supplemental wage payments made after April 30, 1966, the Employment Tax Regulations (26 CFR Part 31) are amended as follows:

Section 31.3402(g)-1 is amended by revising subparagraph (2) of paragraph (a) and the example in subparagraph (1) of paragraph (b). These revised provisions read as follows:

§ 31.3402(g)-1 SUPPLEMENTAL WAGE PAYMENTS.

(a) *In general.* * * *

(2) The supplemental wages, if paid concurrently with wages for a payroll period, shall be aggregated with the wages paid for such payroll period. If not paid concurrently, the supplemental wages shall be aggregated with the wages paid or to be paid within the same calendar year for the last preceding payroll period or for the current payroll period. The amount of tax to be withheld shall be determined as if the aggregate of the supplemental wages and the regular wages constituted a single wage payment for the regular payroll period.

Example (1). A, a single person, is employed as a salesman at a monthly salary of $130 plus commissions on sales made during the month. The number of withholding exemptions claimed is one. During May 1966 A earns $300 in commissions, which together with the salary of $130 is paid on June 10, 1966. Under the wage bracket method the amount of the tax required to be withheld is shown in the table applicable to a monthly payroll period with respect to an employee who is not married. Under this table it will be found that the amount of tax required to be withheld is $58.40.

Example (2). B, a married person, is employed at a salary of $3,600 per annum paid semimonthly on the 15th day and the last day of each month, plus a bonus and commission determined at the end of each 3-month period. The bonus and commission for the 3-month period ending on September 30, 1966, amount to $250, which is paid on October 10, 1966. B has in effect a withholding exemption certificate on which he claimed four withholding exemptions and disclosed that he is married. Under the wage bracket method, the amount of tax required to be withheld on the aggregate of the bonus of $250 and the last preceding semimonthly wage payment of $150, or $400, is shown in the table applicable to a married person with a semimonthly payroll period to be $44.50. However, since tax in the amount of $3.50 was withheld on the semimonthly wage payment of $150, the amount to be withheld on October 10, 1966, is $41.00.

If, however, supplemental wages are paid and tax has been withheld from the employee's regular wages, the employer may determine the tax to be withheld—

(i) From supplemental wages paid prior to May 1, 1966, by using the rate in effect under section 3402(a) at the time the wages are paid, and

(ii) From supplemental wages paid after April 30, 1966, by using a flat percentage rate of 20 percent,

without allowance for exemption and without reference to any regular payment of wages.

* * * * * * *

(b) *Special rule where aggregate withholding exemption exceeds wages paid.* (1) * * *

Example. An employee has a weekly payroll period ending on Saturday of each week, the wages for which are paid on Friday of the succeeding week. On the 10th day of each month he is paid a bonus based upon production during the payroll periods for which wages were paid in the preceding month. The employee is paid a weekly wage of $64 on each of the five Fridays occurring in July 1966. On August 10, 1966, the employee is paid a bonus of $125 based upon production during the five payroll periods covered by the wages paid in July. On the date of payment of the bonus, the employee, who is married and has three children, has a withholding exemption certificate in effect indicating that he is

married and claiming five withholding exemptions. The amount of the tax to be withheld from the bonus paid on August 10, 1966, is computed as follows:

Wages paid in July 1966 for 5 payroll periods (5×$64)	$320.00
Bonus paid August 10, 1966	125.00
Aggregate of wages and bonus	$445.00
Average wage per payroll period ($445÷5)	89.00
Computation of tax under percentage method: Withholding exemptions (5×$13.50)	67.50
Remainder subject to tax	$21.50
Tax on average wage for 1 week under percentage method of withholding (married person with weekly payroll period) (14 percent of $17.50 (excess over $4))	$2.45
Tax on average wage for 5 weeks	$12.25
Less: Tax previously withheld on weekly wage payments of $64	None
Tax to be withheld on supplemental wages	$12.25
Computation of tax under wage bracket method: Tax on $89 wage under weekly wage table for married person ($2.50 per week for 5 weeks)	$12.50
Less: Tax previously withheld on weekly wage payments of $64	None
Tax to be withheld on supplemental wages	$12.50

* * * * * * *

Because this Treasury Decision amends existing regulations merely to prescribe, consistent with congressional intent as reflected in House of Representatives Report No. 1285 (89th Cong.) page 14, [page 436 this Bulletin], and Senate Report No. 1010 (89th Cong.) page 15 [page 476 this Bulletin], a flat percentage rate of 20 percent which may be used, under certain circumstances, in respect of supplemental wage payments made after April 30, 1966, and to revise certain examples to reflect the amount of income tax to be withheld from wages under the graduated withholding rates contained in section 3402 of the Internal Revenue Code of 1954, as amended by section 101 of the Tax Adjustment Act of 1966, effective in respect of wages paid after April 30, 1966, and because of the urgent need of employers to be informed of such flat percentage rate, it is found that it is unnecessary and impracticable 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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved April 6, 1966.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on April 11, 1966, 8:46 a.m., and published in the issue of the Federal Register for April 12, 1966, 31 F.R. 5661)

SUBTITLE D.—MISCELLANEOUS EXCISE TAXES

CHAPTER 31.—RETAILERS EXCISE TAXES

SUBCHAPTER E.—SPECIAL FUELS

SECTION 4041.—IMPOSITION OF TAX

26 CFR 48.4041–6: Dual use of taxable liquid. T.D. 6881 [1]

(Also Section 6421; 48.6421(a)–1.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 48.—MANUFACTURERS AND RETAILERS EXCISE TAXES

Diesel fuel, special motor fuels and gasoline sold for use or used in certain immobilized vehicles.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

On November 30, 1965, notice of proposed rulemaking with respect to the amendments of the Manufacturers and Retailers Excise Tax Regulations (26 CFR Part 48) under sections 4041 and 6421 of the Internal Revenue Code of 1954 to provide rules with respect to diesel fuel, special motor fuels, and gasoline sold for use or used in certain vehicles during periods when they are considered as not having the essential characteristics of motor vehicles and to provide rules for the allocation of fuel used was published in the Federal Register (30 F.R. 14809). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendments of the regulations are hereby adopted.

PARAGRAPH 1. Section 48.4041–6 is amended to read as follows:

§ 48.4041–6 DUAL USE OF TAXABLE LIQUID.—Tax applies to all taxable liquid sold for use or used as a fuel in the motor which is used to propel a diesel-powered highway vehicle or in the motor used to propel a motor vehicle, motorboat, or airplane, even though the motor is also used for a purpose other than the propulsion of the vehicle. Thus, where the motor of a diesel-powered highway vehicle or of a motor vehicle, motorboat, or airplane operates special equipment by means of a power takeoff or power transfer, tax applies to all taxable liquid sold for such use or so used, whether or not the special equipment is mounted on the vehicle. For example, tax applies to diesel fuel sold to operate the mixing unit on a concrete mixer truck if the mixing unit is operated by means of a power takeoff from the motor of the vehicle. Similarly, tax applies to all taxable liquid sold for use or used in a motor propelling a fuel oil truck even though the same motor is used to operate the pump (whether or not mounted on the truck) for discharging the fuel into customers' storage tanks. However, tax does not apply to liquid sold for use or used in a separate motor to operate special equipment (whether or not the equipment is mounted on the vehicle), nor does it apply during the period a vehicle is considered as not having the essential characteristics of a motor vehicle (see paragraph (c)(2) of § 48.4041–7). If

[1] 31 F.R. 5491.

the taxable liquid used in a separate motor or during the period the vehicle does not have the essential characteristics of a motor vehicle is drawn from the same tank as the one which supplies fuel for the propulsion of the vehicle, a reasonable determination of the quantity of taxable liquid used in such separate motor or during such period will be acceptable for purposes of application of the tax. Such determination must be based, however, on the operating experience of the person using the taxable liquid and the taxpayer must maintain records which will support the allocation used. Devices to measure the number of miles the vehicle has traveled, such as hubometers, may be used in making a preliminary determination of the number of gallons of fuel used to propel the vehicle. In order to make a final determination of the number of gallons of fuel used to propel the vehicle, there must be added to this preliminary determination the amount of fuel consumed while idling or warming up the motor preparatory to propelling the vehicle.

PAR. 2. Paragraph (c) of § 48.4041–7 is amended to read as follows:

§ 48.4041–7 DEFINITIONS.

* * * * * * *

(c) *Motor vehicles.*—(1) *In general.*—The term "motor vehicle" includes all types of vehicles propelled by motor which are designed for carrying loads from one place to another, regardless of the type of load or material carried and whether or not the vehicle is registered or required to be registered for highway use, such as forklift trucks used to carry loads at railroad stations, industrial plants, warehouses, etc. The term does not include farm tractors, trench diggers, power shovels, bulldozers, road graders or rollers, and similar equipment which does not carry a load; nor does it include any vehicle which moves exclusively on rails.

(2) *Temporary loss of classification as a motor vehicle.*—(i) A vehicle on which equipment or machinery having a specialized use (as for example specialized oil-field machinery) is mounted and which (except for the provisions of this subparagraph) would be considered a motor vehicle under subparagraph (1) of this paragraph shall not be considered a motor vehicle during a period in which it does not have the essential characteristics of a motor vehicle. Such vehicle will be considered as not having the essential characteristics of a motor vehicle during the period the vehicle is incapable of motion and the equipment or machinery is performing the operation for which it is primarily adapted if—

(*a*) The primary use of such equipment or machinery is other than in connection with the loading, unloading, handling, preserving, or otherwise caring for any cargo transported on the vehicle,

(*b*) A "setting-up" process involving the expenditure of a substantial amount of time and effort is necessary to place the vehicle in such an immobilized and operative condition,

(*c*) After expending the necessary substantial time and effort the vehicle has the essential characteristics of an immobile piece of equipment or machinery designed for a specialized use, and

(*d*) A "break-down" process involving a substantial amount of time and effort is required to restore the vehicle to a mobile condition.

After the "break-down" process described in (*d*) of this subdivision is completed and mobility restored, the vehicle shall again be considered a motor vehicle within the meaning of subparagraph (1) of this paragraph. The mere fact that a vehicle is rendered immobile by the switching or pulling of a lever, such as a handbrake or power takeoff (with or without accompanying minor adjustments to the vehicle), in order to perform the operation for which the vehicle is primarily adapted is not sufficient to cause the temporary loss of classification as a motor vehicle since a substantial expenditure of time and effort is not involved and the vehicle has not attained the essential characteristics of an immobile piece of equipment or machinery designed for a specialized use.

(ii) The provisions of subdivision (i) of this subparagraph may be illustrated by the following example:

Example. (*a*) The X Company which is engaged in the oil well servicing business uses a motor vehicle which is primarily adapted to oil well servicing. On June 1, 1965, X Company moves the motor vehicle from its permanent

yard and travels to a wellhead which is to be serviced. At the wellhead, it is necessary to go through a "setting-up" process before the vehicle is capable of servicing the oil well. This process requires that a derrick-mast be erected and four guy wires attached to the top of the mast and four to the middle of the mast. The guy wires are then hooked to dead-man anchors which are set into the ground. Hydraulic jacks are used to remove all of the weight of the mast from the rear wheels of the vehicle and the front end of the vehicle is jacked up in order to insure the correct pitch of the mast. Outriggers are attached to the bottom of the mast and are laid on the ground to insure further stability. These operations are essential in order that the mast be secure and level over the wellhead and, when completed, the vehicle is incapable of movement. Three men perform this "setting-up" process in 2 hours and complete such process at noon on June 1, 1965, at which time the oil-well-servicing equipment is operative. The power used for operating the special equipment needed to service the oil well is obtained by means of a power transfer from the same motor which is used to propel the vehicle. The vehicle remains at the wellhead until June 10, 1965, at which time the servicing operations are completed. It takes three men 1½ hours to "break-down" the unit and to restore the vehicle to a mobile condition. The "break-down" process is completed at noon on such date.

(*b*) It can be ascertained from the facts that it was necessary to expend a substantial amount of time and effort to place the vehicle in an immobilized condition and to place the equipment in an operative condition, and after expending such time and effort, the vehicle possessed the essential characteristics of an immobile piece of equipment designed for oil well servicing. Furthermore, the "break-down" process also involves substantial time and effort to return the vehicle to a mobile condition and to render the oil-well-servicing equipment inoperative. Accordingly, from noon on June 1, 1965, until noon on June 10, 1965, the vehicle is not considered a motor vehicle. At all other times, such vehicle is considered a motor vehicle.

* * * * * * *

PAR. 3. Section 48.6421(a)–1 is amended by revising paragraphs (c)(1) and (d). These revised provisions read as follows:

§ 48.6421(a)–1 PAYMENTS TO ULTIMATE PURCHASER OF GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES.

* * * * * * *

(c) *Meaning of terms.*—(1) *Highway vehicles.*—The term "highway vehicle" has reference to the type of vehicle and not to the use which is made of the vehicle. The term means any vehicle which is propelled by its own motor or engine and which is of the type used for highway transportation. Such term does not include any vehicle which moves exclusively on rails. It does include automobiles, trucks, buses, highway tractors, trolley buses, and other similar type vehicles. The term "highway vehicle" does not include any vehicle, which, although propelled by means of its own motor, is of a type not used for highway transportation, that is, of a type designed and manufactured for a purpose other than highway transportation. For example, vehicles such as earth movers, power shovels, trench diggers, and bulldozers, which are designed and manufactured as self-propelled units for "off-the-road" operations, are not highway vehicles. Neither are such motorized vehicles as road graders or rollers, which are designed and manufactured for construction or maintenance of roads, considered to be highway vehicles. The same is true of farm tractors, cotton pickers, and other motorized agricultural implements of a similar nature. However, the fact that equipment or machinery having a specialized use (as for example, an air compressor, crane, or specialized oil-field machinery) is mounted on a vehicle which, apart from such equipment or machinery, is of a type used for highway transportation will not remove such vehicle from classification as a highway vehicle. A vehicle will not be considered a "highway vehicle" during the period it does not have the essential characteristics of a motor vehicle, such determination being made under the rules applicable for vehicles powered by diesel fuel and special motor fuels as set forth in paragraph (c)(2) of § 48.4041–7.

* * * * * * *

(d) *Dual use of gasoline.*—No payment shall be made in respect of gasoline used in a highway vehicle solely by reason of the fact that the motor in such vehicle is also used for a purpose other than the propulsion of the vehicle. Thus, if the motor of a highway vehicle operates special equipment, such as a mixing unit on a concrete mixer truck, or a pump for discharging fuel from a tank truck, by means of a power takeoff or power transfer, no payment shall be made in respect of the gasoline used to operate such special equipment, regardless of whether or not the special equipment is mounted on the highway vehicle. However, if a highway vehicle is equipped with a separate motor to operate the special equipment, such as a refrigeration unit, pump, generator, mixing unit, etc., or if for a period a vehicle is considered as not having the essential characteristics of a highway vehicle under paragraph (c)(1) of this section (as determined under paragraph (c)(2) of § 48.4041–7), a claim may be filed in respect of the gasoline used in the separate motor or during such period. In those cases where the gasoline used in a separate motor or during such period is drawn from the same tank as the one which supplies gasoline for the propulsion of the vehicle, the determination as to the quantity of gasoline used in the separate motor operating the special equipment or during such period must be based on operating experience and supported by records. Devices to measure the number of miles the vehicle has traveled, such as hubometers, may be used in making a preliminary determination of the number of gallons of gasoline used to propel the vehicle. In order to make a final determination of the number of gallons of gasoline used to propel the vehicle, there must be added to this preliminary determination the number of gallons of gasoline consumed while idling or warming up the motor preparatory to propelling the vehicle.

(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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved April 1, 1966.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on April 6, 1966, 8:48 a.m., and published in the issue of the Federal Register for April 7, 1966, 31 F.R. 5491)

CHAPTER 32.—MANUFACTURERS EXCISE TAXES

SUBCHAPTER A.—AUTOMOTIVE AND RELATED ITEMS

PART I.—MOTOR VEHICLES

SECTION 4061.—IMPOSITION OF TAX

26 CFR 48.4061(a)–1: Imposition of tax. Rev. Rul. 66–61

Truck chassis, designed to be equipped with high pressure pumping equipment for use in furnishing pumping services in oil fields, are subject to the tax imposed by section 4061(a)(1) of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax on motor vehicle articles to sales by the manufacturer of the truck chassis described below.

Pursuant to contracts with an oil well pumping service company, a manufacturer produces certain truck chassis designed to be equipped

with high pressure pumping equipment. The company uses the high pressure pumps at oil well sites for such services as cementing casing in the hole, fracturing or acidizing oil-bearing sands, killing wells out of control, etc.

The truck chassis in question resemble more conventional truck chassis to the extent they are equipped with pneumatic tires, standard lights, and a cab of conventional design. However, these chassis incorporate certain other features which distinguish them from conventional truck chassis. Such features include a reinforced frame with specially located cross-members to accommodate the high pressure pumping equipment, an oversized diesel truck engine to generate sufficient power for operating pump equipment, a heavy-duty power transmission or torque converter with specially designed hydraulic power take-off driving system, a cooling system which cools not only engine oil and water but also the hydraulic system of the transmission or converter, and a fireproof exhaust system.

In addition to the above features, the truck chassis are so designed as to remain within the maximum size and weight limitations established with respect to highway use under the laws of the various States in which the purchaser plans to use the vehicles. Among these are gross vehicle weight ratings of 45,000 pounds and under, front axle capacities of 13,000 to 16,000 pounds, and tandem rear axle capacities of 30,000 to 34,000 pounds. Such features are necessary because the nature of the purchaser's business requires that its service vehicles be available for prompt dispatch from service point to well site or from one oil field to another. Otherwise, the company would be required to obtain special permits for each movement of the vehicles over the highways, resulting in undesirable delays.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated articles, including automobile truck chassis.

Section 48.4061(a)-1(d) of the Manufacturers and Retailers Excise Tax Regulations provides that a chassis or body specified in section 4061(a) of the Code which is not designed for highway use is not subject to the tax imposed by section 4061(a) of the Code.

Revenue Ruling 57-440, C.B. 1957-2, 721, holds, in part, that the manufacturers excise tax imposed by section 4061(a)(1) of the Code shall not apply to sales by the manufacturer, producer, or importer of any article, regardless of width, which is designed or adapted by the manufacturer for purposes predominantly other than the transportation of persons or property on the highway even though incidental highway use may occur.

The truck chassis in the instant case have certain features (such as reinforced frames, oversized engines, special cooling systems, etc.) which indicate they are designed and suitable for use off the highway. However, the chassis also have features (such as conventional cabs, pneumatic tires, gross weight ratings, and standard lights which are required for highway travel) which indicate they are designed and suitable for more than incidental use on the highway. Therefore, these chassis are concluded to be designed for general use both on and off the highway, rather than for purposes predominantly other than for highway use.

Accordingly, it is held that the manufacturers excise tax imposed by section 4061(a)(1) of the Code applies to the sale by the manufacturer of the automobile truck chassis described above.

(Also Section 4218; 48.4218–5.) Rev. Rul. 66–66 [1]

Revenue Ruling 65–317, C.B. 1965–2, 422, holds that a resident of the United States who purchases a foreign-made automobile under described conditions is the importer of the vehicle for purposes of imposition of the manufacturers excise tax under sections 4061(a)(2) and 4218(a) of the Internal Revenue Code of 1954. *Held*, the tax base applicable in computing the manufacturers excise tax liability on the use of an automobile by an importer under the circumstances described in Revenue Ruling 65–317 is the total cost of acquisition of the vehicle at the time of taxable use. Such total cost includes, in addition to the purchase price of the vehicle, import duties, customs handling fees, ocean freight, agents' or sales commissions, and any other costs of acquiring the vehicle.

Revenue Ruling 65–317 is hereby amplified.

(Also 48.4061(b)–1.) Rev. Rul. 66–163

Certain articles designed to be mounted or placed upon automobile pickup trucks and used as living quarters are not subject to the manufacturers excise tax on automobile truck bodies imposed by section 4061(a)(1) of the Internal Revenue Code of 1954, or on automobile parts or accessories imposed by section 4061(b)(1) of the Code.

Revenue Ruling 60–39, C.B. 1960–1, 406, modified.

The Internal Revenue Service has reconsidered Revenue Ruling 60–39, C.B. 1960–1, 406, as it relates to certain articles variously referred to as "slide-in cabins" or "pickup coaches," etc., designed to be mounted or placed upon pickup trucks, and described in *situations* (1) and (2) of that ruling. These articles are intended to be used as temporary or long-term living quarters and are usually equipped for sleeping and eating purposes. Revenue Ruling 60–39 held these articles to be taxable under section 4061(a)(1) of the Internal Revenue Code of 1954, as automobile truck bodies.

Section 4061(a)(1) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of certain enumerated motor vehicle articles. Included in this enumeration are 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 (other than tires or inner tubes) for any of the articles enumerated in section 4061(a) of the Code.

In the case of *King Trailer Company* v. *United States*, 350 Fed. (2d) 947 (1965), the United States Court of Appeals for the 9th Circuit affirmed a District Court decision holding "pickup coaches" are neither truck bodies nor truck parts or accessories. The Service recognizes this decision as a precedent in the disposition of other cases involving such articles.

Revenue Ruling 60–39 is hereby modified.

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[1] Also released as Technical Information Release 803, dated Feb. 28, 1966.

26 CFR 48.4061(b)–1: Imposition of tax. Rev. Rul. 66–164

Lifting jacks specially designed for use in mounting and dismounting a "slide-in cabin" on or off a pickup automobile truck are not subject to manufacturers excise tax under section 4061(b) of the Internal Revenue Code of 1954.

Revenue Ruling 64–139, C.B. 1964–1 (Part 1), 373, revoked.

Revenue Ruling 64–139, C.B. 1964–1 (Part 1), 373, provides that lifting jacks which are designed for use in mounting or dismounting a "slide-in cabin" on or off a pickup truck are automobile "parts or accessories" as defined by section 48.4061(b)–2(a) of the Manufacturers and Retailers Excise Tax Regulations and are subject to manufacturers excise tax imposed by section 4061(b) of the Internal Revenue Code of 1954, when sold by the manufacturer.

However, Revenue Ruling 66–163, page 252, this Bulletin, recognizes that "slide-in cabins" of the type referred to in Revenue Ruling 64–139 are not taxable as automobile truck bodies under section 4061(a)(1) of the Code. It follows that lifting jacks specially designed for use only with such nontaxable "slide-in cabins" are not subject to the tax imposed upon "parts or accessories" by section 4061(b) of the Code.

Revenue Ruling 64–139 is hereby revoked.

Whether certain articles designed to be mounted or placed upon automobile pickup trucks and used as living quarters are subject to the manufacturers excise tax on automobile parts or accessories. See Rev. Rul. 66–163, page 252.

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26 CFR 48.4061(b)–2: Definition of parts or accessories. Rev. Rul. 66–165

Electric signs designed to be attached to automobile truck bodies or other bodies of the type subject to tax under section 4061(a)(1) of the Internal Revenue Code of 1954, to advertise articles or services, are not taxable "parts or accessories" under section 4061(b).

Advice has been requested concerning the applicability of the manufacturers excise tax to manufacturers' sales of the electric signs described below.

A company manufactures and sells signs designed to be attached to automobile truck bodies or other bodies which are subject to tax under section 4061(a)(1) of the Internal Revenue Code of 1954. These signs are usually installed on top of truck or other bodies to advertise services or products. The signs are of plexiglas construction for either long-term or temporary installation. They may be wired to accommodate 6-volt, 12-volt, or 110-volt electrical systems and come equipped with switches, fuses, and wire. The plexiglas is available in a number of colors and cut plastic letters of the customers' specifications.

Section 4061(b) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories (other than tires and inner tubes) for any of the articles enumerated in section 4061(a)(1) of the Code.

In *Howard H. Smith* v. *Joseph T. McDonald*, the United States Court of Appeals for the 3d Circuit, 214 Fed. (2d) 920 (1954), held that an electrically illuminated sign designed to be attached by suction cups to the tops of taxicabs was not an automobile part or accessory as contemplated by the law.

It is held that sales by manufacturers of signs designed to be installed on vehicles for advertising purposes are not subject to the manufacturers excise tax imposed by section 4061(b) of the Code on "parts or accessories."

SUBCHAPTER D.—RECREATIONAL EQUIPMENT

PART I.—SPORTING GOODS

SECTION 4161.—IMPOSITION OF TAX

26 CFR 48.4161–1: Imposition and rate of tax. Rev. Rul. 66–154

A company places in boxes and sells kits containing various components sufficient to make a given number of wooden plug fishing lures. The company also imports and sells similar kits containing the same variety of components. Included in the kits are such components and materials as preshaped wooden bodies, screw eyes, washers, hooks, clear lacquer, and propellers, which may be assembled to form completed fishing lures.

Certain articles of fishing equipment, including "artificial lures, baits, and flies," are subject to the manufacturers excise tax imposed by section 4161 of the Internal Revenue Code of 1954, when sold by the manufacturer, producer, or importer.

Held, the kits of artificial fishing lures in knockdown condition described above come within the scope of section 4161 of the Code and are subject to the manufacturers excise tax imposed by that section when sold by the company. See Revenue Ruling 61–189, C.B. 1961–2, 185, which holds that sales of kits containing the components required for assembling artificial flies are subject to the tax imposed by section 4161 of the Code.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO MANUFACTURERS TAX

SECTION 4216.—DEFINITION OF PRICE

26 CFR 48.4216(f)–1: Exclusion of local advertising charge from sale price. Rev. Rul. 66–42

A weekly publication in the format of a newspaper which contains articles only of interest to the taxicab industry does not qualify as a "newspaper" or a "magazine" within the meaning of section 4216(f)(4) of the Internal Revenue Code of 1954. Therefore, in determining the manufacturer's sale price of automobiles for pur-

poses of computing manufacturers excise tax, the manufacturer may not exclude charges for advertising by a dealer in the publication.

Advice has been requested whether, in determining a manufacturer's sale price for purposes of computing manufacturers excise tax, there may be excluded the expenditure for advertising in the publication described below.

A dealer selling new taxicabs advertises the articles in a taxicab publication issued weekly in the format of a newspaper. The publication is distributed to subscribers in a local area at an annual rate or at a specified price per copy. Examination of a representative issue of the publication discloses articles pertaining to parking and the traffic situation, information regarding a pending taxicab fare increase, articles dealing with public transportation in the municipality, stories of taxicab drivers being cited for honesty or bravery, information as to possible points of interest to riders, information regarding items of equipment, letters to the editor and editorial comment directed to the taxicab industry, etc.

Section 4216(f)(1) of the Internal Revenue Code of 1954 provides that in determining, for purposes of computing manufacturers excise tax, the price for which an article is sold, there shall be excluded certain charges for local advertising.

Under the provisions of section 4216(f)(4) of the Code, the term "local advertising" means, in part, advertising which is broadcast over a radio or television station or appears in a newspaper or magazine, or is displayed by means of an outdoor advertising sign or poster.

Section 48.4216(f)-1(b)(5) of the Manufacturers and Retailers Excise Tax Regulations provides as follows:

The term "newspaper", as used in subparagraph (1) of this paragraph, is limited to those publications which are commonly understood to be newspapers and which are printed and distributed periodically at daily, weekly, or other short intervals for the dissemination of news of a general character and of a general interest. The term does not include handbills, circulars, flyers, or the like, unless printed and distributed as a part of a publication which constitutes a newspaper within the meaning of this subparagraph. Neither does the term include any publication which is issued to supply information on certain subjects of interest to particular groups, unless such publication otherwise qualifies as a newspaper within the meaning of this subparagraph. For purposes of this subparagraph, advertising is not considered to be news of a general character and of a general interest.

Section 48.4216(f)-1(b)(6) of the regulations limits the term "magazine" to those publications which are (1) commonly understood to be magazines, (2) printed and distributed periodically at least twice a year, and (3) published for the dissemination of information of a general nature or of special interest to particular groups.

The above-described publication disseminates only news of special interest to members of a group engaged in a particular business or occupation. Therefore, the publication is not a "newspaper" within the meaning of the regulations because it does not disseminate news of a general character and of a general interest. Furthermore, the publication is not a "magazine" within the meaning of the regulations because it is not a publication of the type commonly understood to be a magazine.

Accordingly, in determining the manufacturer's sale price of automobiles for purposes of computing the manufacturers excise tax, the

manufacturer may not exclude charges made for advertising by its dealer in the publication described.

SECTION 4218.—USE BY MANUFACTURER OR IMPORTER CONSIDERED SALE

26 CFR 48.4218–5: Computation of tax.

Tax base used for computation of manufacturers excise tax on imported vehicles. See Rev. Rul. 66–66, page 252.

CHAPTER 33.—FACILITIES AND SERVICES

SUBCHAPTER C.—TRANSPORTATION OF PERSONS BY AIR

SECTION 4261.—IMPOSITION OF TAX

26 CFR 49.4261–1: Imposition of tax; in general.

Exemption from the tax on transportation of persons by air of amounts paid by the Department of Defense to Military Air Transport Service contract and charter carriers. See Secretary's Authorization, page 586.

CHAPTER 34.—DOCUMENTARY STAMP TAXES

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

26 CFR 47.4321–1: Imposition of tax. (Also Section 4331; 47.4331–1.) Rev. Rul. 66–2 [1]

> The Internal Revenue Service answers three questions concerning the applicability of section 401 of the Excise Tax Reduction Act of 1965, which repealed the documentary stamp taxes on the issue and transfer of shares of stock and certificates of indebtedness, effective January 1, 1966.

Three questions have been presented to the Internal Revenue Service relative to the applicability of the documentary stamp taxes imposed by sections 4321 and 4331 of the Internal Revenue Code of 1954

[1] Also released as Technical Information Release 788, dated Dec. 22, 1965.

on the transfer of shares of stock and certificates of indebtedness, in the light of the repeal of these taxes by section 401 of the Excise Tax Reduction Act of 1965, Public Law 89–44, C.B. 1965–2, 568.

Question 1.—Shares of stock and a corporate bond are sold through a stockbroker on December 31, 1965. The recording of the transfer and the delivery of the certificates are accomplished during the month of January 1966. Are the transfers subject to the documentary stamp taxes imposed by sections 4321 and 4331 of the Code?

Question 2.—In those instances where transfers of shares of stock or certificates of indebtedness are made other than pursuant to binding agreements to sell or transfer, is either (a) the date of delivery of the shares or certificates to a transfer agent for recording, or (b) the date of delivery of the securities to the transferee, determinative of whether documentary stamp tax is applicable to the transfer?

Question 3.—A corporation issues a notice to its stockholders to surrender certain shares of stock in a nontaxable exchange for other shares of the corporation. Although the stockholders must surrender their shares before the end of December 1965, the new shares will not be issued until some time in January 1966. When surrendering his shares in December 1965, one stockholder requests that the new shares be issued in the name of a person other than the stockholder. Is any documentary stamp tax liability incurred in connection with the latter transaction?

Sections 4321 and 4331 of the Code impose stamp taxes on the sale or transfer of shares or certificates of stock, and on transfers of certificates of indebtedness issued by a corporation, respectively. Section 4321 also imposes a stamp tax on transfers of rights to subscribe for or receive shares or certificates of stock. Sections 47.4321–1(a) and 47.4331–1(a) of the Documentary Stamp Tax Regulations both provide that the tax on transfers attaches at the time of making the sale or transfer, regardless of the time or manner of delivery of the certificate, agreement, or memorandum of sale.

Section 401 of the Excise Tax Reduction Act of 1965 repealed the documentary stamp taxes on transfers of securities imposed by sections 4321 and 4331 of the Code, effective January 1, 1966.

Answer to Question 1.—The taxes imposed by sections 4321 and 4331 of the Code attach to binding agreements to sell or transfer entered into prior to January 1, 1966, regardless of when the transfer is recorded by the transfer agent, or when delivery is made to the transferee. Accordingly, the described transfer, having been made pursuant to sales agreements entered into prior to January 1, 1966, are subject to the taxes imposed by sections 4321 and 4331 of the Code.

Answer to Question 2.—Transfers of shares or certificates made other than pursuant to binding agreements to sell or transfer, are subject to tax if legal title to the shares or certificates is transferred prior to January 1, 1966, regardless of when the transfer is recorded on the books of a transfer agent, or when delivery is made to a transferee. Doubtful questions as to the time of transfer of title should be submitted for a ruling.

Answer to Question 3.—Among other transactions, section 4321 of the Code imposes a stamp tax on transfers of rights to receive shares

or certificates of stock. When an issuing corporation is requested by the person who has the right to receive shares to issue the shares in the name of a person other than that of the person who has the right to receive the shares, there occurs a taxable transfer of the right to receive the shares, within the meaning of section 4321 of the Code. Since, in the case in question, the request for issuance of the shares in the name of someone other than the person who had the right to receive was made prior to January 1, 1966, a transfer resulted which is subject to the tax imposed by section 4321 of the Code.

PART II.—SALES OR TRANSFERS OF CERTIFICATES OF INDEBTEDNESS

SECTION 4331.—IMPOSITION OF TAX

26 CFR 47.4331–1: Imposition of tax.

Effect of repeal on certain transactions. See Rev. Rul. 66–2, page 256.

SUBCHAPTER C.—CONVEYANCES

SECTION 4331.—IMPOSITION OF TAX

26 CFR 47.4361–1: Imposition of tax. Rev. Rul. 66–88

Revenue Ruling 59–282, C.B. 1959–2, 332, holds that the sale of a production payment retained from the assignment of an interest in oil, gas and minerals in place is a conveyance of realty sold within the meaning of section 4361 of the Internal Revenue Code of 1954 and is subject to documentary stamp tax imposed under that section. The principle of that ruling is equally applicable to a transaction of the kind commonly described and known in the industry as the conveyance of a carved-out production payment. *Held*, the conveyance of a carved-out production payment is subject to the documentary stamp tax imposed by section 4361 of the Code.

Revenue Ruling 59–282 is hereby amplified.

SUBCHAPTER D.—POLICIES ISSUED BY FOREIGN INSURERS

SECTION 4371.—IMPOSITION OF TAX

26 CFR 145.5–1: Imposition and payment of tax on policies issued by foreign insurers.

Temporary regulations relating to tax on policies issued by foreign insurers paid by return in lieu of by the affixing of documentary stamps. See T.D. 6868, page 593.

SECTION 4374.—AFFIXING OF STAMPS

26 CFR 145.5–1: Imposition and payment of tax on policies issued by foreign insurers.

Temporary regulations relating to tax on policies issued by foreign insurers paid by return in lieu of by the affixing of documentary stamps. See T. D. 6868, page 593.

SUBCHAPTER E.—MISCELLANEOUS PROVISIONS APPLICABLE TO DOCUMENTARY STAMP TAXES

SECTION 4382.—EXEMPTIONS

26 CFR 47.4382–1: Exemptions.

Application of section 4382 of the Code to an organization separate in form but wholly owned by a foreign government. See Rev. Rul. 66–73, page 174.

CHAPTER 36.—CERTAIN OTHER EXCISE TAXES

SUBCHAPTER D.—TAX ON USE OF CERTAIN VEHICLES

SECTION 4482.—DEFINITIONS

26 CFR 41.4482(b)–1: Definition of taxable gross weight.

Computing actual unloaded weight of packer-type refuse collection trucks. See Rev. Proc. 66–15, page 629.

CHAPTER 41.—INTEREST EQUALIZATION TAX

SUBCHAPTER A.—ACQUISITIONS OF FOREIGN STOCK AND DEBT OBLIGATIONS

SECTION 4916.—EXCLUSION FOR INVESTMENTS IN LESS DEVELOPED COUNTRIES

26 CFR 147.3–1: Exclusion for investments in less developed country corporations. Rev. Rul. 66–1 [1]

The Internal Revenue Service has issued rulings to a number of foreign corporations that qualify as less-developed country corpora-

[1] Based on Technical Information Release 760, dated Sept. 13, 1965, and Technical Information Release 786, dated Dec. 14, 1965.

tions for certain of their annual accounting periods, under section 4916(c)(4) of the Internal Revenue Code of 1954, as added by the Interest Equalization Tax Act, Public Law 88–563, C.B. 1964–2, 615. Revenue Ruling 65–54, C.B. 1965–1, 506, is hereby superseded by this ruling, which contains an updated list of corporations which have received favorable rulings.

The rulings provide that acquisitions by United States persons of stock or debt obligations of such corporations, if made during the period or periods of time stated (including those made on the first and last days of such period or periods) for each corporation, are exempt from the interest equalization tax.

Although the rulings do not exempt acquisitions made during periods other than those designated, such acquisitions might be entitled to a statutory exemption, for which a ruling is not required, under the provisions of section 4916(c)(5) of the Code, if the conditions of that section are satisfied.

The rulings will expire on the last day of the period designated for each corporation unless, within 90 days after the close of the corporation's annual accounting period, a similar request for ruling containing the information required by the rulings is made with regard to the succeeding annual accounting period of the corporation. If such information is timely filed with the Commissioner of Internal Revenue, any acquisition made during the period the request for ruling is pending will be treated as exempt, regardless of the fact that the ruling may eventually be unfavorable. However, if the information is not timely filed, the ruling will expire, and any acquisition made after the last day of the period set forth for each corporation shall not be treated as exempt under the ruling.

From time to time the Service will announce the names of those corporations which have received such a ruling during the period subsequent to this announcement.

The following corporations have been issued favorable rulings under section 4916(c)(4) of the Code:

Adela Investment Company—September 24, 1964, to November 2, 1964, and December 7, 1964, to September 28, 1965.[2]

American Israelis Paper Mills, Ltd.—July 19, 1963, to June 29, 1966.

Anglo-Lautaro Nitrate Corporation—July 19, 1963, to September 28, 1966.

Antilles International Salt Company, N.V.—October 26, 1965, to September 28, 1966.

Bank Leumi le-Israel B.M.—May 3, 1965, to March 31, 1966.

Banque Internationale pour l'Afrique Occidentale—April 1, 1965, to March 31, 1966.

Barracuda Tanker Corporation—February 8, 1965, to September 28, 1966.

Benguet Consolidated, Inc.—July 19, 1963, to March 31, 1966.

Bogo-Medellin Milling Co., Inc.—July 20, 1965, to March 31, 1966.

Brazilian Traction, Light & Power Co., Inc.—February 18, 1965, to March 31, 1966.

Canadian International Power Company Limited—July 19, 1963, to November 2, 1964, and November 24, 1964, to March 31, 1966.

Coastal Caribbean Oils & Minerals, Inc.—April 4, 1965, to March 31, 1966.

Compania de Luz y Fuerza del Centro, S.A.—November 25, 1964, to March 31, 1966.

Compania Shell de Venezuela, Ltd.—May 25, 1965, to March 31, 1966.

[2] An extension request was timely filed. While under consideration the exemption continues to apply.

Consolidated Halliwell Limited—July 19, 1963, to November 2, 1964, and December 8, 1964, to March 31, 1966.
Consolidated Mines, Inc.—October 13, 1965, to March 31, 1966.
Construcciones Populares, S.A. de C.V.—July 8, 1965, to March 31, 1966.
Credit & Development Corporation—May 17, 1965, to March 31, 1966.
Ensom City Limited—April 23, 1965, to March 31, 1966.
Equadorian Corporation, Limited—July 19, 1963, to November 2, 1964, and November 25, 1964, to March 31, 1966.
Grand Bassa Tankers, Inc.—January 25, 1965, to March 31, 1966.
Hawaiian-Philippine Company—August 3, 1965, to March 31, 1966.
Industria Electrica de Mexico, S.A.—July 19, 1963, to November 2, 1964, and December 9, 1964, to March 31, 1966.
Israel Discount Bank, Limited—January 1, 1964, to November 2, 1964, and November 24, 1964, to March 31, 1966.
Jamaica Public Service Limited—January 11, 1965, to March 31, 1966.
Kilembe Copper Cobalt Ltd.—November 4, 1965, to March 31, 1966.
Kupat-Am Bank Limited—August 3, 1965, to March 31, 1966.
La Gloria Palacios, S.A. de C.V.—September 30, 1965, to March 31, 1966.
La Luz Mines Limited—November 23, 1965, to December 29, 1966.
La Tabacalera Mexicana, S.A.—July 19, 1963, to November 2, 1964, and May 7, 1965, to March 31, 1966.
Liberian Iron Ore Limited—July 19, 1963, to November 2, 1964, and December 3, 1964, to March 31, 1966.
Luzon Stevedoring Corporation—September 30, 1965, to March 31, 1966.
Mexican Light and Power Company, Limited—July 19, 1963, to November 2, 1964, and November 25, 1964, to March 31, 1966.
Midepsa Industries Limited—November 24, 1965, to March 31, 1966.
Motorship Tankers, Inc.—November 30, 1964, to March 31, 1966.
National Iranian Tanker Company (Monrovia), Ltd.—July 19, 1963, to November 2, 1964, and November 30, 1964, to March 31, 1966.
Norsul Oil & Mining Limited—March 9, 1965, to July 29, 1966.
Oswego Chemical Carriers Corporation—July 24, 1965, to March 31, 1966.
Oswego Marine Corporation—August 27, 1965, to March 31, 1966.
Oswego Navigation Corporation—October 21, 1965, to March 31, 1966.
Oswego Tanker Corporation—February 25, 1965, to March 31, 1966.
Oswego Unity Corporation—November 10, 1965, to March 31, 1966.
Pato Consolidated Gold Dredging Limited—July 19, 1963, to November 2, 1964, and December 8, 1964, to March 31, 1966.
Philippine Long Distance Telephone Company—November 30, 1964, to March 31, 1966.
Philippine Oil Development Co., Inc.—July 19, 1963, to November 2, 1964, and November 24, 1964, to March 31, 1966.
Premier Consolidated Oilfields Limited—July 19, 1963, to November 2, 1964, and December 9, 1964, to June 29, 1966.
Proyecto Viru Sociedad Anomina—May 17, 1965, to March 31, 1966.
Roan Selection Trust Limited—January 25, 1965, to September 28, 1966.
Rosita Mines Limited—November 23, 1965, to December 29, 1966.
San Carlos Milling Co., Inc.—July 19, 1963, to November 2, 1964, and December 4, 1964, to March 31, 1965, and May 13, 1965, to March 31. 1966.
San Jose Oil Company, Inc.—January 6, 1965, to March 31, 1966.
San Miguel Corporation—July 19, 1963, to November 2, 1964, and November 24, 1964, to March 31, 1966.
Shell Exploratie en Productia Mastschappij, N.V.—May 25, 1965, to March 31, 1966.
Shell Finance (Development) Company Limited—May 25, 1965, to March 31, 1966.
Shell Quimica de Venezuela, C.A.—May 25, 1965, to March 31, 1966.
Signess Shipping Company, Inc.—November 30, 1964, to March 31, 1966.
Space Marine Transport Company—September 23, 1965, to March 31, 1966.
Sterling Tankers Corporation—October 27, 1965, to March 31, 1966.
TACA International Airlines, S.A.—October 22, 1965, to March 31, 1966.
Trinity Marine Corporation—January 1, 1964, to November 2, 1964, and November 25, 1964, to March 31, 1966.
Trinity Navigation Corporation—November 25, 1964, to March 31, 1966.
Tubos de Acero de Mexico, S.A.—July 19, 1963, to November 2, 1964, and December 9, 1964, to March 31, 1966.

Urbanizaciones Guacara, C.A.—May 6, 1965, to March 31, 1966.
Westwaters Shipping Inc.—January 28, 1965, to March 31, 1965, and May 7, 1965, to March 31, 1966.

Rev. Rul. 66-27

In determining whether a foreign corporation qualifies as a less developed country corporation for the purpose of the interest equalization tax, deposits in less developed countries with persons carrying on the banking business, and the income from such deposits, shall be treated as qualifying assets and income in the computation of the 80 percent of assets and 80 percent of income tests prescribed in section 4916(c)(1)(B) of the Internal Revenue Code of 1954.

Advice has been requested regarding the proper treatment of deposits in less developed countries with persons carrying on the banking business and the income from such deposits, in determining whether a foreign corporation qualifies as a less developed country corporation as defined in section 4916(c)(1)(B) of the Internal Revenue Code of 1954.

As far as here pertinent, the foreign corporation has assets consisting of deposits with persons carrying on the banking business in foreign countries and the income from such deposits as shown in the following schedule.

SCHEDULE A

Country	*Assets in dollars*	*Percent*	*Income in dollars*	*Percent*
United States	$7x$	1	$1x$	3
Sweden	$221x$	29	$10x$	33
Great Britain	$260x$	34	$11x$	37
Liberia	$275x$	36	$8x$	27
Totals	$763x$	100	$30x$	100

Section 4916(c)(1)(B) of the Code provides, in pertinent part, that the term "less developed country corporation" means a foreign corporation, which, for a certain period of time: (1) derives 80 percent or more of its gross income, if any, from sources within less developed countries, or from deposits in the United States with persons carrying on the banking business, or both, and (2) has assets 80 percent or more in value of which consists of certain enumerated categories of assets, one of which categories is deposits in the United States with persons carrying on the banking business. Thus, section 4916(c)(1)(B) of the Code prescribes certain ratios which must be satisfied by a foreign corporation in order to qualify as a less developed country corporation: (1) of the corporation's total gross income from all sources (total income), 80 percent or more must qualify as income from certain sources (qualifying income), and (2) of the corporation's total assets (total assets), 80 percent or more must qualify as assets specifically enumerated in section 4916(c)(1)(B) of the Code (qualifying assets).

Examination of Schedule A, above, giving effect to the provisions of section 4916(c)(1)(B) of the Code, shows that, of the total assets amounting to $763x$ dollars, $7x$ dollars is a qualifying asset and represents only 1 percent of the total assets. On the other side, the only

income qualifying is $1x$ dollars, representing only 3 percent of the total income of $30x$ dollars.

However, section 4916(c)(2)(C) of the Code contains a special rule which provides that, in making the computations with respect to the status of a foreign corporation as a less developed country corporation as defined in section 4916(c)(1)(B) of the Code, deposits outside the United States (other than deposits in a less developed country) with persons carrying on the banking business, and income from such deposits, shall not be taken into account. Also, see sections 147.3–1 (b)(2)(ii)(b) and (iii)(c) of the temporary regulations under the Interest Equalization Tax Act.

Section 4916(b) of the Code provides, in part, that the term "less developed country" means any foreign country (other than an area within the Sino-Soviet bloc) or any possession of the United States with respect to which there is in effect an Executive Order by the President designating such country as an economically less developed country for purposes of the interest equalization tax. Under applicable Executive Orders (Executive Order 11071, dated Dec. 27, 1962, C.B. 1963–1, 137; and superseding Executive Order 11224, dated May 13, 1965, C.B. 1965–1, 507) Liberia has been an economically less developed country since the tax has been in effect. On the other hand, under the limitations imposed by section 4916(b) of the Code, the United Kingdom (of which Great Britain is a part) and Sweden cannot be so designated by the President.

Applying the special rule of section 4916(c)(2)(C) of the Code to the 80 percent of gross income and 80 percent of assets tests under section 4916(c)(1)(B) of the Code, it is clear that in determining the ratio of qualifying assets to total assets and of qualifying income to total income the deposits of $221x$ dollars in Sweden and $260x$ dollars in Great Britain, together with the respective amounts of income thereon of $10x$ dollars and $11x$ dollars, are to be excluded from the amounts of qualifying and total assets and income, respectively, since the deposits are located outside the United States (other than in a less developed country). It is equally clear that the deposit of $7x$ dollars in the United States and the income of $1x$ dollars thereon are to be included in such amounts since both the asset and the item of income are specifically qualified under section 4916(c)(1)(B) of the Code.

Based upon the above, the only deposits and the income therefrom not to be taken into account are those of Sweden and Great Britain. This may be illustrated as follows, using the figures shown in Schedule A, above.

SCHEDULE B

ASSETS

$$\frac{7x \text{ (United States)}}{763x \text{ (Total assets)} - 221x \text{ (Sweden)} - 260x \text{ (Great Britain)}} = \frac{7x \text{ (Qualifying assets)}}{282x \text{ (Total assets} = 2.5\% \text{ as revised)}}$$

INCOME

$$\frac{1x \text{ (United States)}}{30x \text{ (Total income)} - 10x \text{ (Sweden)} - 11x \text{ (Great Britain)}} = \frac{1x \text{ (Qualifying income)}}{9x \text{ (Total income} = 11\% \text{ as revised)}}$$

In both situations the 80 percent tests are still not satisfied.

With respect to the treatment of the deposit of $275x$ dollars in Liberia and the income of $8x$ dollars from such deposit, which are included in the above schedule as part of total assets and also of total income, respectively, the question arises whether a deposit in a less developed country with a person carrying on the banking business and the income thereon are also to be included as *qualifying* assets and income.

While section 4916(c)(2)(C) of the Code provides that deposits outside the United States with persons carrying on the banking business, and the income from such deposits, shall not be taken into account, this provision specifically provides that such treatment is not applicable to deposits in a less developed country. Therefore, deposits in a less developed country and the income from such deposits must be fully taken into account in some manner.

The question is whether such deposits and income should be taken into account as qualifying or nonqualifying assets and income. Although section 4916(c)(1)(B)(i) of the Code refers only to deposits in the United States with persons carrying on the banking business, section 4916(c)(1)(B)(ii), (iii), (iv), and (v) of the Code amply demonstrate a congressional intention to accord favorable treatment of less-developed-country oriented assets of holding companies. It would not be consistent with this intention to treat bank deposits actually located in less developed countries and income from such deposits as an impediment to qualification as a less developed country corporation.

Accordingly, in view of the foregoing, it is held that in making the computation of the 80 percent of assets test pursuant to the provisions of section 4916(c)(1)(B) and 4916(c)(2)(C) of the Code, in order to make the determination whether a foreign corporation qualifies as a less developed country corporation for purposes of the interest equalization tax, deposits in less developed countries with persons carrying on the banking business are to be included in both qualifying assets and total assets. Likewise, in making the computation of the 80 percent of gross income test pursuant to sections 4916(c)(1)(B) and 4916(c)(2)(C) of the Code, for purposes of such determination, income from such deposits is to be included in both qualifying income and total income.

The above may be illustrated by the following, using the appropriate figures shown in Schedules A and B, above.

$$\frac{7x \text{ plus } 275x \text{ (Liberia)}}{282x} = \frac{282x}{282x} \text{ (100\%–80\% Asset test satisfied.)}$$

$$\frac{1x \text{ plus } 8x \text{ (Liberia)}}{9x} = \frac{9x}{9x} \text{ (100\%–80\% Income test satisfied.)}$$

SUBTITLE F.—PROCEDURE AND ADMINISTRATION

CHAPTER 61.—INFORMATION AND RETURNS

SUBCHAPTER A.—RETURNS AND RECORDS

PART II.—TAX RETURNS OR STATEMENTS

Subpart A.—General Requirement

SECTION 6011.—GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST

26 CFR 31.6011(a)–7: Execution of returns.

Submission of information required on certain forms and schedules on magnetic tape or other media. See T.D. 6883, page 294.

PART III.—INFORMATION RETURNS

Subpart A.—Information Concerning Persons Subject to Special Provisions

SECTION 6039.—INFORMATION REQUIRED IN CONNECTION WITH CERTAIN OPTIONS

Rev. Rul. 66–117 [1]

Revised Forms 3921, Exercise of a Qualified or Restricted Stock Option, and 3922, Transfer of Stock Acquired by Certain Options, and new Form 4067, U.S. Annual Information Return, reflect the modified reporting requirements relating to transfers of stock acquired under certain stock options in calendar year 1965 and later years.

Form 4067 will serve as a summary of, and transmittal for, revised Forms 3921 and 3922. The use of Form 4067, which must be duly signed, makes it unnecessary for each of the accompanying Forms 3921 and 3922 to be signed.

An automatic extension of time was granted to February 28, 1966, for furnishing to employees the statements required by section 6039(b) of the Internal Revenue Code of 1954. Thus, under this extension, the date for furnishing the statements is the same as the due date for filing the returns. Such statements furnished to employees must contain the information required to be set forth on revised Forms 3921 and 3922.

The interim provisions contained in Revenue Ruling 65–72, C.B. 1965–1, 518, were applicable only to returns required for calendar year 1964. Revised Forms 3921 and 3922 and new Form 4067 must be used for calendar year 1965 and must be filed on or before February 28, 1966.

[1] Based on Technical Information Release 796, dated Jan. 26, 1966.

SECTION 6041.—INFORMATION AT SOURCE

26 CFR 1.6041–1: Return of information as to payments of $600 or more.

Requirements governing the private printing of substitutes for Form 1099, U.S. Information Return. See Rev. Proc. 66–16, page 630.

Information returns for payments of $600 or more by banking institutions acting as agents for the collection of interest on evidences of indebtedness. See Rev. Proc. 66–26, page 654.

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26 CFR 1.6041–5: Information as to actual owner.

Private printing and use of substitutes for Form 1087, Nominee's Information Return. See Rev. Proc. 66–17, page 639.

SECTION 6042.—RETURNS REGARDING PAYMENTS OF DIVIDENDS AND CORPORATE EARNINGS AND PROFITS

26 CFR 1.6042–2: Returns of information as to dividends paid in calendar years after 1962. T.D. 6879[1]

(Also Sections 6044, 6049; 1.6044–2, 1.6049–1.)

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

Dividend and interest information reporting

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

On May 11, 1965, notice of proposed rulemaking with respect to amendment of the Income Tax Regulations (26 CFR Part 1) under sections 6042, 6044 and 6049 of the Internal Revenue Code of 1954 (relating to returns regarding payments of dividends, patronage dividends, and interest, respectively) to permit the reporting of dividend and interest payments on an account basis for 1965 and 1966, and to make certain other liberalizing changes was published in the Fed-

[1] The publication of this Treasury Decision in 31 F.R. 3492, dated Mar. 8, 1966, contains (1) instructions for modifying the notice of proposed rulemaking published in 30 F.R. 6488, dated May 11, 1965, 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.

eral Register (30 F.R. 6488). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendments of the regulations are adopted:

PARAGRAPH 1. Section 1.6042–2 is amended by revising paragraphs (a)(1) and (c) thereof. These revised provisions read as follows:

§ 1.6042–2 RETURNS OF INFORMATION AS TO DIVIDENDS PAID IN CALENDAR YEARS AFTER 1962.—(a) *Requirement of reporting.*—(1) *In general.*—(i) Every person who makes payments of dividends (as defined in § 1.6042–3) aggregating $10 or more to any other person during a calendar year after 1962 shall make an information return on Forms 1096 and 1099 for such calendar year showing the aggregate amount of such payments, the name and address of the person to whom paid, the total of such payments for all persons, and such other information as is required by the forms. In the case of dividends paid during the calendar year 1963 or 1964, the requirement of this subdivision for the filing of Form 1099 will be met if a person making payments of dividends to another person on two or more classes of stock files a separate Form 1099 with respect to each such class of stock on which $10 or more dividends are paid to such other person during the calendar year. Thus, if during 1963 a corporation pays to a person dividends totaling $15 on its common stock and $20 on its preferred stock, it may file separate Forms 1099 with respect to the payments of $15 and $20. If the dividends on the preferred stock totaled $5 instead of $20, no return would be required with respect to the $5. In addition, in the case of dividends paid during the calendar year 1965 or 1966, the requirement of this subdivision for the filing of Form 1099 will be met if a person making payments of dividends to another person on two or more separate stock ownership accounts (regardless of whether the payments are made on only one class of stock) files a separate Form 1099 with respect to each such stock ownership account on which $10 or more of dividends are paid to such other person during the calendar year.

(ii) Every person who during a calendar year after 1962 receives payments of dividends as a nominee on behalf of another person aggregating $10 or more shall make an information return on Forms 1096 and 1087 for such calendar year showing the aggregate amount of such dividends, the name and address of the person on whose behalf received, the total of such dividends received on behalf of all persons, and such other information as is required by the forms. Notwithstanding the preceding sentence, the filing of Form 1087 is not required if—

(*a*) The record owner is required to file a fiduciary return on Form 1041 disclosing the name, address, and identifying number of the actual owner;

(*b*) The record owner is a nominee of a banking institution or trust company exercising trust powers, and such banking institution or trust company is required to file a fiduciary return on Form 1041 disclosing the name, address, and identifying number of the actual owner; or

(*c*) The record owner is a banking institution or trust company exercising trust powers, or a nominee thereof, and the actual owner is an organization exempt from taxation under section 501(a) for which such banking institution or trust company files an annual return,

but only if the name, address, and identifying number of each record owner are included on or with the Form 1041 fiduciary return filed for the estate or trust or the annual return filed for the tax exempt organization.

* * * * * * *

(c) *Time and place for filing.*—The returns required under this section for any calendar year shall be filed after September 30 of such year, but not before the payer's final payment for the year, and on or before February 28 of the following year with any of the Internal Revenue Service Centers, the addresses of which are listed in the instructions for Form 1096. For extensions of time for filing returns under this section, see § 1.6081–1.

* * * * * * *

PAR. 2. Paragraphs (b) and (c)(1) of § 1.6042–4 is amended to read as follows:

§ 1.6042–4 STATEMENTS TO RECIPIENTS OF DIVIDEND PAYMENTS.

* * * * * * *

(b) *Form of statement.*—The written statement required to be furnished to a person under paragraph (a) of this section shall—

(1) Show the aggregate amount of payments shown on the Form 1099 or 1087 as having been made to (or received on behalf of) such person and include a legend stating that such amount is being reported to the Internal Revenue Service, and

(2) Show the name and address of the person filing the form.

The requirement of this section for the furnishing of a statement to any person, including the legend requirement of this paragraph, may be met by the furnishing to such person of a copy of the Form 1099 or 1087 filed pursuant to § 1.6042–2, or a reasonable facsimile thereof, in respect of such person. A statement shall be considered to be furnished to a person within the meaning of this section if it is mailed to such person at his last known address.

(c) *Time for furnishing statements.*—(1) *In general.*—Each statement required by this section to be furnished to any person for a calendar year shall be furnished to such person after November 30 of the year and on or before January 31 of the following year, but no statement may be furnished before the final dividend for the calendar year has been paid. However, if the final dividend for the calendar year is paid during the last quarter of the year, the statement may be furnished with such dividend.

* * * * * * *

PAR. 3. Paragraph (d) of § 1.6044–2 is amended to read as follows:

§ 1.6044–2 RETURNS OF INFORMATION AS TO PAYMENTS OF PATRONAGE DIVIDENDS WITH RESPECT TO PATRONAGE OCCURRING IN TAXABLE YEARS BEGINNING AFTER 1962.

* * * * * * *

(d) *Time and place for filing.*—The return required under this section on Forms 1096 and 1099 for any calendar year shall be filed after September 30 of such year, but not before the payer's final payment for the year, and on or before February 28 of the following year, with any of the Internal Revenue Service Centers, the addresses of which are listed in the instructions for such forms. For extensions of time for filing returns under this section, see § 1.6081–1.

* * * * * * *

PAR. 4. Paragraphs (b) and (c)(1) of § 1.6044–5 are amended to read as follows:

§ 1.6044–5 STATEMENTS TO RECIPIENTS OF PATRONAGE DIVIDENDS.

* * * * * * *

(b) *Form of statements.*—The written statement required to be furnished to a person with respect to whom a return of information is made under § 1.6044–2 shall—

(1) Show the aggregate amount of payments shown on the return as having been made to such person and include a legend stating that such amount is being reported to the Internal Revenue Service, and

(2) Show the name and address of the cooperative making the return.

The requirements of this section for the furnishing of a statement to any person, including the legend requirement of this paragraph, may be met by the furnishing to such person of a copy of the Form 1099 filed pursuant to § 1.6044–2, or a reasonable facsimile thereof, in respect of such person. A statement shall be considered to be furnished to a person within the meaning of this section if it is mailed to such person at his last known address.

(c) *Time for furnishing statements.*—(1) *In general.*—Each statement required by this section to be furnished to any person for a calendar year shall be furnished to such person after November 30 of the year and on or before January 31 of the following year, but no statement may be furnished before the final payment for the calendar year of an amount described in § 1.6044–3 has been paid. However, if the final payment of an amount described in § 1.6044–3 for the calendar year is paid during the last quarter of the year, the statement may be furnished with such payment.

* * * * * * *

PAR. 5. Section 1.6049–1 is amended by revising paragraphs (a)(1) and (c) thereof. These revised provisions read as follows:

§ 1.6049–1 RETURNS OF INFORMATION AS TO INTEREST PAID IN CALENDAR YEARS AFTER 1962.—(a) *Requirement of reporting.*—(1) *In general.*—(i) Every person

who makes payments of interest (as defined in § 1.6049–2) aggregating $10 or more to any other person during a calendar year after 1962 shall make an information return on Forms 1096 and 1099 for such calendar year showing the aggregate amount of such payments, the name and address of the person to whom paid, the total of such payments for all persons, and such other information as is required by the forms. In the case of interest paid during the calendar year 1963 to 1966, inclusive, the requirement of this subdivision for the filing of Form 1099 will be met if a person making payments of interest to another person on two or more accounts, insurance contracts, or investment certificates files a separate Form 1099 with respect to each such account, contract, or certificate on which $10 or more of interest is paid to such other person during the calendar year. In the case of evidences of indebtedness described in section 6049(b)(1)(A), separate Forms 1099 may be filed as provided in the preceding sentence with respect to holdings in different issues. Thus, if during 1963 a bank pays to a person interest totaling $15 on one account and $20 on a second account, it may file separate Forms 1099 with respect to the payments of $15 and $20. If the interest on the second account totaled $5 instead of $20, no return would be required with respect to the $5.

(ii) Every person who during a calendar year after 1962 receives payments of interest as a nominee on behalf of another person aggregating $10 or more shall make an information return on Forms 1096 and 1087 for such calendar year showing the aggregate amount of such interest, the name and address of the person on whose behalf received, the total of such interest received on behalf of all persons, and such other information as is required by the forms. Notwithstanding the preceding sentence, the filing of Form 1087 is not required if—

(*a*) The record owner is required to file a fiduciary return on Form 1041 disclosing the name, address, and identifying number of the actual owner;

(*b*) The record owner is a nominee of a banking institution or trust company exercising trust powers, and such banking institution or trust company is required to file a fiduciary return on Form 1041 disclosing the name, address, and identifying number of the actual owner; or

(*c*) The record owner is a banking institution or trust company exercising trust powers, or a nominee thereof, and the actual owner is an organization exempt from taxation under section 501(a) for which such banking institution or trust company files an annual return,

but only if the name, address, and identifying number of each record owner are included on or with the Form 1041 fiduciary return filed for the estate or trust or the annual return filed for the tax exempt organization.

(c) *Time and place for filing.*—The returns required under this section for any calendar year shall be filed after September 30 of such year, but not before the payer's final payment for the year, and on or before February 28 of the following year with any of the Internal Revenue Service Centers, the addresses of which are listed in the instructions for Form 1096. For extensions of time for filing returns under this section, see § 1.6081–1.

* * * * * * *

PAR. 6. Paragraphs (b) and (c)(1) of § 1.6049–3 is amended to read as follows:

§ 1.6049–3 STATEMENTS TO RECIPIENTS OF INTEREST PAYMENTS.

* * * * * * *

(b) *Form of statement.*—The written statement required to be furnished to a person under paragraph (a) of this section shall—

(1) Show the aggregate amount of payments shown on the Form 1099 or 1087 as having been made to (or received on behalf of) such person and include a legend stating that such amount is being reported to the Internal Revenue Service, and

(2) Show the name and address of the person filing the form.

The requirements of this section for the furnishing of a statement to any person, including the legend requirement of this paragraph, may be met by the furnishing to such person of a copy of the Form 1099 or 1087 filed pursuant to § 1.6049–1, or a reasonable facsimile thereof, in respect of such person. A statement shall be considered to be furnished to a person within the meaning of this section if it is mailed to such person at his last known address.

(c) *Time for furnishing statements.*—(1) *In general.*—Each statement required by this section to be furnished to any person for a calendar year shall be furnished to such person after November 30 of the year and on or before January 31 of the following year, but no statement may be furnished before the final interest payment for the calendar year has been paid. However, if the final interest payment for the calendar year is paid during the last quarter of the year, the statement may be furnished with such payment or at the time the payment is posted to a passbook.

* * * * * * *

(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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved February 28, 1966.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on Mar. 7, 1966, 8:45 a.m., and published in the issue of the Federal Register for Mar. 8, 1966, 31 F.R. 3492)

Private printing and use of substitutes for Form 1087, Nominee's Information Return. See Rev. Proc. 66–17, page 639.

SECTION 6044.—RETURNS REGARDING PAYMENTS OF PATRONAGE DIVIDENDS

26 CFR 1.6044–2: Returns of information as to payments of patronage dividends with respect to patronage occurring in taxable years beginning after 1962.

Amended regulations with respect to information returns as to payments of dividends. See T.D. 6879, page 266.

SECTION 6049.—RETURNS REGARDING PAYMENTS OF INTEREST

26 CFR 1.6049–1: Returns of information as to interest paid in calendar years after 1962.

Amended regulations with respect to information returns as to payments of interest. See T.D. 6879, page 266.

Guidelines for reporting of increments in value of prepaid insurance premiums. See Rev. Rul. 66–120, page 14.

PART VI.—EXTENSION OF TIME FOR FILING RETURNS

SECTION 6081.—EXTENSION OF TIME FOR FILING RETURNS

26 CFR 31.6081(a)–1: Extensions of time for filing returns and other documents.

Extension of time for filing Federal unemployment tax returns for the calendar year 1965 with certain districts. See Rev. Proc. 66–19, page 647.

SUBCHAPTER B.—MISCELLANEOUS PROVISIONS

SECTION 6103.—PUBLICITY OF RETURNS AND LISTS OF TAXPAYERS

26 CFR 301.6103(a)–1: Inspection of returns by certain classes of persons and State and Federal Government establishments pursuant to Executive order.

Inspection of Federal tax returns filed under the Internal Revenue Code of 1954, and the furnishing of copies of such returns. See Rev. Proc. 66–3, page 601.

Inspection of Federal tax returns filed under the Internal Revenue Code of 1954, by State Governments and the furnishing of copies of such returns and abstract data. See Rev. Proc. 66–4, page 607.

26 CFR 301.6103(a)–2: Copies of returns.

Inspection of Federal tax returns filed under the Internal Revenue Code of 1954, and the furnishing of copies of such returns. See Rev. Proc. 66–3, page 601.

26 CFR 301.6103(b)–1: Inspection by States.

Inspection of Federal tax returns filed under the Internal Revenue Code of 1954, by State Governments and the furnishing of copies of such returns and abstract data. See Rev. Proc. 66–4, page 607.

SECTION 6106.—PUBLICITY OF UNEMPLOYMENT TAX RETURNS

26 CFR 301.6106–1: Publicity of unemployment tax returns.

Inspection of Federal tax returns filed under the Internal Revenue Code of 1954, by State Governments and the furnishing of copies of such returns and abstract data. See Rev. Proc. 66–4, page 607.

SECTION 6109.—IDENTIFYING NUMBERS

26 CFR 1.6109–1: Identifying numbers.

Identifying numbers of persons drawing social security benefits as widows age 62 or over before January 1, 1963. See Rev. Proc. 66–29, page 656.

CHAPTER 62.—TIME AND PLACE FOR PAYING TAX

SUBCHAPTER B.—EXTENSIONS OF TIME FOR PAYMENT

SECTION 6166.—EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS

26 CFR 20.6166–3: Acceleration of payment. Rev. Rul. 66–62

Where a change in the operation of a business from a corporate form to an unincorporated form does not alter materially the business (operation of an office building) or the interest of the estate in the business, it is held that the change does not bring about the application of section 6166(h)(1)(A) of the Internal Revenue Code of 1954 so as to cause a termination of the installment privilege otherwise available to the estate under the provisions of section 6166(a) of the Code.

CHAPTER 63.—ASSESSMENT

SUBCHAPTER B.—DEFICIENCY PROCEDURES IN THE CASE OF INCOME, ESTATE, AND GIFT TAXES

SECTION 6213.—RESTRICTIONS APPLICABLE TO DEFICIENCIES; PETITION TO TAX COURT

26 CFR 301.6213–1: Restrictions applicable to deficiencies; petition to Tax Court. Rev. Rul. 66–17
(Also Section 6503; 301.6503(a)–1).

> A waiver of the restrictions on assessment and collection of a deficiency given pursuant to section 6213(d) of the Internal Revenue Code of 1954 terminates the 90-day suspension of the period of limitations on assessment and collection provided by sections 6213(a) and 6503(a)(1) of the Code and starts the 60-day suspension period provided by section 6503(a)(1) of the Code.
>
> A notation added to the waiver by the taxpayers reserving the right to claim refund was not a condition, but an expression of the rights of the taxpayers at that time which did not invalidate the waiver.

Advice has been requested whether the assessment of a deficiency in Federal income tax was timely under the circumstances described be-

low, and also whether a waiver of the restrictions on assessment and collection of a deficiency was valid because of a notation entered thereon by the taxpayers reserving the right to claim refund.

A timely statutory notice of deficiency in income tax was mailed to the taxpayers 2 weeks prior to the expiration of the statutory period of limitations on assessment, as extended by a duly executed consent, Form 872, Consent Fixing Period of Limitation Upon Assessment of Income and Profits Tax. Pursuant to section 6213(a) of the Internal Revenue Code of 1954, the issuance of that notice prevented the district director from making an assessment for 90 days. The taxpayers promptly filed a Form 870, Waiver of Restriction on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment, as provided by section 6213(d) of the Code, specifically waiving restrictions on the immediate assessment and collection of the tax. No action was taken by the district director until 121 days later, when the assessment was made.

Under section 6503(a)(1) of the Code, the running of the statutory period of limitations within which an assessment must be made is suspended for the period during which the district director is prohibited from making an assessment and for 60 additional days. Since the district director is prohibited by section 6213(a) of the Code from making an assessment for a period of 90 days after a notice of deficiency is mailed, the running of the period of limitations on assessment is suspended for an aggregate period of 150 days from the date the notice of deficiency is mailed.

The taxpayers contended that after they signed the waiver, Form 870, the district director was no longer prohibited from making an assessment and the suspension of the running of the period of limitations was terminated, with the result that the assessment made more than 60 days after the date the waiver was filed was invalid.

In *United States* v. *James J. Rae et al.*, United States District Court for the District of Massachusetts, entered January 19, 1959, the Government argued only that the waiver was not properly executed. The Court held:

> It follows therefore that the statute of limitations on assessments of the tax deficiencies in issue would have expired one hundred and fifty days after the notice of June 30, 1950, but that the Form 870 waiver against assessments terminated the ninety day period of section 272(a)(1) and section 277 on July 14, 1950, and started the sixty day period of section 277 running from that date. The assessments of October 27, 1950, were after the expiration of the period and were barred by section 275(a) as modified by the sections cited above.

In *Mutual Lumber Co.* v. *Poe*, 44 Fed. (2d) 922 (1930); *Mutual Lumber Co.* v. *Poe*, 66 Fed. (2d) 904 (1933) (same case on new appeal), certiorari denied, 290 U.S. 706 (1934), a waiver of restrictions was executed prior to issuance of the statutory notice of deficiency. Subsequently, a notice of deficiency was issued which, under the then existing statute, would have suspended the statute of limitations 60 days, the period the district director was prohibited from making the assessment, and for 60 days thereafter. The taxpayer argued that the waiver cut down the period in which the district director was prohibited from making the assessment and that no timely assessment was made. It was determined, however, that under the law as viewed at that time, a waiver filed before the notice of deficiency was mailed

was a nullity and that the suspension of limitations ran from the notice of deficiency.

Section 6213(d) of the Code settled the question of validity of waiver for years subsequent to 1954 by providing that the taxpayer may waive restrictions on assessment at any time, whether a deficiency notice has been issued or not.

Congressional committee reports indicate that Congress intended to give the Commissioner an additional 60 days to make an assessment, to protect him in the eventuality that for some reason the period of suspension was cut down. See House Report No. 356, 69th Congress, 1st session, C.B. 1939–1 (Part 2), 361, at 370. Also Senate Report No. 960, 70th Congress, 1st session, C.B. 1939–1 (Part 2), 409, at 431.

The position taken by the Government in the pertinent cases, the statutory language and legislative history all point to the conclusion that a valid waiver on Form 870, which is filed within the 90-day period of suspension provided by sections 6213(a) and 6503(a)(1) of the Code, has the effect of terminating the running of such 90-day period and starting the running of the 60-day period provided by section 6503(a) of the Code on the date it is filed.

It should be noted in the instant case that 2 weeks of the normal 3-year period of limitation on assessment as extended remained at the time the district director mailed the statutory notice of deficiency. Upon the termination of the period of suspension of the running of the period of limitation, in this case 60 days after the date the waiver was filed, the running of the normal 3-year period of limitation as extended resumes. Thus, the period within which an assessment had to be made in this case did not expire until 2 weeks after the termination of the 60-day period of suspension.

Whether a Form 870 becomes invalid by reason of a notation placed thereon by a taxpayer must be resolved on the basis of the facts in each case. In the instant case the notation made by the taxpayers was not a condition, but an expression of the actual rights of the taxpayers at the time. Since the taxpayers would have had the same rights had the form been left unaltered, the waiver of restrictions signed by the taxpayers was a valid one.

CHAPTER 64.—COLLECTION

SUBCHAPTER A.—GENERAL PROVISIONS

SECTION 6302.—MODE OR TIME OF COLLECTION

26 CFR 31.6302(c)–1: Use of Government depositaries in connection with taxes under Federal Insurance Contributions Act and income tax withheld. T.D. 6884[1]

[1] The publication of this Treasury Decision in 31 F.R. 7183, dated May 17, 1966, contains (1) instructions for modifying the notice of proposed rulemaking published in 31 F.R. 6515, dated Apr. 29, 1966, 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.

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON AND AFTER JANUARY 1, 1955

Amendment of the Employment Tax Regulations to provide revised rules for the deposit of certain employment taxes.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

On April 29, 1966, notice of proposed rulemaking with respect to the amendment of § 31.6302(c)-1 of the Employment Tax Regulations (26 CFR Part 31) to provide revised rules for the deposit of certain employment taxes was published in the Federal Register (31 F.R. 6515). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendment of the regulations is hereby adopted.

Paragraph (a) of § 31.6302(c)-1 is amended by revising subparagraphs (1) and (3) to read as follows:

§ 31.6302(c)-1 USE OF GOVERNMENT DEPOSITARIES IN CONNECTION WITH TAXES UNDER FEDERAL INSURANCE CONTRIBUTIONS ACT AND INCOME TAX WITHHELD.—(a) *Requirement.*—(1) *In general.*—(i) Except as provided in paragraph (b) of this section and subdivision (ii) of this subparagraph, if during any calendar month other than the last month of a calendar quarter, the aggregate amount of taxes (as defined in subdivision (iii) of this subparagraph) exceeds $100 in the case of an employer, such employer shall deposit such aggregate amount within 15 days after the close of such calendar month with a Federal Reserve bank. Notwithstanding the provisions of this subdivision, amounts required to be deposited for May 1966 may be deposited after June 15, 1966, but not later than June 20, 1966, if such amounts are combined with an amount required to be deposited under subdivision (ii) of this subparagraph for the first semimonthly period in June 1966.

(ii) This subdivision shall apply to taxes with respect to wages paid by an employer during June 1966 or during a calendar quarter thereafter if the aggregate of the taxes with respect to wages paid during any calendar month in the preceding calendar quarter exceeded $4,000 in the case of such employer. An employer shall deposit taxes to which this subdivision applies in a Federal Reserve bank within 3 banking days after the close of the semimonthly period during which the wages to which such taxes relate are paid. For purposes of this subdivision, "semimonthly period" means the first 15 days of a calendar month or the portion of a calendar month following the 15th of such month. An employer will be considered to have complied with the requirements of this subdivision for a semimonthly period if—

(*a*) (*1*) His deposit for such semimonthly period is not less than 90 percent of the aggregate amount of the taxes for such period and (*2*) if such period occurs in a month other than the last month in a calendar quarter, he deposits any underpayment for such month within 3 banking days after the 15th day of the following month; or

(*b*) (*1*) His deposit for each semimonthly period in the month is not less than 45 percent of the aggregate amount of the taxes for the month, and (*2*) if such month is other than the last month in a calendar quarter, he deposits any underpayment for such month within 3 banking days after the 15th day of the following month. This subdivision (*b*) shall not apply to any employer who normally pays in the first semimonthly period in each month more than 75 percent of the total wages paid during the month.

(iii) As used in this subparagraph, the term "taxes" means—

(*a*) The employee tax withheld under section 3102,

(*b*) The employer tax under section 3111, and

(*c*) The income tax withheld under section 3402,

exclusive of taxes with respect to wages for agricultural labor or for domestic service in a private home of the employer.

* * * * * * *

(3) *Depository receipts.*—Any deposit required to be made by an employer under subparagraph (1) of this paragraph shall be made separately from any deposit required to be made by him under subparagraph (2) of this paragraph. An employer required to make deposits under subparagraph (1) or subparagraph (2) may make one, or more than one, remittance of the amount required by such subparagraph to be deposited for a calendar month or a semi-monthly period, as the case may be. However, a deposit for a period in one calendar quarter shall be made separately from any deposit for a period in another calendar quarter. Each remittance shall be accompanied by a Federal Depositary Receipt (Form 450) which shall be prepared in accordance with the instructions applicable thereto. The employer shall forward such remittance, together with such depositary receipt, to a Federal Reserve bank or, at his election, to a commercial bank authorized in accordance with Treasury Department Circular No. 848 to accept remittances of the taxes for transmission to a Federal Reserve bank. After the Federal Reserve bank has validated the depositary receipt, such depositary receipt will be returned to the employer. Every employer making deposits pursuant to this section shall attach to his return for the period with respect to which such deposits are made, in part or in full payment of the taxes shown thereon, depositary receipts so validated, and shall pay to the district director the balance, if any, of the taxes due for such period. An amount of tax which is not required to be deposited may nevertheless be deposited if the employer so desires. If such a voluntary deposit is made, the employer shall make it 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.

* * * * * * *

(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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved May 16, 1966.
STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on May 16, 1966, 1:47 p.m., and published in the issue of the Federal Register for May 17, 1966, 31 F.R. 7183)

SUBCHAPTER B.—RECEIPT OF PAYMENT

SECTION 6316.—PAYMENT BY FOREIGN CURRENCY

26 CFR 301.6316-1: Payment of income tax in foreign currency. T.D. 6872[1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Payment of taxes in nonconvertible foreign currency

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

[1] The publication of this Treasury Decision in 31 F.R. 148, dated Jan. 6, 1966, contains (1) instructions for modifying the notice of proposed rulemaking published in 30 F.R. 6222, dated May 4, 1965, 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.

On May 4, 1965, notice of proposed rulemaking providing rules for the payment of Federal Insurance Contributions Act taxes in foreign currency, amending the rules for payment of income tax in foreign currency by extending their applicability to certain recipients of grants or compensation under the Mutual Educational and Cultural Exchange Act of 1961 [Public Law 87-256, C.B. 1961-2, 322], as amended (22 U.S.C. 2451), and section 104 (h), (j), (k), (o), or (p) of the Agricultural Trade Development and Assistance Act of 1954, as amended (7 U.S.C. 1704 (h), (j), (k), (o), (p)), and making certain other changes, was published in the Federal Register (30 F.R. 6222). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendments to the regulations are hereby adopted:

INCOME TAX REGULATIONS (26 CFR Part 1)

PARAGRAPH 1. Paragraph (a) of § 1.6091-3 is amended to read as follows:

§ 1.6091-3 INCOME TAX RETURNS REQUIRED TO BE FILED WITH DIRECTOR OF INTERNATIONAL OPERATIONS.

* * * * * * *

(a) Income tax returns on which all, or a portion, of the tax is to be paid in foreign currency. See §§ 301.6316-1 to 301.6316-6, inclusive, and §§ 301.6316-8 and 9 of this chapter (Regulations on Procedure and Administration).

* * * * * * *

EMPLOYMENT TAX REGULATIONS (26 CFR Part 31)

PAR. 2. Section 31.6011(a)-1 is amended by adding a new paragraph (e) thereto. This amended provision reads as follows:

§ 31.6011(a)-1 RETURNS UNDER FEDERAL INSURANCE CONTRIBUTIONS ACT.

* * * * * * *

(e) WAGES PAID IN NONCONVERTIBLE FOREIGN CURRENCY.—For provisions relating to returns filed by certain employers who pay wages in nonconvertible foreign currency, see § 301.6316-7 of this chapter (Regulations on Procedure and Administration).

PAR. 3. Paragraph (b) of § 31.6151-1 is amended to read as follows:

§ 31.6151-1 TIME FOR PAYING TAX.

* * * * * * *

(b) CROSS REFERENCES.—For provisions relating to the use of Federal Reserve banks and authorized commercial banks in depositing the taxes, see §§ 31.6302 (c)-1 and 31.6302(c)-2. For rules relating to the payment of taxes in nonconvertible foreign currency, see § 301.6316-7 of this chapter (Regulations on Procedure and Administration).

PAR. 4. Paragraph (b) of § 31.6302(c)-1 is amended to read as follows:

§ 31.6302(c)-1 USE OF GOVERNMENT DEPOSITARIES IN CONNECTION WITH TAXES UNDER FEDERAL INSURANCE CONTRIBUTIONS ACT AND INCOME TAX WITHHELD.

* * * * * * *

(b) EXCEPTIONS.—(1) MONTHLY RETURNS.—The provisions of this section are not applicable with respect to taxes for the month in which the employer receives notice from the district director that returns are required under § 31.6011(a)-5, or for any subsequent month for which such a return is required.

(2) WAGES PAID IN NONCONVERTIBLE FOREIGN CURRENCY.—The provisions of this section are not applicable with respect to taxes paid in nonconvertible foreign currency pursuant to § 301.6316–7 of this chapter (Regulations on Procedure and Administration).

REGULATIONS ON PROCEDURE AND ADMINISTRATION (26 CFR Part 301)

PAR. 5. Section 301.6311–1 is amended by adding a new paragraph (c) thereto. This added paragraph reads as follows:

§ 301.6311–1 PAYMENT BY CHECK OR MONEY ORDER.

* * * * * * *

(c) PAYMENT IN NONCONVERTIBLE FOREIGN CURRENCY.—For rules relating to payment of income taxes and taxes under the Federal Insurance Contributions Act in nonconvertible foreign currency, see section 6316 and the regulations thereunder.

PAR. 6. Section 301.6316–1 is amended to read as follows:

§ 301.6316–1 PAYMENT OF INCOME TAX IN FOREIGN CURRENCY.

Subject to the provisions of §§ 301.6316–3 to 301.6316–5, inclusive, that portion of the income tax which is attributable to amounts received by a citizen of the United States in nonconvertible foreign currency may be paid in such currency—

(a) For any taxable year beginning on or after January 1, 1955, and before January 1, 1964, if such amounts—

(1) Are disbursed from funds made available to a foundation or commission established in a foreign country pursuant to an agreement made under the authority of section 32(b) of the Surplus Property Act of 1944, as amended (50 U.S.C. App. 1641(b)(2)), or reestablished under the authority of the Mutual Educational and Cultural Exchange Act of 1961, as amended (22 U.S.C. 2451);

(2) Constitute either a grant made for authorized purposes of the agreement or compensation for personal services performed in the employ of the foundation or commission;

(3) Are at least 75 percent of the entire amount of the grant or compensation; and

(4) Are treated as income from sources without the United States under the provisions of sections 861 to 864, inclusive, and §§ 1.861–1 to 1.864, inclusive, of this chapter (Income Tax Regulations); and

(b) For any taxable year beginning on or after January 1, 1964, if such amounts—

(1) Are disbursed from funds made available either to a foundation or commission, established pursuant to an agreement made under the authority of section 32(b) of the Surplus Property Act of 1944, as amended, or to a foundation or commission established or continued pursuant to an agreement made under the authority of the Mutual Educational and Cultural Exchange Act of 1961, as amended; or are paid from grants made to such citizen, or to a foundation or an educational or other institution, under the authority of the Mutual Educational and Cultural Exchange Act of 1961, as amended, or section 104 (h), (j), (k), (o), or (p) of the Agricultural Trade Development and Assistance Act of 1954, as amended (7 U.S.C. 1704 (h), (j), (k), (o), (p));

(2) Constitute either a grant made for a purpose authorized under any such agreement or law, or compensation for personal services performed in the employ of any organization engaged in administering any program or activity pursuant to any such agreement or law;

(3) Are at least 70 percent of the entire amount of the grant or compensation; and

(4) Are treated as income from sources without the United States under the provisions of sections 861 to 864, inclusive, and §§ 1.861–1 to 1.864, inclusive, of this chapter (Income Tax Regulations).

PAR. 7. Paragraph (a) of § 301.6316–2 is amended to read as follows:

§ 301.6316–2 DEFINITIONS.

For purposes of §§ 301.6316–1 to 301.6316–9, inclusive.

(a) The term "tax", as used in §§ 301.6316–1, 3, 4, 5, and 6 means the income tax imposed for the taxable year by chapter 1 of the Internal Revenue Code of 1954, and as used in § 301.6316–7 means the Federal Insurance Contributions Act taxes imposed by chapter 21 of the Code (or by the corresponding provisions of the Internal Revenue Code of 1939). The term "tax", as used in §§ 301.6316–8 and –9 shall relate to either of such taxes, whichever is appropriate.

* * * * * * *

PAR. 8. Paragraphs (a) and (b)(1) of § 301.6316–4 are amended to read as follows:

§ 301.6316–4 RETURN REQUIREMENTS.

(a) PLACE FOR FILING.—A return of income which includes amounts received in foreign currency on which the tax is paid in accordance with § 301.6316–1 shall be filed with the Director of International Operations, Internal Revenue Service, Washington, D.C., 20225. For the time for filing income tax returns, see sections 6072 and 6081 and §§ 1.6072–1, 1.6081–1, and 1.6081–2 of this chapter (Income Tax Regulations).

(b) STATEMENTS REQUIRED.—(1) A statement, prepared by the taxpayer, and certified by the foundation, commission, or other person having control of the payments made to the taxpayer in nonconvertible foreign currency, shall be attached to the return showing that for the taxable year involved the taxpayer is entitled to pay tax in foreign currency in accordance with section 6316 and the regulations thereunder. This statement shall disclose the total amount of grants or compensation received by the taxpayer during the taxable year under the authority of section 32(b) of the Surplus Property Act of 1944, as amended (50 U.S.C. App. 1641(b)(2)), or of the Mutual Educational and Cultural Exchange Act of 1961, as amended (22 U.S.C. 2451), or section 104 (h), (j), (k), (o), or (p) of the Agricultural Trade Development and Assistance Act of 1954, as amended (7 U.S.C. 1704 (h), (j), (k), (o), (p)), and the amount thereof paid in nonconvertible foreign currency. It shall also state that with respect to the grant or compensation the applicable percentage requirement of § 301.6316–1 is satisfied.

* * * * * * *

PAR. 9. Paragraphs (a), (c), and (d)(1) of § 301.6316–5 are amended to read as follows:

§ 301.6316–5 MANNER OF PAYING TAX BY FOREIGN CURRENCY.

(a) TIME AND PLACE TO PAY.—The unpaid tax required to be shown on a return filed in accordance with § 301.6316–4, whether payable in whole or in part in foreign currency, is due and payable to the Director of International Operations, Internal Revenue Service, Washington, D.C., 20225, at the time the return is filed. However, see paragraph (d) of this section with respect to the depositing of the foreign currency with the disbursing officer of the Department of State.

* * * * * * *

(c) DETERMINATION OF THE TAX.—In determining the tax payable for the taxable year in United States dollars, the taxpayer, with respect to amounts described in paragraph (a) of § 301.6316–1, or amounts described in paragraph (b) of § 301.6316–1 received before November 1, 1965, shall use the rates of exchange which most clearly reflect the correct tax liability in dollars, whether it be the official rate, the open market rate, or any other appropriate rate. With respect to amounts described in paragraph (b) of § 301.6316–1 received on or after November 1, 1965, the taxpayer shall use the official rate of exchange in determining the tax payable for the taxable year in United States dollars. After determining the correct tax liability in United States dollars the taxpayer shall then ascertain, in accordance with the principles of § 301.6316–3, the portion of the tax which is attributable to amounts received in nonconvertible foreign currency.

(d) DEPOSIT OF FOREIGN CURRENCY WITH DISBURSING OFFICER.—(1) After the portion of the tax which is attributable to amounts received in nonconvertible foreign currency is determined in United States dollars, the amount so determined shall be deposited in the same nonconvertible foreign currency with the disbursing officer of the Department of State for the foreign country where the fund is located from which the payments in nonconvertible foreign currency are made to the taxpayer. The amount of foreign currency to be deposited shall

be that amount which, when converted at the rate of exchange used on the date of deposit by that disbursing officer for the acquisition of such currency for his official disbursements, equals the portion of the tax so determined in United States dollars.

* * * * * * *

PAR. 10. Paragraphs (a) and (c)(2) of § 301.6316–6 are amended to read as follows:

§ 301.6316–6 DECLARATIONS OF ESTIMATED TAX.

(a) FILING OF DECLARATION.—A declaration of estimated tax in respect of amounts on which the tax is to be paid in foreign currency under the provisions of § 301.6316–1 shall be filed with the Director of International Operations, Internal Revenue Service, Washington, D.C., 20225, and shall have attached thereto the statements required by paragraph (b)(1) and (2)(i) of § 301.6316–4 in respect of the tax return except that the statement certified by the foundation, commission, or other person having control of the payments to the taxpayer in nonconvertible foreign currency may be based upon amounts expected to be received by the taxpayer during the taxable year if they are not in fact known at the time of certification. A copy of this certified statement shall be retained by the taxpayer for the purpose of exhibiting it to the disbursing officer when making installment deposits of foreign currency under the provisions of paragraph (c) of this section. For the time for filing declarations of estimated tax, see sections 6073 and 6081 and §§ 1.6073–1 to 1.6073–4, inclusive, and §§ 1.6081–1 and 1.6081–2 of this chapter (Income Tax Regulations).

* * * * * * *

(c) PAYMENT OF ESTIMATED TAX.—* * *

(2) Every taxpayer making a deposit of foreign currency in accordance with this paragraph shall tender to the Director of International Operations, Internal Revenue Service, Washington, D.C., 20225, the original of the receipt from the disbursing officer as payment, to the extent of the amount represented thereby in United States dollars, of the estimated tax. For the dates prescribed for the payment of estimated tax, see sections 6153 and 6161 and §§ 1.6153–1 to 1.6153–4, inclusive, and § 1.6161–1 of this chapter (Income Tax Regulations). A taxpayer should make the deposit required by this paragraph in ample time to permit him to tender such receipt by the date prescribed for payment of the estimated tax.

* * * * * * *

PAR. 11. Sections 301.6316–7 and 301.6316–8 are deleted. There are added immediately after section 301.6316–6 the following new sections:

§ 301.6316–7 PAYMENT OF FEDERAL INSURANCE CONTRIBUTIONS ACT TAXES IN FOREIGN CURRENCY.

(a) IN GENERAL.—The taxes imposed on employees and employers by sections 3101 and 3111, respectively, of chapter 21 of the Code (Federal Insurance Contributions Act) or the corresponding sections of the Internal Revenue Code of 1939 may, with respect to wages (as defined in section 3121(a) of chapter 21 of the Code or the corresponding section of the Internal Revenue Code of 1939) paid in nonconvertible foreign currency (as defined in paragraph (b) of § 301.6316–2) for services performed on or after January 1, 1951, be paid in that currency if all such wages—

(1) Are paid from funds made available to a foundation or commission established in a foreign country pursuant to an agreement made under the authority of section 32(b) of the Surplus Property Act of 1944, as amended (50 U.S.C. App. 1641 (b)(2)), or established or continued pursuant to an agreement made under authority of the Mutual Educational and Cultural Exchange Act of 1961, as amended (22 U.S.C. 2451); and

(2) Are paid to a United States citizen for services performed in the employ of such foundation or commission.

(b) RETURN REQUIREMENTS.—(1) STATEMENTS REQUIRED.—(i) A return on which payment of Federal Insurance Contributions Act taxes is made in accordance with this section shall have attached thereto a statement, certified by the foundation or commission filing the return, stating that the foundation or commission is an organization established pursuant to an agreement made under authority of section 32(b) of the Surplus Property Act of 1944, as amended, or

established or continued pursuant to an agreement made under authority of the Mutual Educational and Cultural Exchange Act of 1961, as amended.

(ii) The taxpayer shall also attach to the return a statement showing the rates of exchange used in determining in United States dollars the wages reported on the return and the taxes due with respect thereto. See paragraph (c)(1) of this section.

(2) CROSS REFERENCES.—For the place for filing returns of the Federal Insurance Contributions Act taxes, see § 31.6091–1(c) of this chapter (Employment Tax Regulations). For the time for filing returns of the Federal Insurance Contributions Act taxes, see § 31.6071(a)–1 of this chapter (Employment Tax Regulations).

(c) PAYMENT OF TAX.—(1) DETERMINATION OF THE TAX.—In determining in United States dollars the wages required to be reported on the return and the taxes due with respect thereto, the taxpayer shall use the rate of exchange which most clearly reflects the correct equivalent in dollars, whether it be the official rate, the open market rate, or any other appropriate rate.

(2) DEPOSIT OF FOREIGN CURRENCY WITH DISBURSING OFFICER.—(i) After determination is made in United States dollars of the Federal Insurance Contributions Act taxes with respect to wages paid in nonconvertible foreign currency, the amount so determined shall be deposited in the same nonconvertible foreign currency with the disbursing officer of the Department of State for the foreign country where the fund is located from which such wages were paid. The amount of the foreign currency to be deposited shall be that amount which, when converted at the rate of exchange used on the date of deposit by the disbursing officer for the acquisition of such currency for his official disbursements, equals the taxes determined in United States dollars.

(ii) The disbursing officer may rely upon the taxpayer for the determination of the amount of tax payable in foreign currency but may not accept any such currency for deposit until the taxpayer has presented for inspection the certified statement referred to in paragraph (b)(1) of this section. Upon acceptance of foreign currency for deposit the disbursing officer shall give the taxpayer a receipt in duplicate showing the name and address of the depositor, the date of the deposit, the amount of foreign currency deposited and its equivalent in United States dollars on the date of deposit, and the kind of tax for which the deposit is made.

(iii) Every taxpayer making a deposit of foreign currency in accordance with this paragraph shall attach to the return required to be filed in accordance with paragraph (b) of this section the original of the receipt given by the disbursing officer. Tender of such receipt to the Director of International Operations shall be considered as payment of tax in an amount equal to the United States dollars represented by the receipt.

(iv) A taxpayer shall make the deposit required by this paragraph in ample time to permit it to attach the receipt to its return for filing within the time prescribed by § 31.6071(a)–1 of this chapter (Employment Tax Regulations).

§ 301.6316–8 REFUNDS AND CREDITS IN FOREIGN CURRENCY.

(a) REFUNDS.—The refund of any overpayment of tax which has been paid under section 6316 in foreign currency may, in the discretion of the Commissioner, be made in the same foreign currency by which the tax was paid. The amount of any such refund made in foreign currency shall be the amount of the overpayment in United States dollars converted, on the date of the refund check, at the rate of exchange then used for his official disbursements by the disbursing officer of the Department of State in the country where the foreign currency was originally deposited.

(b) CREDITS.—Unless otherwise in the best interest of the Internal Revenue Service, no credit of any overpayment of tax which has been paid under section 6316 in foreign currency shall be allowed against any outstanding liability of the person making the overpayment except in respect of that portion of the liability which, in accordance with § 301.6316–1 or § 301.6316–7, would otherwise be permitted to be paid in the same foreign currency.

§ 301.6316–9 INTEREST, ADDITIONS TO TAX, ETC.

Any reference in §§ 301.6316–1 to 301.6316–8, inclusive, to "tax" shall be deemed also to refer to the interest, additions to the tax, additional amounts, and penalties attributable to the tax.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68 Stat. 917; 26 U.S.C. 7805).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved December 30, 1965.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on Jan. 5, 1966, 8:50 a.m., and published in the issue of the Federal Register for Jan. 6, 1966, 31 F.R. 148)

SUBCHAPTER C.—LIEN FOR TAXES

SECTION 6323.—VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS

26 CFR 301.6323-1: Validity of lien against mortgagees, pledgees, purchasers, and judgment creditors. Ct. D. 1905

INCOME TAX—INTERNAL REVENUE CODE OF 1954—DECISION OF SUPREME COURT OF THE UNITED STATES

1. UNRECORDED TAX LIEN—VALIDITY AGAINST TRUSTEE IN BANKRUPTCY.

A trustee in bankruptcy has the rights of a statutory "judgment creditor", and as such prevails over an unrecorded Federal tax lien under section 6323 of the Internal Revenue Code of 1954.

2. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Sixth Circuit, 335 Fed. (2d) 311, affirmed.

SUPREME COURT OF THE UNITED STATES

No. 17.—OCTOBER TERM, 1965

United States, petitioner, v. *Speers, Trustee in Bankruptcy*

[382 U.S. 266]

On writ of certiorari to the United States Court of Appeals for the Sixth Circuit

[December 13, 1965]

OPINION

MR. JUSTICE FORTAS delivered the opinion of the Court.

This case presents the question whether a federal tax lien, unrecorded as of the time of bankruptcy, is valid as against the trustee in bankruptcy.

On June 3, 1960, a District Director of Internal Revenue assessed more than $14,000 in withholding taxes and interest against the Kurtz Roofing Company. Demand for payment was made, and the taxpayer refused to pay. This gave rise to a federal tax lien.[1] Notice of the lien was not filed either in the Office of the

[1] 26 U.S.C. § 6321 (1964 ed.) provides: "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

26 U.S.C. § 6322 (1964 ed.) provides: "Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time."

Recorder of Erie County, Ohio, where Kurtz had its principal place of business, or in the United States District Court, at least not before February of 1961.[2] On June 20, 1960, Kurtz filed a petition in bankruptcy. In the ensuing proceedings the trustee took the position that the federal tax lien was invalid as to him. He relied upon § 70c of the Bankruptcy Act, 11 U.S.C. § 110(c) (1964 ed.), which, he asserted, vested in him the rights of a "judgment creditor," and upon 26 U.S.C. § 6323 (1964 ed.), which entitles a "judgment creditor" to prevail over an unrecorded federal tax lien. Section 70c provides in part:

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

Section 6323 provides in part:

> "[T]he lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate . . . ."

The trustee's position, in short, was that his statutory lien attached to all property of the bankrupt as of the date of filing of the petition; that he was a statutory "judgment creditor"; and that, under § 6323, the unrecorded tax lien of the United States was not valid against him. This position, if sustained, would reduce the Government's claim for unpaid taxes to the status of an unsecured claim, sharing fourth-class priority with unsecured state and local tax claims under § 64a(4) of the Bankruptcy Act, 11 U.S.C. § 104(a)(4) (1964 ed.), and ranking behind administrative expenses, certain wage claims, and specified creditors' expenses.[3] The result in the present case is that instead of recovering the full amount owing to it, the United States would receive only 53.48%.

The trustee's position was affirmed by the referee, the District Court, and the the Court of Appeals for the Sixth Circuit. 335 F. 2d 311. Certiorari was granted, 379 U.S. 958, to resolve the conceded conflict between decisions of Courts of Appeals for the Second, Third, and Ninth Circuits[4] and the decision below. We affirm.

Despite the language of the applicable statutory provisions, § 70c and § 6323, most of the Courts of Appeals passing on the question have sustained the validity of an unrecorded federal tax lien as against the trustee in bankruptcy. They have arrived at this result on the authority of a statement in *United States* v. *Gilbert Associates, Inc.*, 345 U.S. 361, 364 [Ct. D. 1757, C.B. 1953–1, 474, 476], that the phrase "judgment creditor" in § 3672, the predecessor of § 6323, was used by Congress "in the usual, conventional sense of a judgment of a court of record . . . ."

It is clear, however, that this characterization was not intended to exclude a trustee in bankruptcy from the scope of the phrase "judgment creditor." The issue before the Court in *Gilbert* was quite different.

Gilbert involved neither a bankruptcy proceeding nor the rights of a trustee in bankruptcy. *Gilbert* arose out of a state insolvency proceeding. The issue was whether an unrecorded federal tax lien was valid as against a municipal tax assessment which had neither been reduced to judgment nor accorded "judgment creditor" status by any statute. The asserted superior position of the local tax claim was based upon the fact that the New Hampshire court, in

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[2] In its brief in the Court of Appeals the Government for the first time stated that notice of the lien was in fact filed with the Recorder on February 9, 1961. The statement in the Referee's certificate that notice of the lien was never filed was not controverted in the District Court and, as respondent contends, there is no proof of the February filing in the record.

[3] See §§ 64a (1)–(3), 11 U.S.C. §§ 104(a) (1)–(3) (1964 ed.). Secured creditors, including those whose security was obtained subsequent to creation of the Government's lien, would have recourse to their security before any of the Bankruptcy Act priorities come into play. *Coggin* v. *California Labor Div.*, 336 U.S. 118; *City of Richmond* v. *Bird*, 249 U.S. 174. Administrative expenses and wage claims precede all other statutory liens on personal property not accompanied by possession if not enforced by sale prior to bankruptcy. § 67c, 11 U.S.C. § 107(c) (1964 ed.); *Coggin, supra*, 126–130.

[4] See *Brust* v. *Sturr*, 237 F. 2d 135 (C.A. 2d Cir.); *In re Fidelity Tube Corp.*, 278 F. 2d 776 (C.A. 3d Cir.) (Kalodner and Hastie, JJ., dissenting), cert. denied *sub nom. Borough of East Newark* v. *United States*, 364 U.S. 828; *Simonson* v. *Granquist*, 287 F. 2d 489 (C.A. 9th Cir.) (Hamley, J., expressing contrary views), rev'd on other grounds, 369 U.S. 38 [Ct. D. 1867, C.B. 1962–1, 302]. See also *United States* v. *England*, 226 F. 2d 205 (C.A. 9th Cir.) [Ct. D. 1790, C.B. 1956–1, 696]; *In re Taylorcraft Aviation Corp.*, 168 F. 2d 808 810 (C.A. 6th Cir.) (dictum).

the *Gilbert* insolvency proceeding, had, for the first time, conveniently characterized the local tax claim as "in the nature of a judgment," relying upon the procedures used by the taxing authorities.[5] Because the effect of federal tax liens should not be determined by the diverse rules of the various States, the Court held that the municipality was not a "judgment creditor" for purposes of the federal statute. The Court said:

> "A cardinal principal of Congress in its tax scheme is uniformity, as far as may be. Therefore, a 'judgment creditor' should have the same application in all the states. In this instance, we think Congress used the words 'judgment creditor' in § 3672 in the usual, conventional sense of a judgment of a court of record, since all states have such courts. We do not think Congress had in mind the action of taxing authorities who may be acting judicially as in New Hampshire and some other states, where the end result is something 'in the nature of a judgment,' while in other states the taxing authorities act quasi-judicially and are considered administrative bodies." (Footnotes omitted.) 345 U.S., at 364 [C.B. 1953–1, 476].[6]

In view of the nature of the claim for which superiority was asserted and because its dominant theme was the need for uniformity in construing the meaning of § 3672, *Gilbert* cannot be considered as governing the entirely different situation with respect to the rights conferred by Congress upon a trustee in bankruptcy. In the latter circumstance we are confronted with a specific congressional Act defining the status of the trustee. We have no problem of evaluating widely differing state laws. We have no possibility of unequal application of the federal tax laws, depending upon variances in the terms and phraseology of different state and local tax assessment statutes and judicial rulings thereon. Here we are faced with a uniform federal scheme—the rights of the trustee in bankruptcy in light of an unequivocal statement by Congress that he shall have "all" the rights of a judicial lien creditor with respect to the bankrupt's property.

The legislative history lends support to the conclusion drawn from the statutory language that the purpose of Congress was to invalidate an unrecorded federal tax lien as against the trustee in bankruptcy. It was in 1910 that Congress enacted § 70c, vesting the trustee "with all the rights, remedies, and powers of a judgment creditor."[7] Three years later, in 1913, Congress enacted the predecessor of § 6323, providing that an unrecorded federal tax lien was invalid as against a "judgment creditor."[8] These two statutes, with their corresponding references to "judgment creditor," co-existed for nearly 40 years. During that period, and prior to our decision in *Gilbert* in 1953, the only Court of Appeals squarely to pass upon the question decided that the trustee was a "judgment creditor" for purposes of avoiding an unrecorded federal tax lien. *United States* v. *Sands*, 174 F. 2d 384, 385 (C.A. 2d Cir.), rejecting contrary dictum in *In re Taylorcraft Aviation Corp.*, 168 F. 2d 808, 810 (C.A. 6th Cir.).

In amending the Bankruptcy Act in 1950, Congress deleted from § 70c the phrase "judgment creditor," providing instead that whether or not the bankrupt's property was in possession or control of the court, the trustee was to have "all the rights, remedies, and powers" of a creditor holding a judicial lien,[9]

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[5] 345 U.S., at 363 [C.B. 1953–1, 475], quoting from *Petition of Gilbert Associates, Inc.*, 97 N.H. 411, 414, 90 A. 2d 499, 502.

[6] The Government's brief also emphasized this concern for uniformity in administration of the federal tax laws. See brief for petitioner in *Gilbert*, No. 440, 1952 Term, pp. 22–24, where the Government argued: "Congress did not intend to subordinate federal tax liens to local tax liens merely because by state statute or state court decisions the local tax assessments are for local purposes denominated 'judgments' . . . . Moreover, in holding that under our 'decisions' and in 'this jurisdiction' the Town's tax assessments are 'judgments,' the court below failed to give sufficient heed to the repeated declarations of this Court that the federal revenue laws should be interpreted 'so as to give a uniform application to a nationwide scheme of taxation,' and hence their provisions are not to be deemed subject to state law unless the language of the section involved, expressly or by necessary implication, so requires."

[7] The Act of June 25, 1910, c. 412, 36 Stat. 838, 840, § 8, provided in part: "such trustees, as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a creditor holding a lien by legal or equitable proceedings thereon; and also, as to all property not in the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a judgment creditor holding an execution duly returned unsatisfied."

[8] Act of March 4, 1913, c. 166, 37 Stat. 1016.

[9] Act of March 18, 1950, c. 70, 64 Stat. 24, 26, now 11 U.S.C. § 70c. Prior to the amendment, § 70c characterized the trustee as a lien holder as to property in the court's possession or control and as a "judgment creditor" as to property not so reduced to possession. See n. 7, *supra*; *Lewis* v. *Manufacturers National Bank*, 364 U.S. 603, 605–606.

Elsewhere in the same legislation it was recognized that the category of those holding judicial liens includes judgment creditors,[10] and a judicial lien holder generally has "greater rights than a judgment creditor." [11] It is clear, therefore, that, with respect to the present problem, it was not the purpose of the 1950 amendments to reduce the powers of the trustee. As the House report accompanying the legislation noted, the revision of § 70c "has been placed in the bill for the protection of trustees in bankruptcy . . . also to simplify, and to some extent expand, the general expression of the rights of trustees in bankruptcy." [12]

In 1954 Congress dealt explicitly with the question whether the trustee ought to prevail against unrecorded federal tax liens. An unsuccessful effort was made, reflected in the House version of the proposed § 6323, expressly to exclude "artificial" judgment creditors like the trustee in bankruptcy.[13] At conference, the House conferees acceded to the views of the Senate, which deemed it "advisable to rely upon judicial interpretation of existing law instead of attempting to prescribe specific statutory rules." [14] The Government suggests that the "existing law" sought to be preserved was this Court's decision in *Gilbert*. But as of the date of the 1954 amendments, *Gilbert* had not yet been applied by any court to displace the rights of the trustee in bankruptcy as against an unrecorded federal tax lien. So far as that issue is concerned, it is more likely that reference to "existing law" was to the specific and then unchallenged rule announced by the Second Circuit in *United States* v. *Sands*, *supra*, and by other courts in other cases holding the trustee to have the rights of a judgment creditor.[15] As we have already noted, *Gilbert* is not inconsistent with the rule announced in *Sands*.

In recent years, and since the view began to spread that *Gilbert* compelled exclusion of the trustee from the benefits of § 6323, legislation has been introduced expressly to reiterate the trustee's power to upset unrecorded federal tax liens.[16] Such legislation was proposed not to alter the statutory scheme, but to remove what was thought to be an erroneous gloss placed upon it by the courts. Thus, both Senate and House committee reports accompanying a recent bill, H.R. 394, 88th Cong., reflect the belief that those decisions upon which the Government now relies "would appear to be contrary to the legislative purpose which gave the trustee all the rights of an ideal judicial lien creditor." [17]

In light of these legislative materials—the adoption of the phrase "judgment creditor" in both statutes, the legislative broadening of § 70c in 1950, and the expressions of congressional discontent with recent decisions excluding the trustee from § 6323—we are persuaded that, read together, § 6323 and § 70c entitle the trustee to prevail over unrecorded federal tax liens.

The Government seeks to ward off this result with the argument that so to read the statutes is to confer upon certain classes of creditors "windfalls" unwarranted by the equities of their situation. The question may, however, be stated less invidiously than the argument indicates: it is whether the Govern-

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[10] Act of March 18, 1950, c. 60, 64 Stat. 24, 25, now 11 U.S.C. § 96(a)(4). See 4 Collier, Bankruptcy, ¶ 70.49, n. 3, at 1415 (1962 ed.).

[11] See, *e.g.*, H.R. Rep. No. 745 86th Cong., 1st Sess., to accompany H.R. 7242, p. 10: "As a matter of general law the holder of a lien by legal proceedings has greater rights than a judgment creditor . . . . It would seem anomalous to allow judgment creditors to prevail over secret tax liens and to deny that right to a judicial lien holder."

[12] H.R. Rep. No. 1293, 81st Cong., 1st Sess., to accompany S. 88, p. 7. That this was the tenor of the amendment is generally conceded. See. *e.g.*, *In re Fidelity Tube Corp.*, 278 F. 2d, at 781, 786–787 (both majority and dissenting opinions); 4 Collier, *op. cit. supra*, at 1415; Seligson, Creditors' Rights, 32 N.Y.U.L. Rev. 708, 710 (1957).

[13] The proposed legislation was to make clear that "such protection is not extended to a judgment creditor who does not have a valid judgment obtained in a court of record and of competent jurisdiction" and that "particular persons shall not be treated as judgment creditors because State or Federal law artificially provides or concedes such persons rights or privileges of judgment creditors, or even designates them as such, when they have not actually obtained a judgment in the conventional sense." H.R. Rep. No. 1337, 83d Cong., 2d Sess., to accompany H.R. 8300, p. A407. See Treas. Reg. § 301.6323–1, incorporating the material rejected by the Eighty-third Congress.

[14] S. Rep. No. 1622, 83d Cong., 2d Sess., to accompany H.R. 8300, p. 575; H. Conf. Rep. No. 2543, 83d Cong., 2d Sess., to accompany H.R. 8300, p. 78.

[15] *E.G., Sampsell* v. *Straub*, 194 F. 2d 288, 231 (C.A. 3d Cir.), cert. denied, 343 U.S. 927; *McKay* v. *Trusco Finance Co.*, 198 F. 2d 431, 433 (C.A. 5th Cir.); *In re Lustron Corp.*, 184 F. 2d 789 (C.A. 7th Cir.), cert. denied *sub nom. Lafayette Steel Co.* v. *Lustron Corp.*, 340 U.S. 946.

[16] On two occasions the proposed legislation was approved by the appropriate House and Senate committees, and one bill received the assent of both Houses. See H.R. 7242, 86th Cong., 1st Sess., § 6, vetoed by President on September 8, 1960, 106 Cong. Rec. 19168; H.R. 394, 88th Cong., 2d Sess., § 6; H.R. 136, 89th Cong., 1st Sess., § 6.

[17] H.R. Rep. No. 454, 88th Cong., 1st Sess., p. 10; S. Rep. No. 1133, 88th Cong., 2d Sess., p. 11.

ment, unlike other creditors, and contrary to the general policy against secret liens, should be given advantage of a lien which it has not recorded as of the date of bankruptcy.[18] It is true that the consequences of depriving the United States of its secret lien is to improve the relative position of creditors—if there are any not already protected by § 6323—whose security was obtained subsequent to the Government's lien and who, once the federal lien is invalidated, have a prior claim to the secured assets. And our decision will enhance the possibility that there will be something in the bankrupt's estate for those claimants whose priorities are higher than that afforded unsecured tax claims,[19] as well as for state and local tax claims which share with the Federal Government the priority in § 64a(4), 11 U.S.C. § 104(a)(4). Whether this result is inadvisable need not detain us,[20] for the question is one of policy which in our view has been decided by Congress in favor of the trustee. In any event, it is possible for the Government in cases which it deems appropriate, to avoid a result which it regards with unhappiness by promptly filing notice of its lien.[21] Should experience indicate that inclusion of the trustee within § 6323 is inadvisable, the fact will not be lost upon Congress.

The Government advances one last and quite novel[22] argument predicated upon § 67b of the Bankruptcy Act, 11 U.S.C. § 107b (1964 ed.) which provides:

> "The provisions of section 60 of the Act to the contrary notwithstanding, statutory liens [including those] for taxes and debts owing to the United States or to any State or any subdivision thereof . . . may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four prior months prior to the filing of the petition . . . . Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws . . . ."

The contention is that the lower court's reading of § 70c and § 6323 cannot be correct, for it precludes the possibility which appears to be contemplated by § 67b—that a federal tax lien not perfected until after bankruptcy may nevertheless be "valid against the trustee." We find no such inconsistency. The purpose of § 67b, insofar as tax claims are concerned, is to protect them from § 60, 11 U.S.C. § 96 (1964 ed.), which permits the trustee to avoid transfers made within four months of bankruptcy. Thus § 67b permits an otherwise inchoate

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[18] In enacting the predecessor of § 6323 in 1913, Congress seems generally to have answered this question in the negative—and against secret liens. See H.R. Rep. No. 1018, 62d Cong., 2d Sess., pp. 1–2.

[19] See §§ 64a(1)–(3), 11 U.S.C. §§ 104(a)(1)–(3), giving priority to claims for administrative expenses, wages, and certain creditors' expenses. The claims of general creditors are, of course, in no way affected by our decision. And in some circumstances administrative expense and wage claimants would in any case prevail over the Government's lien. See n. 3, *supra*.

[20] We note that failure of the Government to record its lien may work a hardship upon persons subsequently extending credit in ignorance of the unrecorded lien, and that nondisclosure may induce others to incur administrative or other expenses which they would not incur if there were no hope of repayment. Moreover, state and local governments might reduce their claims to judgment if they knew of the existence of a federal lien. See Memorandum of Chairman, Drafting Committee of National Bankruptcy Conference, contained in S. Rep. No. 1133, 88th Cong., 2d Sess., to accompany H.R. 394, pp. 24–25.

[21] In its letter to Senator Eastland opposing H.R. 394, dated September 8, 1961, the Treasury asserted that "The Service has, as a matter of administrative practice, exercised forebearance as a creditor in cases when there exists a reasonable possibility that the business can regain financial stability. Enactment of the proposed amendments . . . could very well force the service to change this practice, which it is believed has been proved by experience to be highly desirable." S. Rep. No. 1133, 88th Cong., 2d Sess., p. 18. This same argument was made to an earlier Congress and rejected. See letter from Treasury, dated Aug. 9, 1960, in opposition to H.R. 7242, contained in S. Rep. No. 1871, 86th Cong., 2d Sess., p. 36.

[22] In the Court of Appeals the Government advanced, as an alternative basis for disposition of the case, the contention that pursuant to § 67b the alleged filing of notice in February of 1961 retroactively validated the lien as against the trustee. The court declined to reach the merits of this claim, noting that it had not been presented either to the referee or to the District Court and that there was no proof of record with respect to the alleged February filing. 335 F. 2d, at 314.

The § 67b argument raised in this Court differs from that rejected below, for that subsection is now cited to us as an aid in construing the relationship between § 70c and § 6323. Insofar as it is relevant to the particular problem of statutory construction presented by this case, we regard the § 67b argument as properly before us, for "Where the mind labours to discover the design of the legislature, it seizes every thing from which aid can be derived." *United States* v. *Fisher*, 2 Cranch 358, 386 (Marshall, C. J.). See also *United States* v. *Hutcheson*, 312 U.S. 219; *Estate of Sanford* v. *Commissioner*, 308 U.S. 39, 42–44; *United States* v. *Aluminum Co. of America*, 148 F. 2d 416, 429 (C.A. 2d Cir.) (L. Hand, J.).

federal tax claim to be "perfected" by assessment and demand within the four months prior to bankruptcy or afterwards.[23] It does not nullify or purport to nullify the consequences which flow from the Government's failure to file its perfected lien prior to the date when the trustee's rights as a statutory judgment creditor attach—namely, on filing of the petition in bankruptcy.[24] There is no indication in the language of § 67b, in the legislative history or in decisions of any court, that the subsection was intended to affect the construction or application of § 6323. In any event, we should hesitate to read § 67b as relevant to the relationship between § 70c and § 6323, for Congress in the very legislation proposed to clarify the trustee's rights under § 6323 did consider § 67b, and evidenced no awareness of interrelationship or of inconsistency.[25]

Affirmed.

Rev. Rul. 66–63 [1]

In view of the legislative history behind the adoption of the Revised Uniform Federal Tax Lien Registration Act in effect in Massachusetts, the Internal Revenue Service will consider the validity of the provisions of the law relating to real property separately from those relating to personal property.

Accordingly, since the Service has no objections to the provisions of Massachusetts law which require that liens against real property be filed with the register of deeds of the county where the real property is situated, notice of Federal tax lien against real property in the State of Massachusetts will no longer be filed with the clerk of the United States district court, and persons who have occasion to search for such notices will only have to search the office of the register of deeds where the real property is situated.

However, notice of Federal tax lien against personal property will continue to be filed with the clerk of the United States district court for the judicial district in which the taxpayer is domiciled. In addition, solely for the convenience of persons who have occasion to search, the Service will file a notice of such lien against personal property in the office of the clerk of the city or town in which the taxpayer is domiciled.

Revenue Ruling 64–170, C.B. 1964–1 (Part 1), 499, and Revenue Ruling 64–252, C.B. 1964–2, 497, which provide that the notices of Federal tax lien with respect to real property will be filed with the clerk of the United States district court in the judicial district in which the property is physically located, are modified insofar as they relate to real property in the State of Massachusetts.

SUBCHAPTER D.—SEIZURE OF PROPERTY FOR COLLECTION OF TAXES

SECTION 6334.—PROPERTY EXEMPT FROM LEVY

26 CFR 301.6334: Statutory provisions; property exempt from levy. T.D. 6870 [2]

[23] See *Simonson* v. *Granquist*, 369 U.S. 38, 41 [Ct. D. 1867, C.B. 1962–1, 302, 303]; 4 Collier, *op. cit. supra*, ¶ 67.20, at 183; cf. *Lewis* v. *Manufacturers National Bank*, 364 U.S., at 609.

[24] 4 Collier, *op. cit. supra*, ¶ 67.26, at 283–286, and ¶ 70.48, at 1407.

[25] See legislative materials cited at notes 11, 16, and 17, *supra*.

[1] Based on Technical Information Release 791, dated December 22, 1965.

[2] 30 F.R. 17165.

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Property exempt from levy—undelivered mail

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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) under section 6334 of the Internal Revenue Code of 1954, relating to property exempt from levy, to changes made by section 812 of the Excise Tax Reduction Act of 1965 [P.L. 89-44, C.B. 1965-2, 568], such regulations are amended as follows:

PARAGRAPH 1. Section 301.6334 is amended by adding a new paragraph (5) to section 6334(a) and by revising the historical note. The added and revised provisions read as follows:

§ 301.6334 STATUTORY PROVISIONS; PROPERTY EXEMPT FROM LEVY.

SEC. 6334. PROPERTY EXEMPT FROM LEVY.

(a) ENUMERATION.—There shall be exempt from levy.—

* * * * * * *

(5) UNDELIVERED MAIL.—Mail, addressed to any person, which has not been delivered to the addressee.

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[Sec. 6334 as amended by sec. 406, Social Security Amendments 1958 (72 Stat. 1047) [P.L. 85-840, C.B. 1958-3, 85]; as amended by sec. 812, Excise Tax Reduction Act of 1965 (79 Stat. 170) [P.L. 89-44, C.B. 1965-2, 568]]

PAR. 2. Paragraph (a) of § 301.6334-1 is amended by adding at the end thereof the following new subparagraph:

§ 301.6334-1 PROPERTY EXEMPT FROM LEVY.

(a) ENUMERATION.—There shall be exempt from levy.—

* * * * * * *

(5) UNDELIVERED MAIL.—Mail, addressed to any person, which has not been delivered to the addressee.

* * * * * * *

Because this Treasury Decision amends existing regulations merely by adding an additional item to the list of items of property exempt from levy to conform such regulations to the amendment made by section 812 of the Excise Tax Reduction Act of 1965 (79 Stat. 170), it is 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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved December 27, 1965.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on Dec. 30, 1965, 8:46 a.m., and published in the issue of the Federal Register for Dec. 31, 1965, 30 F.R. 17165)

CHAPTER 65.—ABATEMENTS, CREDITS, AND REFUNDS

SUBCHAPTER B.—RULES OF SPECIAL APPLICATION

SECTION 6421.—GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS

Refund of excise tax on gasoline used otherwise than as a fuel in a highway vehicle after June 30, 1965. See Rev. Rul. 66–48, page 9.

26 CFR 48.6421(a)–1: Payments to ultimate purchaser of gasoline used for certain nonhighway purposes.

Payments for fuel consumed by immobilized vehicles. See T.D. 6881, page 247.

SECTION 6424.—LUBRICATING OIL NOT USED IN HIGHWAY MOTOR VEHICLES

Refund of excise tax on lubricating oil used otherwise than in a highway motor vehicle after December 31, 1965. See Rev. Rul. 66–48, page 9.

CHAPTER 66.—LIMITATIONS

SUBCHAPTER A.—LIMITATIONS ON ASSESSMENT AND COLLECTION

SECTION 6501.—LIMITATIONS ON ASSESSMENT AND COLLECTION

26 CFR 301.6501(d)–1: Request for prompt assessment.

Whether an executor or administrator of an estate can be held personally liable for additional income taxes of a decedent by reason of the application of section 6501 (c) or (e) of the Code where prompt assessment under section 6501(d) of the Code was requested and the assets of the estate were subsequently distributed. See Rev. Rul. 66–43, page 291.

SECTION 6503.—SUSPENSION OF RUNNING OF PERIOD OF LIMITATION

26 CFR 301.6503(a)–1: Suspension of running of limitation; issuance of statutory notice of deficiency.

Effect of execution of waiver of restrictions. See Rev. Rul. 66–17, page 272.

SUBCHAPTER B.—LIMITATIONS ON CREDIT OR REFUND

SECTION 6511.—LIMITATIONS ON CREDIT OR REFUND

26 CFR 301.6511(b)-1: Limitations on allowance of credits and refunds. (Also Section 7503; 301.7503-1.) Rev. Rul. 66-118

The amount of a refund or credit will not be limited under the provisions of section 6511(b)(2)(A) of the Internal Revenue Code of 1954 where the last day of the limitation period is a Saturday, Sunday, or legal holiday and the claim is filed on the next succeeding day which is not a Saturday, Sunday, or legal holiday.
Revenue Ruling 57-354, C.B. 1957-2, 913 superseded in part.

Advice has been requested whether the limitation on the amount of a refund or credit under section 6511(b)(2)(A) of the Internal Revenue Code of 1954 is applicable in a situation where the filing of a claim was timely under section 7503 of the Code.

The taxpayer's individual income tax return for the calendar year 1958 was filed on or before April 15, 1959, the due date for filing the return. His sole source of income was salary and the amount of tax withheld exceeded the tax liability shown on the return. The overassessment was refunded on the initial processing of the return. No other action was taken by the Internal Revenue Service on the return. On April 16, 1962 (Monday), the taxpayer filed a claim for refund for the year 1958.

Section 6511(a) of the Code provides, in pertinent part, that a claim for credit or refund of an overpayment of any tax in respect of which the taxpayer is required to file must be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later.

Section 6511(b)(2)(A) of the Code provides that if the claim for refund was filed by the taxpayer during the 3-year period prescribed in subsection (a), the amount of the credit or refund shall not exceed the portion of the tax paid within the period, immediately preceding the filing of the claim, equal to 3 years plus the period of any extension of time for filing the return.

Section 6513(b) of the Code provides in part that for purposes of section 6511 or 6512 of the Code, any tax actually deducted and withheld at the source during any calendar year is deemed to have been paid by the recipient of the income on the 15th day of the fourth month following the close of his taxable year. A similar provision applies to taxpayers who file and pay their estimated income taxes during the taxable year.

Section 7503 of the Code provides that when the last day prescribed under authority of the internal revenue laws for performing any act falls on Saturday, Sunday, or a legal holiday, the performance of such act shall be considered timely if it is performed on the next succeeding day which is not a Saturday, Sunday, or a legal holiday.

Under the circumstances in the instant case, the claim for refund filed on Monday, April 16, 1962, was timely, having been filed within the 3-year period set forth in section 6511(a) of the Code in view of the provisions of section 7503 of the Code.

The question is then presented as to whether, notwithstanding that the filing of the claim was timely by reason of the provisions of section 7503 of the Code, the amount of refund allowable is restricted by section 6511(b) of the Code for the reason that in fact no tax was paid within the 3-year period immediately preceding the date of actual filing of the claim, the withheld tax in this case being deemed to have been paid on April 15, 1959, by virtue of section 6513(b) of the Code. Nothing in section 7503 of the Code affects the time when the tax was actually paid or is deemed to have been paid. Nevertheless, it would obviously nullify the full effectiveness of that section if the limitation of section 6511(b)(2)(A) of the Code were so applied that the refund could not be allowed under the circumstances here presented. Under the circumstances, it is considered that the effect of section 7503 of the Code in requiring that the filing "be considered timely if it is performed on the next succeeding day" is to treat the claim as if it had in fact been filed on the last day otherwise prescribed for such filing.

Accordingly, under the stated facts, the filing of the claim for refund in this case is not only deemed to have been timely by virtue of the provisions of section 7503 of the Code but to have occurred for purposes of section 6511(b) on April 15, 1962, so that section 6511(b) does not serve to restrict the amount refundable.

In view of the fact that Revenue Ruling 57–354, C.B. 1957–2, 913, was based, in part, on section 6511 of the Code prior to the amendment of such section by section 82 of the Technical Amendments Act of 1958, Public Law 85–866, C.B. 1958–3, 254, at 311, the last three paragraphs of that Revenue Ruling are hereby superseded.

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

26 CFR 301.6651–1: Failure to file tax return.

Period for computing delinquency penalty where the provisions of section 3402(d) of the Code are applicable. See Rev. Rul. 66–113, page 244.

CHAPTER 71.—TRANSFEREES AND FIDUCIARIES

SECTION 6901.—TRANSFERRED ASSETS

26 CFR 301.6901–1: Procedure in the case of transferred assets. Rev. Rul. 66–43

(Also Section 6501; 301.6501(d)–1.)

Where an executor or administrator has neither personal knowledge of an unpaid income tax liability of decedent nor has such

knowledge as would put a reasonably prudent man on inquiry, he cannot be held personally liable for the tax payment under section 3467 of the Revised Statutes.

Advice has been requested whether an executor or administrator of an estate can be held personally liable for additional Federal income taxes of a decedent by reason of the application of section 6501 (c) or section 6501(e) of the Internal Revenue Code of 1954 where the executor or administrator has requested prompt assessment of the decedent's tax under section 6501(d) of the Code and has not been advised by the Internal Revenue Service of any action with respect thereto within the 18-month period prescribed by section 6501(d) of the Code, and thereafter has proceeded to distribute the assets of the estate.

Section 6501(d) of the Code provides that, except as otherwise provided in subsection (c), (e), or (f), income tax of a decedent or his estate during the period of administration shall be assessed, and any proceeding in court without assessment for the collection of such tax shall be begun, within 18 months after proper written request therefor by the executor, administrator, or other fiduciary representing the estate of the decedent, but not after 3 years from the filing of the return. Thus, even though prompt assessment under section 6501(d) of the Code has been properly requested, the tax may be assessed at any time in the case of false or fraudulent returns, willful attempt to evade tax, or no returns filed, as provided under section 6501(c) of the Code, and within 6 years after filing of the return in the case of an omission from gross income as provided under section 6501(e) of the Code. In view of the provisions of section 6901(a)(1)(B) of the Code, the question arises whether personal liability can be imposed on an executor or administrator where such an assessment of tax has been made after the 18-month period has expired and after distribution of an estate's assets.

Section 301.6901–1(a) of the Regulations on Procedure and Administration provides that the amount of the personal liability of a fiduciary under section 3467 of the Revised Statutes (31 U.S.C. 192) in respect of the payment of income tax, whether shown on the return of the taxpayer or determined as a deficiency in the tax, shall be assessed against the fiduciary and paid and collected in the same manner and subject to the same provisions and limitations as in the case of a deficiency in the tax with respect to which such liability is incurred. Section 3467 of the Revised Statutes provides that every executor, administrator, assignee, or other person who pays, in whole or in part, any debt due by the person or estate for whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate to the extent of such payments for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

In *Irving Trust Company*, 36 B.T.A. 146, acquiescence C.B. 1937–2, 15, the personal liability of a trustee under section 3467 of the Revised Statutes was considered and there it was stated:

* * * Section 3467 imposes personal liability upon a trustee who distributes the debtor's property to other creditors before satisfying the debts due the United States. The trustee may become personally liable even though the United States has not proved its claim in the bankruptcy proceedings. But the courts have

held, in interpreting section 3467, that in order to render a trustee personally liable, it must appear that the trustee is chargeable with knowledge of the debt due to the United States. "It is only when the assignee has notice of the claim of the Government that he incurs personal liability for making distribution of the estate without providing for the claim." *United States* v. *Barnes*, 31 Fed. 705. The claim may be listed in the schedules of the bankrupt, notice may be given to the trustee, or the trustee may learn of the debt in some other way. If the trustee has knowledge of the debt, it matters not how that knowledge was obtained. The trustee can not disregard or ignore the debt, and if he does, his breach of duty renders him liable personally. *United States* v. *Kaplan*, 74 Fed. (2d) 664. "It is enough if the trustee be in possession of such facts as that a faithful and fair discharge of his duty would put him on inquiry." *United States* v. *Clark*, 25 Fed. Cases 447, 451. But he is not personally liable for a tax without notice which should put a reasonably prudent man upon inquiry. *Livingston* v. *Becker*, 40 Fed. (2d) 673; *United States* v. *Eyges*, 286 Fed. 683. No case is cited which holds a fiduciary personally liable where he was not chargeable with knowledge of the debt due the United States.

The personal liability of a fiduciary was considered in *Giovaninni Terranova*, 2 T.C.M. 616 (1943), and it was held the administrators were not personally liable for income tax deficiencies of their decedent which were not assessed by the Commissioner until after the administrators had secured their discharge and there was nothing in the facts to put them on notice that the decedent owed income taxes. In this case the Tax Court referred to the above language in the *Irving Trust Company* decision as a complete answer to the question.

Accordingly, an executor or administrator of an estate cannot be held personally liable under section 3467 of the Revised Statutes for any unpaid income tax liability of a decedent unless he has either personal knowledge of the debt, or has such knowledge as would put a reasonably prudent man on inquiry.

CHAPTER 74.—CLOSING AGREEMENTS AND COMPROMISES

SECTION 7121.—CLOSING AGREEMENTS

26 CFR 301.7121–1: Closing agreements.

Closing agreements with respect to liability for tax on accumulated earnings in respect of deposits or accounts in banks or similar financial institutions. See Rev. Proc. 66–27, page 655.

CHAPTER 77.—MISCELLANEOUS PROVISIONS

SECTION 7503.—TIME FOR PERFORMANCE OF ACTS WHERE LAST DAY FALLS ON SATURDAY, SUNDAY, OR LEGAL HOLIDAY

26 CFR 301.7503–1: Time for performance of acts where last day falls on Saturday, Sunday, or legal holiday.

Timeliness of refund claim filed on the next succeeding day which is not a Saturday, Sunday, or legal holiday, where the last day to file

refund claim falls on a Saturday, Sunday, or legal holiday. See Rev Rul. 66–118, page 290.

CHAPTER 79.—DEFINITIONS

SECTION 7701.—DEFINITIONS

26 CFR 301.7701–11: Account number.

Identifying numbers of persons drawing social security benefits as widows age 62 or over before January 1, 1963. See Rev. Proc. 66–29, page 656.

CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

26 CFR 301.7805–1: Rules and regulations.

Method of computing the period during which a capital asset must be held in order to have been "held for more than 6 months." See Rev. Rul. 66–7, page 188.

Applicability of the tax to Panamanian social security benefit payments subsequent to December 31, 1965. See Rev. Rul. 66–34, page 22.

MISCELLANEOUS PROVISIONS

26 CFR 1.9101–1: Permission to submit information required by certain returns and statements on magnetic tape. (Also Section 6011; 31.6011(a)–7.) T.D. 6883[1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON AND AFTER JANUARY 1, 1955

Permission to submit information required by certain returns and statements on magnetic tape.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

In order to provide authority under the Income Tax Regulations (26 CFR Part 1) and the Employment Tax Regulations (26 CFR

[1] 31 F.R. 6589.

Part 31) for the granting of permission to payers and others to submit information required by certain returns and statements on magnetic tape or by other media, such regulations are amended as follows:

INCOME TAX REGULATIONS

(26 CFR Part 1)

PARAGRAPH 1. There is inserted immediately after § 1.6041–6 the following new section:

§ 1.6041–7 PERMISSION TO SUBMIT INFORMATION REQUIRED BY FORM 1099 OR W–2 ON MAGNETIC TAPE.—For rules relating to permission to submit the information required by Form 1099 or W–2 on magnetic tape or other media, see § 1.9101–1. See also paragraph (b)(2) of § 31.6011(a)–7 of this chapter (Employment Tax Regulations) for additional rules relating to Form W–2.

PAR. 2. Section 1.6042–2 is amended by adding a new paragraph (e) to read as follows:

§ 1.6042–2 RETURNS OF INFORMATION AS TO DIVIDENDS PAID IN CALENDAR YEARS AFTER 1962.

* * * * * * *

(e) *Permission to submit information required by Form 1087 or 1099 on magnetic tape.*—For rules relating to permission to submit the information required by Form 1087 or 1099 on magnetic tape or other media, see § 1.9101–1.

PAR. 3. Section 1.6044–2 is amended by adding a new paragraph (f) to read as follows:

§ 1.6044–2 RETURNS OF INFORMATION AS TO PAYMENTS OF PATRONAGE DIVIDENDS WITH RESPECT TO PATRONAGE OCCURRING IN TAXABLE YEARS BEGINNING AFTER 1962.

* * * * * * *

(f) *Permission to submit information required by Form 1099 on magnetic tape.*—For rules relating to permission to submit the information required by Form 1099 on magnetic tape or other media, see § 1.9101–1.

PAR. 4. Section 1.6047–1 is amended by adding a new paragraph (d) to read as follows:

§ 1.6047–1 INFORMATION TO BE FURNISHED WITH REGARD TO EMPLOYEE RETIREMENT PLAN COVERING AN OWNER-EMPLOYEE.

* * * * * * *

(d) *Permission to submit information required by Form 1099 on magnetic tape.*—For rules relating to permission to submit the information required by Form 1099 on magnetic tape or other media, see § 1.9101–1.

PAR. 5. Section 1.6049–1 is amended by adding a new paragraph (e) to read as follows:

§ 1.6049–1 RETURNS OF INFORMATION AS TO INTEREST PAID IN CALENDAR YEARS AFTER 1962.

* * * * * * *

(e) *Permission to submit information required by Form 1087 or 1099 on magnetic tape.*—For rules relating to permission to submit the information required by Form 1087 or 1099 on magnetic tape or other media, see § 1.9101–1.

PAR. 6. There is inserted immediately after § 1.9100–1 the following new section:

§ 1.9101–1 PERMISSION TO SUBMIT INFORMATION REQUIRED BY CERTAIN RETURNS AND STATEMENTS ON MAGNETIC TAPE.—In any case where the use of a Form 1087, 1099, or W–2 is required by the regulations under this part for the purpose of making a return or reporting information, such requirement may be

satisfied by submitting the information required by such form on magnetic tape or by other media, provided that the prior consent of the Commissioner or other authorized officer or employee of the Internal Revenue Service has been obtained. Applications for such consent must be filed in accordance with procedures established by the Internal Revenue Service. See paragraph (b)(2) of § 31.6011(a)–7 of this chapter (Employment Tax Regulations) for additional rules relating to Form W–2.

EMPLOYMENT TAX REGULATIONS

(26 CFR Part 31)

PAR. 7. Paragraph (b) of § 31.6011(a)–7 is amended to read as follows:

§ 31.6011(a)–7 EXECUTION OF RETURNS.

* * * * * * *

(b) *Use of prescribed forms.*—(1) *In general.*—Copies of the prescribed return forms will so far as possible be regularly furnished taxpayers by district directors. A taxpayer will not be excused from making a return, however, by the fact that no return form has been furnished to him. Taxpayers not supplied with the proper forms should make application therefor to the district director in ample time to have their returns prepared, verified, and filed with the district director on or before the due date. See §§ 31.6071(a)–1 and 31.6091–1, relating, respectively, to the time and place for filing returns. In the absence of a prescribed return form, a statement made by a taxpayer disclosing the aggregate amount of wages or compensation reportable on such form for the period in respect of which a return is required and the amount of taxes due may be accepted as a tentative return. If filed within the prescribed time, the statement so made will relieve the taxpayer from liability for the addition to tax imposed for the delinquent filing of the return, provided that without unnecessary delay such tentative return is supplemented by a return made on the proper form. For additions to the tax in case of failure to file a return within the prescribed time, see the provisions of § 301.6651–1 of this chapter (Regulations on Procedure and Administration).

(2) *Permission for use of magnetic tape.*—(i) *Form W–2.*—In any case where an employer is required by the regulations under this part to submit a copy of a Form W–2 as part of a return or together with an information statement, such requirement may be satisfied by submitting the information required by such form on magnetic tape or by other media, provided that the prior consent of the Commissioner or other authorized officer or employee of the Internal Revenue Service has been obtained. Applications for such consent must be filed in accordance with procedures established by the Internal Revenue Service. See § 1.9101–1 of this chapter (Income Tax Regulations) for additional rules relating to Form W–2.

(ii) *Schedule A of Form 941 or 943.*—In any case where the use of a Schedule A of Form 941 or 943 is required by such Forms or the regulations under this part for the purpose of making a return, such requirement may be satisfied, to the extent prior consent is obtained from the Commissioner or other authorized officer or employee of the Internal Revenue Service, by submitting selected items of the information required by such Schedule on magnetic tape or by other media. Applications for such consent must be filed in accordance with procedures established by the Internal Revenue Service.

* * * * * * *

Because this Treasury Decision merely prescribes regulations to provide an alternative means for submitting information required by certain returns and statements, it is 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 the 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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved April 27, 1966.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on May 2, 1966, 8:46 a.m., and published in the issue of the Federal Register for May 3, 1966, 31 F.R. 6589)

PART II

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939 AND OTHER PUBLIC LAWS, EXCEPT THOSE PERTAINING TO ALCOHOL, AND TOBACCO TAXES

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 23(m).—DEDUCTIONS FROM GROSS INCOME: DEPLETION

REGULATIONS 118, SECTION 39.23(m)–5: Computation of depletion based on percentage of income in case of certain mines or other natural deposits.

Denial of depletion allowance for clay used, or sold for use, by a mineowner or operator, as one of the constituents of the kiln feed in the manufacture of cement. See Rev. Rul. 66–24, page 157.

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT B.—COMPUTATION OF NET INCOME

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION

REGULATIONS 118, SECTION 39.114–1: Basis for allowance of depreciation and depletion.

Denial of depletion allowance for clay used, or sold for use, by a mineowner or operator, as one of the constituents of the kiln feed in the manufacture of cement. See Rev. Rul. 66–24, page 157.

SECTION 127(c).—WAR LOSSES: RECOVERIES

Regulations 118, Section 39.127(a)–1: War losses generally.

Tax treatment of awards received by corporations from the Foreign Claims Settlement Commission under the War Claims Act of 1948, as amended. See Rev. Rul. 66–115, page 192.

PART III

ALCOHOL AND TOBACCO TAX MATTERS

SUBPART A.—ALCOHOL TAX RULINGS AND DECISIONS UNDER CHAPTER 51 OF THE INTERNAL REVENUE CODE OF 1954 AND THE FEDERAL ALCOHOL ADMINISTRATION ACT

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 B.—Rectification

SECTION 5021.—IMPOSITION AND RATE OF TAX

26 CFR 201.422: Form 27–B Supplemental. Rev. Rul. 66–121

Revenue Ruling 54–235, C.B. 1954–1, 304, held that while simple syrup or a sugar solution of not less than 60° Balling could be used on rectifying plant premises in the manufacture of a wine product, rectified wine, or wine cocktail, water as such could not be used.

The provisions of the above Ruling precluding the use of water as such were based on section 2801(b) of the Internal Revenue Code of 1939 (reenacted as section 5021(b) of the Internal Revenue Code of 1954). However, paragraph (b) of section 5021 of the Code was eliminated by the Excise Tax Technical Changes Act of 1958, Public Law 85–859, C.B. 1958–3, 92.

Since the use of water in the treatment of wine subject to the rectification tax is no longer precluded by law, Revenue Ruling 54–235, C.B. 1954–1, 304, is hereby revoked.

PART II.—OCCUPATIONAL TAX

Subpart D.—Wholesale Dealers

SECTION 5114.—RECORDS

26 CFR 251.135: Forms to be provided by users at own expense.

Application for modification of Forms 52A, 52B, or 338. See T.D. 6875, page 312.

SUBCHAPTER B.—QUALIFICATION REQUIREMENTS FOR DISTILLED SPIRITS PLANTS

SECTION 5174.—WITHDRAWAL BONDS

26 CFR 170.41: Scope of subpart. T.D. 6877[1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PART 170.—MISCELLANEOUS REGULATIONS RELATING TO LIQUOR

Miscellaneous amendments

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

On January 7, 1966, a notice of proposed rulemaking was published in the Federal Register (31 F.R. 217) to amend 26 CFR Part 170, to (1) provide for the deferred payment of taxes on distilled spirits, withdrawn from internal revenue bond under section 5174(a)(2) of the Internal Revenue Code, after operations incidental to the rectification and bottling of such spirits have been completed; and (2) discontinue the optional 3-day period (provided for in Subpart W of 26 CFR Part 170 as added by Treasury Decision 6848, 30 F.R. 11599 [C.B. 1965–2, 499]) for the filing of returns by proprietors of distilled spirits plants. On January 12, 1966, a Correction Notice was published in the Federal Register (31 F.R. 352). In accordance with the notice, interested persons were afforded an opportunity to submit written comments or suggestions pertaining thereto. No comments or suggestions were received within the 30-day period prescribed in the notice, and the following amendments to the regulations are hereby adopted.

SUBPART C.—REGULATIONS RESPECTING THE FILING OF RETURNS AND PAYMENT OF TAXES ON DISTILLED SPIRITS AND RECTIFIED PRODUCTS BY RETURN

PREAMBLE

These regulations shall not affect any liability accruing or accrued, or any suit commenced before the effective date of these regulations.

Sec.

170.41 Scope of subpart.
170.42 Other regulations applicable.
170.43 Meaning of terms.

PAYMENT OF TAXES ON DISTILLED SPIRITS AND RECTIFIED PRODUCTS

170.44 General.
170.45 Deferred payment of distilled spirits tax by proprietor of bonded premises.

[1] The publication of this Treasury Decision in 31 F.R. 3178, dated Feb. 26, 1966, contains (1) instructions for modifying the notice of proposed rulemaking published in 31 F.R. 217, dated Jan. 7, 1966, 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.

170.46 Deferred payment of distilled spirits tax by proprietor of bottling premises.
170.47 Deferral denied under certain conditions.
170.48 Deferred payment of tax on rectified products.
170.49 Return periods and times for filing.
170.50 Computation of amount of tax to be paid by proprietor of bottling premises.
170.51 Default in payment of taxes.

CONTROL PREMISES

170.52 Control premises.
170.53 Segregation of stocks.

BONDS AND CONSENTS OF SURETY

170.54 Bonds.
170.55 Consents of surety.

OPERATIONS BY ALTERNATING PROPRIETORS

170.56 Procedure for alternating proprietors.

DISCONTINUANCE OF BUSINESS

170.57 Permanent discontinuance of business.

INVENTORIES AND RECORDS

170.58 Establishment of controlled stock inventory.
170.59 Inventories of controlled stock.
170.60 Record of inventories.
170.61 Summary records.
170.62 Record of tax liability.
170.63 Credits against assumed liability.

§ 170.41 SCOPE OF SUBPART.—This subpart provides regulations respecting (a) the deferred payment, by proprietors of distilled spirits plants, of taxes on distilled spirits pursuant to returns on Form 2522 and Form 4077, and of taxes on rectified products and wines pursuant to returns on Form 2527, (b) the periods to be covered by such returns, and (c) the times for filing such returns, with remittances. The requirements of this subpart with respect to control premises and controlled stock shall be applicable only to proprietors of bottling premises required to file returns on Form 4077 under the provisions of this subpart.

§ 170.42 OTHER REGULATIONS APPLICABLE.—All provisions of Part 201 of this chapter not inconsistent with the provisions of this subpart shall remain in full force and effect, and all such provisions applicable to returns, remittances, bonds and consents of surety (other than the provisions of § 201.194 of this chapter relating to powers of attorney), operations by alternate proprietors, and inventories and records, shall be applicable to returns, remittances, bonds and consents of surety, operations by alternate proprietors, and inventories and records under this subpart. The provisions of Subpart B of this part shall be applicable to powers of attorney authorizing agents or officers to execute bonds and consents of surety given under this subpart.

§ 170.43 MEANING OF TERMS.—When used in this subpart, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, terms shall have the meanings ascribed in Part 201 of this chapter and in this subpart.

Control premises.—The premises, as provided in § 170.52, on which controlled stock is rectified, bottled, packaged, or stored.

Controlled stock.—Stock on control premises, comprising:

(a) tax-determined domestic spirits received for rectification or bottling;

(b) tax-determined imported spirits received from internal revenue bond (as authorized by section 5232, I.R.C.) for rectification or bottling;

(c) other tax-determined imported spirits dumped and reported on batch record Form 122 for use in production of rectified distilled spirits product;

(d) alcoholic flavoring materials, wines, and products made with wine, dumped and reported on batch record Form 122 for use in production of a rectified distilled spirits product;

(e) distilled spirits products received and dumped for reprocessing or rebottling;

(f) any mixture of, or product made from, the preceding;

(g) any of the preceding (1) on the control premises of a proprietor on the commencement of business under the provisions of this subpart, or (2) received from an outgoing proprietor as controlled stock under the provisions of § 170.56.

PAYMENT OF TAXES ON DISTILLED SPIRITS AND RECTIFIED PRODUCTS

§ 170.44 GENERAL.—Notwithstanding any provision of Part 201 of this chapter, or of Subpart W of this part, relating to (a) the periods to be covered by returns on Form 2522 for the deferred payment of taxes on distilled spirits, and on Form 2527 for the deferred payment of taxes on rectified products and wines, (b) the times for filing returns for the deferred payment of taxes, and (c) the amount of tax to be included for payment with such returns, proprietors of distilled spirits plants shall file returns for the deferred payment of taxes on distilled spirits, and on rectified products and wines, determined on and after the effective date of this subpart, on the forms, for the periods, by the times, and with remittances in the amounts, as provided in this subpart.

§ 170.45 DEFERRED PAYMENT OF DISTILLED SPIRITS TAX BY PROPRIETOR OF BONDED PREMISES.—A proprietor of bonded premises who has withdrawn spirits from such premises on determination and before payment of tax shall file a tax return covering such spirits on Form 2522, with remittance, for the periods and by the times provided in § 170.49. The proprietor of bonded premises shall include, for payment, on his return on Form 2522 the full amount of distilled spirits tax determined in respect of all spirits released for withdrawal from bonded premises on determination of tax during the period covered by the return (except spirits on which tax has been prepaid, and spirits withdrawn on determination of tax by proprietors of bottling premises). The proprietor of bonded premises who is qualified under bond, Form 2613 or 2615, to defer payment of distilled spirits tax, shall execute and file a return on Form 2522 to cover each return period, notwithstanding that no tax is due for payment for such period.

§ 170.46 DEFERRED PAYMENT OF DISTILLED SPIRITS TAX BY PROPRIETOR OF BOTTLING PREMISES.—A proprietor of bottling premises

who has assumed the liability for tax on spirits withdrawn from internal revenue bond under section 5174(a)(2), I.R.C., shall pay such tax pursuant to returns on Form 4077, or, if he is in default, pursuant to a prepayment return on Form 2521, as prescribed in § 170.51. Returns on Form 4077 shall be filed for the periods and by the times provided in §170.49. The amount of such tax to be paid with each return on Form 4077 shall be computed as provided in § 170.50. Spirits withdrawn from bond under section 5174(a)(2), I.R.C., shall be conveyed without delay to the bottling premises and shall be reported as received when they arrive at the bottling premises. The proprietor of each bottling premises who is qualified under bond, Form 2614 or 2615, to defer payment of distilled spirits tax, shall execute and file a return on Form 4077 to cover each return period, notwithstanding that no tax is due for payment on such form.

§ 170.47 Deferral Denied Under Certain Conditions.—Any proprietor deferring payment of tax under the provisions of § 170.46 who, after having been advised of his deficiency by the assistant regional commissioner, fails to maintain the records required by, or who otherwise fails to conform to any provisions of, this subpart and who is then so notified by the assistant regional commissioner, may thereafter withdraw from internal revenue bond for rectification or bottling only spirits in respect of which the tax thereon has been paid prior to such withdrawal: *Provided*, That he shall be permitted to again withdraw spirits under the provisions of section 5174(a)(2), I.R.C., if he satisfies the assistant regional commissioner that he is properly maintaining the prescribed records and will, in all respects, conform to the provisions of this subpart.

§ 170.48 Deferred Payment of Tax on Rectified Products.—A proprietor of bottling premises who has, during a return period, incurred liability for taxes determined on rectified products, and has not prepaid such taxes, shall file a tax return for that period, covering such products, on Form 2527, with remittance, in the full amount of the taxes so determined but not paid. Returns on Form 2527 shall be filed for the periods and by the times provided in § 170.49.

§ 170.49 Return Periods and Times for Filing.—Return periods shall run from the 1st day of each month through the 15th day of that month, and from the 16th day of each month through the last day of that month. Returns for periods ending on the 15th day of the month shall be filed, with remittances, not later than the 25th day of the same month; and returns for periods ending on the last day of a month shall be filed, with remittances, not later than the 10th day of the next succeeding month. Commencing with the return for the period beginning July 1, 1966, and for each subsequent return period, returns shall be filed, with remittances, for each such return period, not later than the last day of the return period next succeeding that period. The provisions of § 201.383 of this chapter regarding (a) the 2 p.m. time of filing the return and remittance, (b) the person with whom the return and remittance shall be filed, and (c) the date of delivery when delivery is by United States mail, shall be applicable to the filing of returns, with remittances, under this subpart. (72 Stat. 1335; 26 U.S.C. 5061.)

§ 170.50 Computation of Amount of Tax To Be Paid by Proprietor of Bottling Premises.—A proprietor of bottling premises who is

required to file returns on Form 4077 (as provided in § 170.46) shall, as of the close of each return period, compute the amount of tax to be paid with such return, in the following manner:

(a) Determine the balance of his outstanding liability from the record required by § 170.62 (less any payments made by returns on Form 4077 for prior return periods but filed subsequent to the close of the return period for which the computation is being made).

(b) Determine the tax value of the controlled stock inventory (1) by deducting from the total proof gallons in such inventory (i) the proof gallons of all alcoholic materials (distilled spirits, wines, products made with wine, and alcoholic flavoring materials) entered into controlled stock during the period which were not withdrawn from bond under the provisions of section 5174(a)(2), I.R.C., and (ii) the proof gallons in the controlled stock inventory of any mixture or product which derived less than half of its proof gallon content from tax-determined spirits, and (2) by multiplying the remainder of proof gallons by an amount equal to the rate of tax prescribed by section 5001(a)(1), I.R.C.

(c) Determine, and pay with the return for the period, the amount by which the balance of his outstanding liability (as determined in paragraph (a) of this section) exceeds the tax value (as determined in paragraph (b) of this section of the controlled stock inventory: *Provided*, That in any case where the proof gallons to be deducted from the controlled stock inventory under the provisions of paragraph (b)(1) of this section equals or exceeds the total proof gallons in the end of the period inventory of controlled stock, the total liability remaining unpaid (as determined under the provisions of paragraph (a) of this section) shall be paid with the return for the period.

(d) Notwithstanding the provisions of paragraph (c) of this section, the amount to be paid with the return shall be increased by any amount necessary to comply with the requirements of paragraphs (e) and (f) of this section, and shall be reduced by the amount of any authorized credit taken on the return.

(e) Any tax for which liability for payment was assumed under the provisions of section 5174(a)(2), I.R.C., which has not been previously paid as provided in this subpart shall be paid with the return on Form 4077 for the twelfth return period next succeeding (1) the return period in which falls the date of receipt at the bottling premises of the spirits reported on the withdrawal form, or (2) the return period in which falls the twenty-first day after the date of the certificate of tax determination on the withdrawal form, whichever period occurs first.

(f) The outstanding liability which would remain after compliance with the provisions of paragraphs (a) through (e) of this section shall not exceed the tax value of the controlled stock removed by the proprietor during any six consecutive return periods within the thirty return periods preceding the period for which the return on Form 4077 is being prepared; such tax value to be computed by (1) determining (from the record prescribed by § 170.61(c)(3)) the total proof gallons removed from controlled stock during the six consecutive return periods, and (2) multiplying that total by an amount equal to the rate of tax prescribed by section 5001(a)(1), I.R.C. The six con-

secutive return periods shall be designated by the proprietor. The provisions of this paragraph shall not be applicable to the liability outstanding at the close of each of the first six return periods after the commencement of operations by the proprietor under this subpart.

§ 170.51 DEFAULT IN PAYMENT OF TAXES.—The provisions of Part 201 of this chapter relating to default in deferred pyament of taxes shall be applicable to default in deferred payment of taxes under this subpart. In addition, if a proprietor of bottling premises has defaulted in payment of any tax under this subpart, he shall not remove any controlled stock from his control premises until he has filed a return on Form 2521 (appropriately modified), with remittance, in an amount not less than the product of the number of proof gallons of the controlled stock proposed to be removed and the rate of tax prescribed by section 5001(a)(1), I.R.C.; however, notwithstanding that the tax is paid pursuant to return on Form 2521 under the provisions of this section, a return on Form 4077 shall be filed for each return period as provided in § 170.46. The proprietor shall retain with his copy of each return on Form 2521 (showing receipt of the remittance by the internal revenue officer or district director, as the case may be) a record showing the kind of spirits, type, size, and serial numbers of the containers and the proof gallons of the spirits removed, or to be removed, pursuant to such return. Where a proprietor of bottling premises has defaulted in any payment of tax under this subpart, during the period of such default and thereafter until the assistant regional commissioner finds that the revenue will not be jeopardized by payment of tax pursuant to return on Form 4077, tax shall be paid by such proprietor in accordance with the provisions of this section.

CONTROL PREMISES

§ 170.52 CONTROL PREMISES.—The bottling premises of the distilled spirits plant shall constitute the control premises: *Provided*, That a proprietor who desires to establish additional control premises on his general plant premises may submit to the assistant regional commissioner an application for amended registration, Form 2607, and an amended plat delineating such additional premises. Approval of the Form 2607 by the assistant regional commissioner shall constitute approval of the additional control premises, and the control premises shall then consist of the bottling premises and the additional premises depicted on the amended plat. Each plat submitted under this section shall be prepared in accordance with the applicable provisions of §§ 201.154 and 201.155 of this chapter, and shall depict the relative location of the bottling premises and the proposed additional control premises. The provisions of § 201.174(a) of this chapter shall be applicable to operation by alternating proprietors of additional control premises established under the provisions of this subpart.

§ 170.53 SEGREGATION OF STOCKS.—Proprietors of bottling premises shall keep all controlled stock physically separated from other stock on their control premises. Such separation shall be effectuated by use of separate tanks, rooms, or buildings, or by partitioning, or by such other manner or method satisfactory to the assistant regional commissioner as will clearly and readily distinguish controlled stock from other stock on the control premises and as will facilitate verification

of the inventory. All stock on control premises shall be so identified as to enable internal revenue officers to readily ascertain whether the stock is controlled stock or other stock.

BONDS AND CONSENTS OF SURETY

§ 170.54 BONDS.—(a) *Form 2613, 2614, or 2615.*—A proprietor whose bond on Form 2613, 2614, or 2615, covering the deferred payment of taxes on distilled spirits withdrawn from bonded premises on determination of tax, is in a sufficient penal sum shall give either a new bond on Form 2613, 2614, or 2615, as applicable, or a consent of surety on Form 1533 to extend the terms of his bond then in force to cover the deferred payment of tax on distilled spirits under the provisions of this subpart. A proprietor whose bond on Form 2613, 2614, or 2615 is not in a sufficient penal sum, shall give either a new bond in a sufficient penal sum on Form 2613, 2614, or 2615, as applicable, or a strengthening bond to increase the total penal sum of the bonds in force to a sufficient penal sum. Each proprietor giving a strengthening bond shall also file a consent of surety on Form 1533 to extend the terms of his bond, Form 2613, 2614, or 2615, then in force to cover the payment of taxes on distilled spirits under the provisions of this subpart.

(b) *Form 2601.*—A proprietor of bottling premises who files returns on Form 2527 shall give either a new bond on Form 2601 or a consent of surety on Form 1533 to extend the terms of his bond, Form 2601, then in force, to cover the payment of taxes on rectified products and wines under the provisions of this subpart.

(c) *Exception.*—Notwithstanding the provisions of paragraphs (a) and (b) of this section, a proprietor whose bond is in a sufficient penal sum and who is qualified under the provisions of Subpart W of this part (as added by Treasury Decision 6848, effective September 24, 1965) for extended deferral of payment of taxes (1) on spirits withdrawn from bond in his capacity as a proprietor of bonded premises, or (2) on rectified products and wines, shall be deemed to be qualified for deferral of payment of taxes on spirits so withdrawn or on rectified products and wines, as the case may be, under the provisions of this subpart. (72 Stat. 1349, 1352; 26 U.S.C. 5173, 5174.)

§ 170.55. CONSENTS OF SURETY.—Each consent of surety on Form 1533 required under the provisions of § 170.54 shall identify the particular bond to which it applies and shall contain a statement of purpose as follows—

(a) With respect to bond, Form 2613, 2614, or 2615:

"To continue in effect said bond (including all extensions or limitations of terms and conditions previously consented to and approved), notwithstanding that the deferred payment of taxes on distilled spirits withdrawn from bond on determination of tax will be made as provided for by regulations in Subpart C of 26 CFR Part 170."

(b) With respect to bond, Form 2601:

"To continue in effect said bond (including all extensions or limitations of terms and conditions previously consented to and approved), notwithstanding that the deferred payment of taxes

on rectified products and wines will be made as provided for by regulations in Subpart C of 26 CFR Part 170."

Operations by Alternating Proprietors

§ 170.56 Procedures for Alternating Proprietors.—(a) *General.*—Where bottling premises are operated by alternating proprietors under § 201.174 of this chapter, the outgoing proprietor may transfer any or all of his controlled stock to the incoming proprietor, and such transfer shall constitute a removal of controlled stock from control premises by the outgoing proprietor. The outgoing proprietor may retain on the bottling premises any of his controlled stock which has not been packaged or cased for removal, and he may retain on any portion of his control premises which is not to be operated by the incoming proprietor any of his controlled stock which has been packaged or cased for removal. Any controlled stock not transferred to the incoming proprietor and not retained by the outgoing proprietor as provided in this section shall be considered to have been removed from the control premises by him at the time the premises are alternated to the incoming proprietor.

(b) *Procedure for outgoing proprietor.*—The outgoing proprietor shall file a return on Form 4077 (with remittance, if payment is due) for the return period in which the change in proprietorship is made and for each subsequent return period during which the alternate proprietor operates the bottling premises. If the outgoing proprietor is in default, a return on Form 2521, with remittance, must be filed as provided in § 170.51 before the removal or transfer of any controlled stock, as provided in paragraph (a) of this section.

(c) *Procedure for incoming proprietor.*—If the outgoing proprietor transfers any of his controlled stock to the incoming proprietor, all stock so transferred which has not been packaged or cased for removal shall become a part of the incoming proprietor's inventory of controlled stock when received by him, and he shall include the quantity of such controlled stock in his record required by § 170.61(a).

Discontinuance of Business

§ 170.57 Permanent Discontinuance of Business.—Where the proprietor of bottling premises permanently discontinues business, he shall comply with the provisions of § 201.176 of this chapter, and shall include for payment with his return on Form 4077, for the period in which such discontinuance becomes effective, the full amount of any unpaid tax for which liability was assumed by him under section 5174(a)(2), I.R.C.: *Provided*, That where such proprietor is required to pay tax pursuant to return on Form 2521 as provided in § 170.51, he shall, before filing Form 2607 as provided in § 201.176 of this chapter, file a return on Form 2521 with remittance in the full amount of any unpaid tax for which liability was assumed by him under section 5174(a)(2), I.R.C.

Inventories and Records

§ 170.58 Establishment of Controlled Stock Inventory.—Each proprietor of bottling premises shall, before commencing business on

or after the effective date of this subpart, take a physical inventory of his controlled stock. Such inventory shall show all quantities in proof gallons and shall be taken under such supervision, or verified in such manner, as the assistant regional commissioner may require.

§ 170.59 Inventories of Controlled Stock.—Each proprietor of bottling premises shall establish an inventory, in proof gallons, of his controlled stock on hand as of the close of each return period. The inventory shall differentiate between stocks of mixtures and products which derive less than half of their proof gallon content from tax-determined spirits and other controlled stocks. For the return periods ending June 30 and December 31 of each year, and for such other return periods as may be required by the assistant regional commissioner, physical inventories shall be taken. Physical inventories required under the provisions of this section shall be taken under such supervision, or verified in such manner, as the assistant regional commissioner may require. Whenever a physical inventory of controlled stock is to be taken, the proprietor shall, at least five business days in advance, advise the assistant regional commissioner of the date and time he will take such inventory.

§ 170.60 Record of Inventories.—Each proprietor of bottling premises shall prepare a record of each required physical inventory of controlled stock taken by him under the provisions of this subpart. The record of each such inventory shall show the following:

(a) as to containers (including uncased bottles), the kind, size, and serial number where applicable, of each container, and the kind, and quantity in proof gallons, of spirits contained therein;

(b) as to cases of bottled spirits, the kind of spirits therein, the number and size of bottles per case, the proof gallons per case, and the number of such cases; and

(c) the total proof gallons of the inventory.

The provisions of § 201.627 of this chapter relating to the signing and retention of inventories shall be applicable to the signing and retention of inventories required by this subpart.

§ 170.61 Summary Records.—Each proprietor of bottling premises qualified to defer payment of tax under the provisions of this subpart shall, in addition to the records required under the provisions of 26 CFR Part 201, prepare summaries, in proof gallons, of additions to and removals from controlled stock as follows:

(a) *Daily summary of additions to controlled stock.*—Additions to controlled stock shall be summarized daily, showing separately (1) spirits received on withdrawal from internal revenue bond under section 5174(a)(2), I.R.C., and (2) all other additions to controlled stock. Each summary shall be supported, as applicable, by copies of Forms 179 covering spirits withdrawn from internal revenue bond on determination of tax; by invoices or other commercial documents covering other tax-determined domestic spirits received for rectification or bottling; by batch records, Forms 122, reporting imported spirits (other than those received from internal revenue bond), alcoholic flavoring materials, wines, and products made with wine, dumped for use in rectified distilled spirits products; and by Forms 122 covering returned distilled spirits products dumped for reprocessing or rebottling.

(b) *Daily summary of removals from controlled stock.*—In addition to the daily summary of removals required under § 201.623(h) of this

chapter, removals from controlled stock shall be summarized daily, showing separately (1) removals, (2) spirits voluntarily destroyed, (3) determined breakage after completion, and determined casualty losses, and (4) losses or gains disclosed by inventories: *Provided*, That removals in cases may, in lieu of being reported in the proof gallon total of removals, be recorded in the summary by number of cases, wine gallons per case, and proof of the contents but, if that is done, the proprietor shall, on request by an internal revenue officer, promptly convert the quantities of such removals to proof gallons. Each summary shall be supported, where applicable, by records showing the name and address of each consignee.

(c) *Summary of controlled stock operations for return period.*—At the close of each return period, a summary shall be prepared for that return period showing:

(1) Spirits received on withdrawal from internal revenue bond under section 5174(a)(2), I.R.C.;
(2) Other additions to controlled stock; and
(3) Removals of controlled stock (total proof gallons of items required by paragraph (b) of this section to be summarized daily).

A copy of each return period summary required by this paragraph shall be delivered to the assigned officer on or before the third business day preceding the due date for filing the return for that period.

§ 170.62 Record of Tax Liability.—Each proprietor of bottling premises qualified to defer payment of tax under the provisions of this subpart shall maintain a record of the tax-determined liability assumed by him on spirits withdrawn from internal revenue bond under the provisions of section 5174(a)(2), I.R.C. Such record shall show, in chronological order, the tax liability on each lot of such spirits received on the bottling premises (unless previously entered therein as required by this section), the amount of tax paid and credited with each return, and the daily balance of outstanding liability on spirits received on the bottling premises. Each entry on the record shall show, as to each receipt of spirits, the date of receipt, the serial number of the withdrawal Form 179, and the liability assumed; and as to each tax return on Form 4077, the period covered by the return, the date filed, and the amount credited and paid. Where an entire lot of spirits withdrawn from internal revenue bond under the provisions of section 5174(a)(2), I.R.C., is lost prior to receipt on the bottling premises, the proprietor shall, at the time he makes the report required by § 201.484 of this chapter, enter the total tax liability on such spirits in his tax liability accounting; and where any lot of spirits so withdrawn has been in transit for two return periods following the return period in which falls the 21st day after the date of the certificate of tax determination on the withdrawal form, the liability thereon, if not previously entered into the tax liability accounting, shall, at the beginning of the third return period next succeeding that in which fell the said 21st day, be entered by the proprietor in his tax liability accounting. The record shall also show, as of the close of each return period, but not as a part of the tax liability accounting, the serial numbers of the Forms 179 and the tax liability assumed thereon, for those spirits which were in transit at the close of each return period, showing sep-

arately those which were in transit less than 21 days and those which were in transit 21 days or more.

§ 170.63 CREDITS AGAINST ASSUMED LIABILITY.—Notwithstanding any provisions of this subpart with respect to the method of computing the tax to be paid with the return on Form 4077, or of maintaining records of tax liability, amounts paid or credited on returns filed under the provisions of § 170.46 shall be considered to be in satisfaction of the oldest outstanding liability in respect of tax-determined spirits withdrawn under the provisions of section 5174(a)(2), I.R.C.

This Treasury Decision shall become effective on the first day of the first month which begins not less than 30 days after the date of its 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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved February 23, 1966.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on February 25, 1966, 8:48 a.m., and published in the issue of the Federal Register for February 26, 1966, 31 F.R. 3178)

SUBCHAPTER C.—OPERATION OF DISTILLED SPIRITS PLANTS

PART I.—GENERAL PROVISIONS

SECTION 5205.—STAMPS

26 CFR 251.72: Exportation of imported distilled spirits; red strip stamps. (Also Sections 5114, 5313, 5555; 251.135, 251.136, 251.184.) — T.D. 6875[1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PART 251.—IMPORTATION OF DISTILLED SPIRITS, WINES, AND BEER

Miscellaneous amendments

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
OFFICE OF COMMISSIONER OF CUSTOMS,
Washington, D.C., 20224

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

On December 8, 1965, a notice of proposed rulemaking to amend 26 CFR Part 251 was published in the Federal Register (30 F.R. 15172). In accordance with the notice, interested persons were af-

[1] 31 F.R. 2377.

forded an opportunity to submit written comments or suggestions pertaining thereto. No comments or suggestions were received within the 30-day period prescribed in the notice, and the following amendments to the regulations are hereby adopted.

In order to (1) provide for the voiding of red strip stamps attached to bottles of imported spirits diverted for exportation, (2) eliminate the requirement that the customs officer make entries on Form 1444, (3) prescribe the number of copies to be prepared for certain notices and applications, and (4) make minor editorial changes, the regulations in 26 CFR Part 251, Importation of Distilled Spirits, Wines, and Beer, are amended as follows:

PARAGRAPH 1. Section 251.65a is amended to require the notice requesting an extension of time for making a final accounting of strip stamps to be filed in duplicate. As amended, § 251.65a reads as follows:

§ 251.65a EXTENSION OF TIME FOR FINAL ACCOUNTING OF STRIP STAMPS.—Where an importer is not able, within the eighteen-month period prescribed in §§ 251.64 and 251.65, or within any extension period which might be granted in this section, to give a complete accounting for all strip stamps issued with respect to any requisition on Form 428 in the manner prescribed in this part, he shall notify the collector of customs, in writing, in duplicate, prior to the expiration of the eighteen-month period or any extension period granted under this section, setting forth all pertinent facts and requesting an extension of time wherein to make his final accounting. If satisfied that the circumstances warrant an extension of time, the collector of customs may grant an extension, or extensions, not to exceed a total of twelve months. If any application is made for a further extension of time, the collector of customs shall submit it, with his recommendation, to the Commissioner of Customs, who may, when the circumstances warrant, grant an additional extension of time. Where the collector of customs is not satisfied with the reasons given for requesting an extension of time, he shall proceed as prescribed in § 251.92. (72 Stat. 1358; 26 U.S.C. 5205.)

PAR. 2. Section 251.72 is amended to provide for the voiding, when so authorized by the collector of customs, of red strip stamps attached to bottles of imported spirits diverted for exportation. As amended, § 251.72 reads as follows:

§ 251.72 EXPORTATION OF IMPORTED DISTILLED SPIRITS; RED STRIP STAMPS.—When imported distilled spirits to which red strip stamps were affixed prior to arrival in the United States are diverted for exportation purposes by the importer, the strip stamps shall be effectively destroyed by the importer under customs supervision, prior to exportation: *Provided*, That the collector of customs may authorize the importer to void, rather than destroy, such strip stamps under customs supervision. When voiding of red strip stamps has been authorized, they shall be voided by legibly stamping thereon, with indelible ink and in bold face capital letters no smaller than 10-point type, the word "VOIDED" or the word "CANCELLED." Red strip stamps affixed to distilled spirits originating in the United States, evidencing the tax or indicating compliance with the provisions of chapter 51, I.R.C., shall not be removed at or prior to the time of exportation. (72 Stat. 1358; 26 U.S.C. 5205.)

PAR. 3. Section 251.73 is amended to provide for the destruction of red strip stamps, rather than to refer to § 251.72 for such provision. As amended, § 251.73 reads as follows:

§ 251.73 WITHDRAWAL WITHOUT PAYMENT OF TAX: RED STRIP STAMPS.—Red strip stamps affixed to imported distilled spirits to be withdrawn from customs custody free of tax for entry into the United States shall be effectively destroyed by the importer, his agent, or the subsequent purchaser, under customs supervision, prior to such tax-free withdrawal. (72 Stat. 1358; 26 U.S.C. 5205.)

PAR. 4. Section 251.91 is amended to reflect the change in § 251.72 as to voiding red strip stamps. As amended, § 251.91 reads as follows:

§ 251.91 CREDIT FOR RED STRIP STAMPS AFFIXED TO CONTAINERS DIVERTED BY THE IMPORTER FOR EXPORTATION.—When red strip stamps are destroyed or voided under the provisions of § 251.72, the importer may be given credit for such stamps if he obtains from the supervising customs officer a certificate regarding the destruction or voiding and submits the certificate to the collector of customs. The collector of customs shall, on receipt of the certificate, credit the original application for the stamps and the importer shall make appropriate entries on his strip stamp record. (72 Stat. 1358; 26 U.S.C. 5205.)

PAR. 5. Section 251.135 is amended to require that application, in triplicate, be filed for modification of Form 52A, 52B, or 338. As amended, § 251.135 reads as follows:

§ 251.135 FORMS TO BE PROVIDED BY USERS AT OWN EXPENSE.—Forms 52A, 52B, and 338 shall be provided by importers at their own expense, but must be in the form prescribed: *Provided*, That with the approval of the Director, of an application, in triplicate, the forms may be modified to adapt their use to tabulating or other mechanical equipment. (72 Stat. 1342, 1395; 26 U.S.C. 5114, 5555.)

PAR. 6. Section 251.136 is amended to require that the application to keep files at a location other than the importer's place of business be filed in duplicate. As amended, § 251.136 reads as follows:

§ 251.136 FILING.—If the importer maintains looseleaf records of receipt or disposition, one legible copy of each such record shall be marked or stamped "Government File Copy," and shall be filed not later than the close of the business day next succeeding that on which the transaction occurred. All records required by this part, and legible copies of all reports required by this part to be submitted to the assistant regional commissioner or to the collector of customs, shall be filed separately, chronologically, and in numerical sequence within each date, at the importer's place of business to which they relate: *Provided*, That on application, in duplicate, the assistant regional commissioner may authorize the files, or any individual files, to be maintained at other premises under control of the importer, if he finds that such maintenance will not delay the timely filing of any document, or cause undue inconvenience to internal revenue or customs officers desiring to examine such files. Supporting documents, such as consignors' invoices, delivery receipts, or bills of lading, or exact copies thereof, may be filed in accordance with the importer's customary practice. Documents supporting records of disposition shall have noted thereon the serial numbers of the records of disposition to which they refer. (72 Stat. 1342, 1345, 1361, 1395; 26 U.S.C. 5114, 5124, 5207, 5555.)

PAR. 7. Section 251.184 is amended to eliminate the requirement for entries on Form 1444 by the customs officer. As amended, § 251.184 reads as follows:

§ 251.184. CUSTOMS GAUGE AND RELEASE.—Where the appropriate permit, Form 1444, is on file, and on receipt of entry for release of distilled spirits, the spirits shall be gauged by a customs officer, who shall prepare a report of gauge on Form 2629, in triplicate. The distilled spirits may then be released free of tax for shipment to the United States or governmental agency thereof named in the permit, Form 1444. The customs officer shall state on each copy of Form 2629 the permit number of the Form 1444 under which the distilled spirits were withdrawn. The original of Form 2629 shall be retained by the collector of customs, one copy shall be forwarded to the governmental agency to whom the distilled spirits are consigned, and one copy shall be forwarded to the Director. (72 Stat. 1375; 26 U.S.C. 5313.)

This Treasury Decision shall become effective on the first day of the first month which begins not less than 30 days after the date of its 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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.
EDWIN F. RAINS,
Acting Commissioner of Customs.

Approved January 28, 1966.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on Feb. 3, 1966, 8:46 a.m., and published in the issue of the Federal Register for Feb. 4, 1966, 31 F.R. 2377)

PART II.—OPERATIONS ON BONDED PREMISES

Subpart A.—General

SECTION 5214.—WITHDRAWAL OF DISTILLED SPIRITS FROM BONDED PREMISES FREE OF TAX OR WITHOUT PAYMENT OF TAX

26 CFR 201.11: Meaning of terms.

Terms "spirits or distilled spirits" do not include denatured spirits. See Rev. Rul. 66–99, below.

26 CFR 201.601: Samples for analysis or testing.
(Also 201.11.)

Rev. Rul. 66–99

Where denatured distilled spirits are sold subject to approval as to the quality of the undenatured alcohol used to produce them, distilled spirits plant proprietors may withdraw samples of the undenatured alcohol, free of tax, and furnish such samples to their customers.

Revenue Ruling 61–63, C.B. 1961–1, 806, amplified.

Advice has been requested as to whether a distilled spirits plant proprietor may withdraw samples of undenatured alcohol from his closed distilling system, or from containers on his bonded premises, and furnish such samples free of tax to his specially denatured alcohol user customers for their use in determining if such alcohol will be suitable for producing the specially denatured alcohol which they will purchase from him.

In defining the terms "spirits" or "distilled spirits," as used in 26 CFR Part 201, 26 CFR 201.11 states that such terms shall not include denatured spirits unless specifically stated.

With reference to tax-free samples of distilled spirits, 26 CFR 201.601 includes, among others, a provision which states that "* * * where spirits are sold subject to approval as to quality a sample may be furnished the purchaser." Since this provision does not include a specific reference to denatured spirits, it would seem that it does not apply to denatured spirits. It is held, however, that it is not

the intent of the regulations to be more restrictive as to the furnishing of samples of spirits where denatured spirits are being sold than where undenatured spirits are being sold. Therefore, within the provisions of 26 CFR 201.601, distilled spirits plant proprietors who have entered into bona fide agreements, either written or oral, to sell specified quantities of denatured spirits, subject to the purchasers' approval of the quality of the undenatured spirits used therein, may furnish tax-free samples of the undenatured spirits to such purchasers.

This Revenue Ruling amplifies Revenue Ruling 61–63, C.B. 1961–1, 806, to the extent that it recognizes that tax-free samples of distilled spirits may be furnished to purchasers of specially denatured spirits under the conditions stated above.

Subpart D.—Denaturation

SECTION 5242.—DENATURING MATERIALS

26 CFR 212.15: General.

Authorization for use of specially denatured alcohol formulas not specifically provided for. See Rev. Rul. 66–8, below.

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26 CFR 212.57: Formula No. 40. Rev. Rul. 66–8
(Also 212.15, 212.65.)

26 CFR 212.57 prescribes the use of brucine (alkaloid), brucine sulfate, or quassin as denaturants authorized in the production of specially denatured alcohol Formula No. 40.

For a temporary period ending December 31, 1965, Revenue Ruling 65–177, C.B. 1965–2, 507, authorized additional options in the production of Formula No. 40 not requiring the use of brucine (alkaloid) or brucine sulfate which were in short supply.

Because of the apparent continued shortage in the available supply of brucine and, also, because of the current shortage in the supply of quassin, the Director, Alcohol and Tobacco Tax Division, has been requested to extend the temporary options authorized by Revenue Ruling 65–177, and to provide for the temporary use of other options in the production of Formula No. 40.

Accordingly, the two options provided for by Revenue Ruling 65–177 and two additional options are authorized for a temporary period, under the authority of 26 CFR 212.65, in the production of Formula No. 40. Withdrawals from distilled spirits plant premises of Formula No. 40 made under these options will be limited to a 6-month period beginning January 1, 1966. The options are as follows:

(a) One pound of sucrose octa-acetate and ¼ gallon of *tert.*-butyl alcohol; or

(b) Two avoirdupois ounces of sucrose octa-acetate, ⅛ gallon of *tert.*-butyl alcohol, and $\frac{1}{16}$ avoirdupois ounce of denaturing grade benzyldiethyl (2:6 xylylcarbamoyl methyl) ammonium benzoate (Bitrex (THS–839)); or

(c) ¼ gallon of *tert.*-butyl alcohol, and $\frac{1}{16}$ avoirdupois ounce of denaturing grade benzyldiethyl (2:6 xylylcarbamoyl methyl) ammonium benzoate (Bitrex (THS–839)); or

(d) Three gallons of *tert.*-butyl alcohol.

Option (d) above will be permitted, under the authority of 26 CFR 212.15(b), to be used only in the manufacture of products which will be packaged in pressurized containers.

Revenue Ruling 65–177 is hereby superseded.

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26 CFR 212.65: General.

Authorization for substitute denaturants. See Rev. Rul. 66–8, page 316.

SUBCHAPTER E.—GENERAL PROVISIONS RELATING TO DISTILLED SPIRITS

PART III.—MISCELLANEOUS PROVISIONS

SECTION 5313.—WITHDRAWAL OF DISTILLED SPIRITS FROM CUSTOMS CUSTODY FREE OF TAX FOR USE OF THE UNITED STATES

26 CFR 251.184: Customs gauge and release.

Elimination of requirement for noting withdrawals on Form 1444. See T.D. 6875, page 312.

SUBCHAPTER F.—BONDED AND TAXPAID WINE PREMISES

PART II.—OPERATIONS

SECTION 5367.—RECORDS

Procedures for reporting amelioration and sweetening of wine by winemakers. See Rev. Proc. 66–2, page 599.

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26 CFR 240.914b: Record of sweetening.

Records of sweetening maintained by proprietor of bonded wine cellar. See T.D. 6880, page 318.

PART III.—CELLAR TREATMENT AND CLASSIFICATION OF WINE

SECTION 5382.—CELLAR TREATMENT OF NATURAL WINE

26 CFR 240.13: Amelioration. T.D. 6880 [1]
(Also Sections 5367, 5383, 5384, 5385, 5392; 240.354, 240.366, 240.409, 240.430, 240.914 (b).)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PART 240.—WINE

Amelioration and sweetening of wine

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

On December 7, 1965, a notice of proposed rule making to amend 26 CFR Part 240, in order to implement the provisions of section 806 (b) and (c) of Public Law 89–44 [C.B. 1965–2, 568], with respect to (a) amelioration and sweetening of wine, (b) the use of sugar in the production of wine, and (c) the total solids content of wine; and to make conforming amendments, was published in the Federal Register (30 F.R. 15099). In accordance with the notice, interested persons were afforded an opportunity to submit written comments or suggestions pertaining thereto. No comments or suggestions were received within the 15-day period prescribed in the notice; however, after further consideration of the proposed amendments, the following amendments to the regulations are hereby adopted:

PARAGRAPH 1. Section 240.13 is amended to redefine the term "Amelioration." As amended, § 240.13 reads as follows:

§ 240.13 AMELIORATION.—"Amelioration" shall mean the addition to juice or wine, before, during, and after fermentation, of either water or pure sugar, or a combination of water and pure sugar, or liquid sugar or invert sugar syrup, to adjust the acid content or to develop alcohol by fermentation.

§§ 240.30 and 240.36 [REVOKED]

PAR. 2. Sections 240.30 and 240.36 are revoked.

PAR. 3. Section 240.40 is amended to redefine the term "Pure sugar." As amended, § 240.40 reads as follows:

§ 240.40 PURE SUGAR.—"Pure sugar" shall mean pure refined sugar, suitable for human consumption, having a dextrose equivalent of not less than 95 percent on a dry basis, and produced from cane, beets, or fruit, or from grain or other sources of starch: *Provided*, That invert sugar syrup produced from such pure sugar by recognized methods of inversion may be used to prepare any sugar syrup, or solution of water and pure sugar.

PAR. 4. Section 240.40a is amended to redefine the term "Liquid sugar." As amended, § 240.40a reads as follows:

[1] The publication of this Treasury Decision in 31 F.R. 3451, dated Mar. 5, 1966, contains (1) instructions for modifying the notice of proposed rulemaking published in 30 F.R. 15099, dated Dec. 7, 1965, 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.

§ 240.40a LIQUID SUGAR.—"Liquid sugar" shall mean a substantially colorless pure sugar and water solution containing not less than 60 percent pure sugar by weight (60 degrees Brix).

PAR. 5. A new section, § 240.40c, is added immediately following § 240.40b to define the term "Sugar." As added, § 240.40c reads as follows:

§ 240.40c SUGAR.—"Sugar" shall mean pure sugar, liquid sugar, and invert sugar syrup.

§ 240.42 [REVOKED]

PAR. 6. Section 240.42 is revoked.

PAR. 7. Section 240.46 is amended to redefine the term "Specially sweetened natural wine." As amended, § 240.46 reads as follows:

§ 240.46 SPECIALLY SWEETENED NATURAL WINE.—"Specially sweetened natural wine" shall mean a product having a total solids content in excess of 17 percent by weight and an alcohol content of less than 14 percent by volume, made in accordance with the provisions of section 5385, I.R.C., and Subpart R of this part.

PAR. 8. Section 240.163 is amended to delete references to intermediate storage, reserve storage, and permanent storage. As amended, § 240.163 reads as follows:

§ 240.163 MARKINGS ON FERMENTING AND STORAGE TANKS.—Each tank used for the fermentation or storage of wine or for addition of wine spirits to wine will be marked with a permanent serial number and the capacity in wine gallons. Tanks of uniform dimensions from top to bottom shall be marked in addition with the capacity per inch of depth. Each tank will be marked to show its current use, either by permanent markings or by removable signs of durable materials. The use will be shown as "Fermenting Tank" (or "Fermenter"), "Storage Tank," or "Wine Spirits Addition Tank," and may be abbreviated to the initial letters if desired. Notification to the assistant regional commissioner is not required when changing the use and designation of such tanks, but only tanks approved for use in the addition of wine spirits to wine as provided in § 240.198 may be used for that purpose. A single series of numbers will be used for all fermenting, storage, and wine spirits addition tanks, except that separate series, preceded by an identifying letter, may be used for tanks in different buildings or rooms, if desired. (72 Stat. 1379; 26 U.S.C. 5357.)

PAR. 9. Section 240.221 is amended to delete the parenthetical reference to wine in intermediate storage. As amended, § 240.221 reads as follows:

§ 240.221. BOND, FORM 700.—Each proprietor of a bonded wine cellar shall give bond, Form 700, for the payment of taxes imposed by the United States, including rectification and occupational taxes and penalties and interest, for which the proprietor shall become liable to the United States, respecting wine and wine spirits and the operation of the bonded wine cellar, whether the transaction or operation upon which the liability of the proprietor is based occurred on the bonded wine cellar premises (including transfers between noncontiguous portions thereof), or in transit, and for the faithful compliance, without fraud or evasion, with all requirements of the laws of the United States and regulations made in conformity therewith respecting wine and wine spirits and the operation of the bonded wine cellar. The penal sum of the bond shall be not less than the tax on all wine and wine spirits possessed at the bonded wine cellar, in transit to the bonded wine cellar, wine spirits authorized to be withdrawn under approved applications, or wine or wine spirits unaccounted for, at any one time, and the tax on all wine removed for export or for use as supplies on vessels or aircraft, but not exported or otherwise accounted for. The penal sum of the bond shall be not less than $1,000 or more than $50,000, except that where the amount of tax exceeds $250,000, the penal sum of the bond shall be $100,000: *Provided*, That the obligation on Form 700 shall not apply with respect to taxes in excess of $100 which have been determined for deferred payment upon removal of the wine from the bonded wine cellar, or transfer to a taxpaid wine room on the bonded wine cellar premises. (72 Stat. 1379; 26 U.S.C. 5354.)

PAR. 10. Section 240.354 is amended to authorize the use in standard wine of pure sugar as redefined in § 240.40. As amended, § 240.354 reads as follows:

§ 240.354 SUGAR.—If dry sugar is to be used in the production of standard wine, only pure sugar, as defined in § 240.40, may be used. If a solution of water and pure sugar is to be used, liquid sugar, or invert syrup produced from pure sugar by recognized methods of inversion, may be used in the preparation of such solution. The use of mixtures of either different kinds of dry sugar or of different kinds of liquid sugar is permissible. (72 Stat. 1387, as amended; 26 U.S.C. 5392.)

PAR. 11. Section 240.360 is amended to delete the reference to total sugar solids. As amended, § 240.360 reads as follows:

§ 240.360 GENERAL.—Natural grape wine is the product of the juice of sound, ripe grapes, made with cellar treatment authorized by this part and having a total solids content subject to limitations stated in this subpart, but the total solids content of the wine shall in no case exceed 21 percent by weight. (72 Stat. 1383, as amended, 1384, as amended; 26 U.S.C. 5381, 5382, 5383.)

PAR. 12. Section 240.362 is amended to delete the requirement that the liquid in fermenters must be reported as wine produced within 30 days after deposit therein or be transferred to intermediate storage, and to require that the quantity of liquid in fermenters at the close of each month shall be reported on Form 702. As amended, § 240.362 reads as follows:

§ 240.362 CRUSHING AND FERMENTATION.—Water added at the time of crushing, including that necessary to flush equipment, may not reduce the density of the juice below 22 degrees Brix, in the production of natural wine: *Provided*, That if the total solids content of the juice is less than 23 degrees Brix, water used to flush equipment shall reduce the total solids content of the juice less than one degree Brix. (This limitation does not apply where water is used in the production of wine from high acid grapes; however, the limitations stated in § 240.366 are applicable.) Upon removal of wine from fermenters, the quantity of liquid will be determined accurately and recorded as wine produced. The quantity of liquid in fermenters at the close of each month shall be reported on Form 702 in the part of the form provided specifically therefor. (72 Stat. 1381, 1383, as amended; 26 U.S.C. 5367, 5382.)

PAR. 13. Section 240.363 is amended to prescribe procedures for the sweetening, with juice or sugar, of natural grape wine made without the use of sugar. As amended, § 240.363 reads as follows:

§ 240.363 SWEETENING OF NATURAL GRAPE WINE PRODUCED WITHOUT THE USE OF SUGAR.—Natural grape wine produced without the use of sugar may be sweetened with concentrated or unconcentrated grape juice, before or after the addition of wine spirits; the only limitation being that the total solids content of the finished wine shall not exceed 21 percent by weight. Any natural grape wine produced without the use of sugar and containing less than 12 percent by weight of total solids, may be sweetened, after removal from fermenters, with pure dry sugar or liquid sugar if the total solids content of the finished wine does not exceed 12 percent by weight and the alcoholic content of the finished wine after sweetening is less than 14 percent by volume: *Provided*, That the use under this section of liquid sugar shall be so limited that the resulting volume will not exceed the volume which could result from the maximum authorized use of pure dry sugar only. The gallons of wine before and after sweetening shall be determined and entered on the record provided for in § 240.908. Where wine is sweetened with pure dry sugar or liquid sugar, show in such record which of those was used. (72 Stat. 1383, as amended, 1384, as amended, 1387, as amended; 26 U.S.C. 5382, 5383, 5392.)

PAR. 14. Section 240.366 is amended to authorize the addition of ameliorating material after fermentation, and to delete the require-

ment that ameliorating material may be added only in fermenters or intermediate storage. As amended, § 240.366 reads as follows:

§ 240.366 LIMITATIONS ON AMELIORATION.—In producing wine from grapes or grape juice having a high acid content, there may be added to the juice or to the wine, or both, ameliorating material consisting of either water, pure dry sugar, a combination of water and pure dry sugar, liquid sugar, or invert sugar syrup. The total volume of ameliorating material shall not reduce the natural fixed acid content of the juice and ameliorating material combined to less than five parts per thousand. The acid content shall be determined before fermentation, and calculated as tartaric acid. The volume of ameliorating material shall not exceed 35 percent of the total volume of the ameliorated juice or wine (calculated exclusive of pulp). The ameliorating material may be added before, during, or after fermentation. Where ameliorating material is added after fermentation, the gallons of wine before and after such addition shall be determined and entered on the record provided for in § 240.908. See Subpart XX of this part for tables showing the maximum quantity in gallons of ameliorating material that may be added to each 1,000 gallons of juice (exclusive of pulp) based on the acid expressed in parts per thousand of tartaric acid. (72 Stat. 1384, as amended; 26 U.S.C. 5383.)

PAR. 15. Section 240.367 is amended to delete the requirement that the liquid in fermenters must be reported as wine produced within 30 days after deposit therein or be transferred to intermediate storage, and to require that the quantity of liquid in fermenters at the close of each month shall be reported on Form 702. As amended, § 240.367 reads as follows:

§ 240.367 RECORD OF PRODUCTION.—Upon completion of fermentation and removal from fermenters, the quantity of liquid will be determined accurately and recorded as wine produced. The quantity of liquid in fermenters at the close of each month shall be reported on Form 702 in the part of the form provided specifically therefor. (72 Stat. 1381, 1384, as amended; 26 U.S.C. 5367, 5383.)

PAR. 16. Section 240.368 is amended to prescribe procedures for the sweetening, with juice or sugar, of natural grape wine made with the use of sugar. As amended, § 240.368 reads as follows:

§ 240.368 SWEETENING OF NATURAL GRAPE WINE PRODUCED WITH THE USE OF SUGAR.—(a) *Use of concentrated or unconcentrated juice.*—Any natural grape wine produced with the use of sugar may be sweetened, with concentrated or unconcentrated grape juice, before or after the addition of wine spirits; the only limitation being that the total solids content of the finished wine shall not exceed 21 percent by weight.

(b) *Use of pure dry sugar or liquid sugar.*—(1) Any natural grape wine produced with the use of sugar and containing less than 12 percent by weight of total solids, may be sweetened, after removal from the fermenters, with pure dry sugar or liquid sugar, if the total solids content of the finished wine does not exceed 12 percent by weight and the alcoholic content of the finished wine after sweetening is less than 14 percent by volume: *Provided*, That the use under this subparagraph of liquid sugar shall be limited so that the resulting volume will not exceed the volume which could result from the maximum authorized use of dry sugar only.

(2) Any natural grape wine of a winemaker's own production, produced under the provisions of § 240.365, may be sweetened, after removal from fermenters, with pure dry sugar or liquid sugar: *Provided*, That the total solids content of the finished wine shall not exceed 17 percent by weight if the alcoholic content is 14 percent or more by volume, and shall not exceed 21 percent by weight if the alcoholic content is less than 14 percent by volume: *Provided further*, That the volume of finished wine shall not exceed the volume of the juice from which produced and total allowable ameliorating material by more than 0.0675 gallon per gallon of juice and ameliorating material combined.

(3) Where wine is sweetened under the provisions of subparagraph (1) of this paragraph, the gallons of wine before and after sweetening shall be determined and entered on the record provided for in § 240.908; where wine is sweet-

ened with pure dry sugar or liquid sugar, show in such record which of those was used. Where wine is sweetened under subparagraph (2) of this paragraph, a record of such sweetening shall be kept in accordance with § 240.914b. (72 Stat. 1384, as amended; 26 U.S.C. 5383.)

§§ 240.369 through 240.373 [REVOKED]

PAR. 17. Sections 240.369, 240.370, 240.371, 240.372, and 240.373 are revoked.

PAR. 18. Section 240.374 is amended to delete the reference to reserve inventory and to prescribe requirements respecting the addition of wine spirits to wine, in general, and to ameliorated wine. As amended, § 240.374 reads as follows:

§ 240.374 GENERAL.—Grape wine spirits may be added only to natural grape wine of the proprietor's own production. The wine spirits may be added only in wine spirits addition tanks approved as provided in § 240.198. If the wine has been ameliorated, wine spirits may be added only if the juice or wine contains less than 14 percent of alcohol by volume at the time of such addition, unless wine spirits were previously added. The wine spirits will be procured as provided in Subpart PP of this part and will be added to the wine under the supervision of an internal revenue officer. The proprietor will advise the assistant regional commissioner, or other designated officer, in sufficient time that an internal revenue officer may be assigned. The assistant regional commissioner may permit the addition of wine spirits without supervision. (72 Stat. 1381, 1382, 1383, as amended, 1384, as amended; 26 U.S.C. 5366, 5373, 5382, 5383.)

PAR. 19. Section 240.402 is amended to delete the requirement that the liquid in fermenters must be reported as wine produced within 30 days after deposit therein or be transferred to intermediate storage, and to require that the quantity of liquid in fermenters at the close of each month shall be reported on Form 702. As amended, § 240.402 reads as follows:

§ 240.402 CRUSHING AND FERMENTATION.—Water added at the time of crushing, including that necessary to flush equipment, may not reduce the density of the juice below 22 degrees Brix, in the production of natural fruit wine: *Provided*, That if the total solids content of the juice is less than 23 degrees Brix, water used to flush equipment shall reduce the total solids content of the juice less than one degree Brix. (This limitation does not apply where water is used in the production of wine from high acid fruit; however, the limitations stated in § 240.407 are applicable.) Upon removal of wine from fermenters, the quantity of liquid will be determined accurately and recorded as wine produced. The quantity of liquid in fermenters at the close of each month shall be reported on Form 702 in the part of the form provided specifically therefor. (72 Stat. 1381, 1383, as amended; 26 U.S.C. 5367, 5382.)

PAR. 20. Section 240.406 is amended to provide for the production of fruit or berry wine with pure sugar or liquid sugar and to delete the reference to permanent storage. As amended, § 240.406 reads as follows:

§ 240.406 USE OF PURE DRY SUGAR OR LIQUID SUGAR.—A winemaker producing wine from fruit or berries, other than grapes, or from mixtures (which may include grapes) of two or more fruits or berries, with the addition of pure dry sugar or liquid sugar, but without water added to reduce acid content, may add such pure dry sugar or liquid sugar to the juice in the fermenters, or to the wine after fermentation: *Provided*, That such wine shall have less than 14 percent alcohol by volume after complete fermentation, or after complete fermentation and sweetening, and a total solids content not in excess of 21 percent by weight. The use of liquid sugar under this section shall be limited so that the resultant volume will not exceed the volume which could result from the maximum authorized use of pure dry sugar only. Where pure dry sugar or liquid sugar is added to the juice in the fermenters, the winemaker shall main-

tain a separate record thereof showing the kind and quantity of juice (exclusive of pulp) deposited in fermenters and the quantity of pure dry sugar or liquid sugar added thereto. Where wine produced as provided in this section is sweetened after complete fermentation with pure dry sugar or liquid sugar, the gallons of wine before and after sweetening shall be determined and entered on the record provided for in § 240.908. After completion of fermentation of the wine, wine spirits may be added thereto in accordance with the provisions of §§ 240.374 through 240.380. (72 Stat. 1383, as amended, 1385, as amended; 26 U.S.C. 5382, 5384.)

PAR. 21. Section 240.407 is amended to provide for the amelioration with liquid sugar of wine made from fruit, to authorize amelioration of such wines after fermentation, and to delete the reference to intermediate storage. As amended, § 240.407 reads as follows:

§ 240.407 LIMITATIONS ON AMELIORATION.—In producing wine from fruit other than grapes, or from mixtures (which may include grapes) of two or more fruits, if not made under § 240.406, the juice may be adjusted to correct for natural deficiencies by adding a sufficient quantity of pure dry sugar or liquid sugar to adjust the juice to a total solids content prior to fermentation of not more than 25 degrees Brix: *Provided*, That the pure dry sugar or liquid sugar so used shall not reduce the natural fixed acid in the corrected juice or wine to less than five parts per thousand: *Provided further*, That, if liquid sugar is so used, the volume of water contained therein shall be deducted from the volume of ameliorating material authorized to be used in the corrected juice or wine. Thereafter, there may be added to the juice or to the wine, or to both, ameliorating material consisting of either water, pure dry sugar, a combination of water and pure dry sugar, liquid sugar, or invert sugar syrup in such total volume as may be necessary to reduce the natural fixed acid content of the mixture of juice and such ameliorating material to a minimum of five parts per thousand. Where it is desired to so reduce the natural fixed acid content and to so adjust the total solids content of juice, the operations may be combined, and the pure dry sugar or liquid sugar for the adjustment of the total solids content may be mixed with the ameliorating material. The acid content shall be determined before fermentation, and calculated as malic acid for apple wine and as citric acid for other fruit wine. The volume of the ameliorating material shall not exceed 35 percent of the total volume of the ameliorated juice or wine (calculated exclusive of pulp), except that in the case of wine made exclusively from loganberries, currents, or gooseberries, the volume limitation shall be 60 percent. In determining the amount of ameliorating material permitted, the volume of the juice obtained after correction with pure dry sugar or liquid sugar within the 25 degrees limitation shall be used as a basis for the calculation. The ameliorating material may be added before, during, or after fermentation. Where ameliorating material is added after fermentation, the gallons of wine before and after such addition shall be determined and entered on the record provided for in § 240.908. See Subpart XX of this part for tables showing the maximum quantity in gallons of ameliorating material that may be added to each 1,000 gallons of juice (exclusive of pulp) based on the acid expressed in parts per thousand. (72 Stat. 1385, as amended; 26 U.S.C. 5384.)

PAR. 22. Section 240.408 is amended to delete the requirement that the liquid in fermenters must be reported as wine produced within 30 days after deposit therein or be transferred to intermediate storage, and to require that the liquid in fermenters at the close of each month shall be reported on Form 702. As amended, § 240.408 reads as follows:

§ 240.408 RECORD OF PRODUCTION.—Upon removal from fermenters, in the production of wine under the provisions of § 240.406 or 240.407, the quantity of liquid will be determined accurately and recorded as wine produced. The quantity of liquid in fermenters at the close of each month shall be reported on Form 702 in the part of the form provided specifically therefor. (72 Stat. 1381, 1385, as amended; 26 U.S.C. 5367, 5384.)

PAR. 23. Section 240.409 is amended to prescribe procedures respecting the sweetening of natural fruit wine produced with the use of sugar. As amended, § 240.409 reads as follows:

§ 240.409 SWEETENING OF NATURAL FRUIT WINE PRODUCED WITH THE USE OF SUGAR.—The provisions of § 240.368 respecting the sweetening of natural grape wine produced with the use of sugar shall be applicable to the sweetening of natural fruit wine produced with the use of sugar: *Provided*, That where such wine is sweetened with concentrated or unconcentrated juice, such juice shall be derived from the same kind of fruit: *Provided further*, That where natural fruit wine (other than grape) is sweetened under the provisions of § 240.368(b)(2), the total solids content of the finished wine may exceed 17 percent but shall not exceed 21 percent by weight, whether or not wine spirits have been added. The records required by § 240.368(b)(3), shall be applicable to the sweetening of natural fruit wine. (72 Stat. 1384, as amended, 1385, as amended; 26 U.S.C. 5383, 5384.)

§ 240.410 [REVOKED]

PAR. 24. Section 240.410 is revoked.

PAR. 25. Section 240.411 is amended to delete the reference to reserve inventory. As amended, § 240.411 reads as follows:

§ 240.411 ADDITION OF WINE SPIRITS.—To fruit wine produced from one kind of fruit under the provisions of § 240.401 or 240.407, wine spirits from the same kind of fruit may be added according to the procedures prescribed in §§ 240.374 through 240.380. Wine spirits may not be added to fruit wine made from mixtures of two or more fruits. Where the proprietor desires to add wine spirits made from the same kind of fruit to juice or concentrated juice, the provisions of §§ 240.382 and 240.383 (relative to the addition of wine spirits to grape juice or concentrated grape juice) shall be followed. (72 Stat. 1382, 1383, as amended; 26 U.S.C. 5373, 5382.)

PAR. 26. Section 240.430 is amended to change the reference to sugar solids of 15 percent by weight to total solids of 17 percent by weight and to delete the reference to reserve inventory. As amended, § 240.430 reads as follows:

§ 240.430 PRODUCTION.—Specially sweetened natural wine is produced by adding to natural wine (including unfinished natural wine containing 14 percent or more of alcohol) of the proprietor's own production sufficient dry sugar, or juice, or concentrated juice of the same kind of fruit, separately or in combination, so that the finished product has a total solids content in excess of 17 percent by weight, a total solids content not over 35 percent by weight, and an alcohol content less than 14 percent by volume. The containers of unfinished natural wine having an alcohol content of 14 percent or more, held for the production of specially sweetened natural wine, will be marked to show the intended use. Natural wine containing added wine spirits may be used in the production of specially sweetened natural wine; however, wine spirits may not be added to specially sweetened natural wine. (72 Stat. 1386, as amended; 26 U.S.C. 5385.)

PAR. 27. Section 240.443 is amended to delete the reference to reserve inventory and the requirement that the liquid in fermenters must be reported as wine produced within 30 days after deposit therein or be transferred to intermediate storage, and to require that the liquid in fermenters at the close of each month shall be reported on Form 702. As amended, § 240.443 reads as follows:

§ 240.443 PRODUCTION BY FERMENTATION.—If, in the production of special natural wine, the flavoring materials are added before or during fermentation, adequate precautions must be taken to prevent the accidental flavoring of other wine by contamination. Special natural wine made under this section may be ameliorated with pure dry sugar, water, or a combination of pure dry sugar and water, liquid sugar, or invert sugar syrup in the same manner and to the same extent as natural wine made from the same fruit, as provided in Subpart P of this part in the case of grape wine, or Subpart Q of this part in the case of fruit

wine. Wine spirits may not be added to special natural wine, except the wine spirits contained in authorized essences made on bonded wine cellar premises as provided in § 240.446, or approved essences made elsewhere. Retsina wine is an example of special natural wine made under this section. Upon removal of the wine from fermenters the quantity of liquid will be determined accurately and recorded as wine produced. The quantity of liquid in fermenters at the close of each month shall be reported on Form 702 in the part of the form provided specifically therefor. (72 Stat. 1381, 1386; 26 U.S.C. 5367, 5386.)

PAR. 28. Sections 240.463 and 240.464 are amended to qualify the maximum solids content as total solids content. As amended, §§ 240.463 and 240.464 read as follows:

§ 240.463 HONEY WINE.—In the production of wine from honey, a quantity of water may be added to facilitate fermentation, but the density of the mixture of honey and water shall not be reduced below 22 degrees (Brix). Hops may be added in quantities not to exceed one pound for each 1,000 pounds of honey, and pure dry sugar or honey may be added for sweetening. The product shall have an alcohol content less than 14 percent after complete fermentation or complete fermentation and sweetening, and a total solids content not more than 35 degrees (Brix). If the finished wine has a total solids content of more than 21 degrees (Brix), it must be removed under a designation showing that it is unusually sweet. (72 Stat. 1386, 1387; 26 U.S.C. 5387, 5388.)

§ 240.464 OTHER AGRICULTURAL PRODUCTS.—In the production of wine from agricultural products other than those specified in §§ 240.461, 240.462, and 240.463, water and pure dry sugar or liquid sugar or invert sugar syrup may be added to the extent necessary to facilitate fermentation: *Provided*, That the total weight of pure dry sugar used for fermentation shall be less than the weight of the primary winemaking material and the density of the mixture prior to fermentation shall not be less than 22 degrees (Brix), if water, or liquid sugar, or invert sugar syrup is used. Additional sugar may be used for sweetening, provided the alcohol content of the finished wine after complete fermentation, or after complete fermentation and sweetening, shall be less than 14 percent by volume and the total solids content shall not be more than 35 degrees (Brix). If the finished wine has a total solids content of more than 21 degrees (Brix), it must be removed under a designation showing that it is unusually sweet. (72 Stat. 1386, 1387; 26 U.S.C. 5387, 5388.)

PAR. 29. Section 240.483 is amended to delete paragraph (b) and redesignate paragraph "(c)" as paragraph "(b)". As amended, § 240.483 reads as follows:

§ 240.483 HIGH FERMENTATION WINE.—High fermentation wine is a wine made within the limitations of § 240.365 for grape wine or § 240.405 for fruit wine, except (a) that the alcohol content after complete fermentation or complete fermentation and sweetening is 14 percent or more; and (b) that wine spirits may not be added. While high fermentation wine is not a natural wine or a standard wine, it may be produced, stored, and handled on standard wine premises, subject to appropriate marking or labeling. (72 Stat. 1381, 1387; 26 U.S.C. 5364, 5388.)

PAR. 30. Sections 240.488 and 240.634 are amended to change the reference to "kinds" of sugar to "sugar other than pure sugar". As amended, §§ 240.488 and 240.634 read as follows:

§ 240.488 OTHER WINES.—Except as provided in §§ 240.483, 240.486 and 240.487, wine produced with sugar, water, liquid sugar, or invert sugar syrup beyond the limitations prescribed for standard wine, or wine made with sugar other than pure sugar, may be produced and stored only on premises qualified for that purpose and on which no standard wine is produced or stored. Upon removal, such wine shall be marked or labeled with a designation which will adequately disclose the nature and composition of the wine. (72 Stat. 1381, 1387; 26 U.S.C. 5364, 5388.)

§ 240.634 MARKING OF CONTAINERS.—Each container removed, in addition to bearing the marks required by § 240.562, must be plainly marked "For Distilling Material" and show the kind or nature of the material, as standard grape (apple, peach, etc.) wine, or wine lees, raisin wine, etc., in order that the spirits distilled

therefrom may be properly marked as to class and type. Where wine made with sugar other than pure sugar, or fermented with sugar in excess of the quantities authorized for a standard wine, is removed for distilling material, the composition of the material must be marked on the containers, and such wine may be transferred only to the production facilities of distilled spirits plants for the production of spirits other than wine spirits or brandy. (72 Stat. 1364, 1381; 26 U.S.C. 5215, 5368.)

§§ 240.906 and 240.907 [REVOKED]

PAR. 31. Sections 240.906 and 240.907 are revoked.

PAR. 32. Section 240.908 is amended to delete the reference to wine in reserve. As amended, § 240.908 reads as follows:

§ 240.908 FORM 2056, RECORD OF STILL WINE.—Each proprietor of a bonded wine cellar who produces or receives still wine, other than distilling material or vinegar stock made with excess water, shall maintain a record of still wine on Form 2056, showing the quantities produced, received, removed, or used in effervescent wine production. A separate Form 2056 shall be maintained for each tax class of still wine. In each tax class, transactions for all still wines (including special natural wine but not including distilling material or vinegar stock) shall be entered on a single record. At the end of each month the totals shown by Form 2056 shall be reported on Form 702. (72 Stat. 1381; 26 U.S.C. 5367.)

PAR. 33. Section 240.914 is amended to delete the requirement for showing tank or lot numbers of wine in which sugar is used and to delete the reference to reserve inventory. As amended, § 240.914 reads as follows:

§ 240.914 SUGAR RECORD.—Each proprietor receiving, storing, and using sugar shall keep a separate record of such receipt and use. The record shall show the date of receipt, from whom received, and the kind and quantity. Invoices covering purchases shall be retained in support of this record. When sugar is used for ameliorating or sweetening purposes, the record shall show the date, kind, and quantity used. The sugar record shall also show sugar used in the production of allied products and sugar removed from the premises. At the close of each month the account shall be balanced and the quantity of each kind of sugar remaining on hand shall be shown in such record. (72 Stat. 1381; 26 U.S.C. 5367.)

PAR. 34. A new section, § 240.914a, is added immediately following § 240.914 to prescribe requirements for a record of amelioration. As added, § 240.914a reads as follows:

§ 240.914a RECORD OF AMELIORATION.—(a) *General.*—Each proprietor who ameliorates juice or wine shall maintain daily records of such amelioration. Separate records shall be kept for each kind of fruit or berries, including grapes. No form of record is prescribed, but the records maintained shall contain all data necessary to enable internal revenue officers to readily ascertain whether the limitations on amelioration have been complied with. All quantities shall be recorded in gallons, and, where dry sugar is used, the quantity shall be determined either by measuring the increase in volume or by considering that each 13.5 pounds of dry sugar results in a volumetric increase of one gallon. Each separate record shall include the following:

(1) The quantity of juice (exclusive of pulp) deposited in fermenters.

(2) For juice from fruit and berries, other than grapes, the maximum quantity of pure dry sugar or liquid sugar authorized for adjustment, as provided in § 240.407.

(3) The maximum quantity of ameliorating material to which the juice is entitled, as provided in § 240.366 or 240.407, as applicable.

(4) The quantity of ameliorating materials used, including pure dry sugar or liquid sugar used for adjustment of the total solids.

(5) The quantity of ameliorating material authorized but not yet used. Supporting records shall be maintained showing the basis for entries and calculations, including determination of the natural fixed acid content and total solids content of juice, as applicable. At the close of each month, transactions respecting ameliorating materials (including sugar used for adjustment of total solids) shall be summarized, by kind of fruit or berries, including grapes, on Form 702, in the part of the form specifically provided therefor. The records of amelioration

shall be maintained on the basis of annual accounting periods, with each period commencing on July 1 of a year and ending on June 30 of the following year: *Provided*, That the record for an accounting period shall be continued after June 30, where the juice or wine included therein is to be held after that date for completion of fermentation or amelioration. When the amelioration of wine included in the record for one accounting period is complete, the record shall be closed and any unused ameliorating material shall not be used. Wines included in the records for different accounting periods shall not be mixed with each other until the amelioration of both wines is complete.

(b) *Variation.*—Notwithstanding the provisions of paragraph (a) of this section prohibiting the mixing of wines included in the records for different accounting periods, the assistant regional commissioner may, pursuant to written application, authorize a winemaker to mix such wines, before amelioration of such wines has been completed, when the assistant regional commissioner finds that the winemaker maintains such other records, in addition to those required by paragraph (a) of this section, as are necessary (1) to establish the quantity of unused authorized ameliorating material to which the resultant mixture would be entitled, and (2) to enable internal revenue officers to readily ascertain whether the limitations on amelioration have been complied with. Each application for variation under this paragraph shall be filed in duplicate, shall state the need for the variation, and shall describe the addition records to be maintained. (72 Stat. 1381, 1385, as amended; 26 U.S.C. 5367, 5384.)

PAR. 34a. A new section, § 240.914b, is added immediately following § 240.914a to prescribe requirements for record of sweetening. As added, § 240.914b reads as follows:

§ 240.914b RECORD OF SWEETENING.—(a) *General.*—Each proprietor who sweetens natural wine of his own production under the provisions of § 240.368 (b) (2), shall maintain, as prescribed in this section, daily records of such sweetening. Separate records shall be kept for each kind of fruit or berries, including grapes. No form of record is prescribed, but the records maintained shall contain all data necessary to enable internal revenue officers to readily ascertain whether the limitations prescribed in § 240.368 (b) (2), have been complied with. All quantities shall be recorded in gallons, and, where dry sugar is used, the quantity shall be determined either by measuring the increase in volume or by considering that each 13.5 pounds of dry sugar results in a volumetric increase of one gallon. Each separate record shall include the following:

(1) The quantity of wine to be sweetened.

(2) The quantity of sweetening material to which the wine would be entitled (the sum of the gallons of juice (after adjustment, if any, of total solids) from which the wine was produced and the gallons of allowable ameliorating material to which such juice was entitled, multiplied by 0.0675).

(3) The quantity of wine used for sweetening.

(4) The kind (pure dry sugar or liquid sugar) and quantity of sweetening material used.

(5) The quantity of wine produced by sweetening.

(6) The quantity of wine remaining to be sweetened.

(7) The quantity of sweetening material remaining unused.

Supporting records shall be maintained showing the basis for entries in the separate records. The quantity of wine used for sweetening and the quantity of wine produced by sweetening, recorded in the separate records, shall be totaled daily and entered on the record of still wine required by § 240.908. The records of sweetening shall be maintained on the basis of annual accounting periods, with each period commencing on July 1 of a year and ending on June 30 of the following year: *Provided*, That the record for an accounting period shall continue after June 30, where the wine included therein is to be held after that date for completion of sweetening. When the sweetening of wine included in the record for one accounting period is complete, the record shall be closed and any unused sweetening material shall not be used. Wines included in the records for different accounting periods shall not be mixed with each other until the sweetening of both wines is complete.

(b) *Variations.*—Notwithstanding the provisions of paragraph (a) of this section prohibiting the mixing of wines included in the records for different accounting periods, the assistant regional commissioner may, pursuant to written application, authorize a winemaker to mix such wines, before sweetening of such wines has been completed, when the assistant regional commissioner finds that the

winemaker maintains such other records, in addition to those required by paragraph (a) of this section, as are necessary (1) to establish the quantity of sweetening material to which the resultant mixture would be entitled, and (2) to enable internal revenue officers to readily ascertain whether the limitations on sweetening have been complied with. Each application for variation under this paragraph shall be filed in duplicate, shall state the need for the variation, and shall describe the additional records to be maintained. (72 Stat. 1381; 26 U.S.C. 5367.)

PAR. 35. Section 240.915 is amended to delete the reference to Form 2054. As amended, § 240.915 reads as follows:

§ 240.915 SEPARATE RECORD OF MATERIALS RECEIVED AND USED.—Each proprietor producing wine shall maintain a separate record showing the receipt and use or other disposition of basic winemaking materials, such as fruit, juice or concentrated juice. Where juice, concentrated juice, or must is received from a concentrate plant, the record shall also show whether the identical volatile fruit flavor has been restored to such juice, concentrated juice, or must, and further, as to any such concentrated juice, its original density. If volatile fruit-flavor concentrate is received for use in the cellar treatment of natural wine, as authorized in Subpart O of this part, the record shall also show the receipt of such concentrate, the fold of such concentrate, the percent of alcohol by volume contained therein, and the use or other disposition of such concentrate. The record must show the date of receipt, the quantity received, the name and address of the person from whom received, and the date of use or other disposition of the materials. Where materials are received from others, the invoices or commercial papers showing the receipt will be retained in chronological order in support of the record. If materials are received off bonded premises and subsequently transferred to the bonded premises, the record will be maintained only with respect to material received on the bonded premises and will show the date of transfer and quantity transferred, but the invoices or commercial papers covering the purchase of the materials will also be kept available for inspection. Where grapes (or other fruit) received on the bonded premises are used in producing juice to be stored for future use or for removal, the record will show the quantities of grapes used and juice produced. Where fruit or juice is used to produce concentrated juice the record will show the quantity of fruit or juice used and the quantity of concentrated juice produced. The record must also show the use or other disposition of the juice or concentrated juice produced. At the close of each month the materials account will be balanced and the totals reported on Form 702. (72 Stat. 1381; 26 U.S.C. 5367.)

PAR. 36. The undesignated center heading immediately preceding § 240.972 is amended to read "Determination of Total Solids".

PAR. 37. Section 240.975 and its heading are amended to delete "and sugar solids" from the heading and the procedure for determining sugar solids from the text. As amended, § 240.975 reads as follows:

§ 240.975 TOTAL SOLIDS IN WINE.—Total solids content of wines means the degrees Brix of the dealcoholized wine, and is approximately equal to the percent of solids by weight in the dealcoholized wine. The total solids may be determined by dealcoholizing a measured volume of wine, restoring to the original volume with water, and determining the degrees Brix of this solution according to the instructions in §§ 240.972 to 240.974.

PAR. 38. The undesignated center heading immediately preceding § 240.976 is amended to read "Use of Pure Dry Sugar or Liquid Sugar to Correct Juice (Other Than Grape) to 25 Degrees Brix".

PAR. 39. Sections 240.976 and 240.978 are amended to include the use of other pure dry sugars having a dextrose equivalent of 95 percent on a dry basis. As amended, §§ 240.976 and 240.978 read as follows:

§ 240.976 INSTRUCTIONS RESPECTING THE USE OF PURE DRY SUGAR.—Section 240.978 (Table IV) shows the pounds of pure dry sugar required to raise the total solids content of one gallon of juice to 25 degrees Brix with commercial dextrose (1 molecule of water of crystallization), cane or beet sugar, or other pure dry sugars having a dextrose equivalent of not less than 95 percent on a dry basis. This table shall be used in determining the quantity of pure dry

sugar that may be added to fruit and berry juice to correct natural deficiencies in the juice.

§ 240.978 TABLE IV, SHOWING POUNDS OF SUGAR REQUIRED TO RAISE ONE GALLON OF JUICE TO 25 DEGREES BRIX AND THE RESULTANT GALLONAGE.—Table IV shows the pounds of cane or beet sugar and the pounds of commercial dextrose required to raise one gallon of juice to 25 degrees Brix, and the resultant gallonage. Where other pure dry sugars having a dextrose equivalent of not less than 95 percent on a dry basis are used, the pounds of commercial dextrose required to raise one gallon of juice to 25 degrees Brix shall be used to determine the pounds of such other pure dry sugars required to raise one gallon of juice to 25 degrees Brix.

Table IV

Brix of juice	Pounds cane or beet sugar	Resultant gallonage	Pounds commercial dextrose	Resultant gallonage
0	2. 7760	1. 2069	3. 3625	1. 2625
*	*	*	*	*
25	0	1. 0000	0	1. 0000

PAR. 40. New sections, §§ 240.978a, 240.978b, 240.978c, are added immediately following § 240.978 to provide, respectively, instructions, formula, and table, with respect to the use of liquid sugar for correction of natural deficiencies in juice of fruit or berries. As added, §§ 240.978a, 240.978b, and 240.978c read as follows:

§ 240.978a INSTRUCTIONS RESPECTING THE USE OF LIQUID SUGAR.—Section 240.978c (Table IVa) shows the specific gravity and pounds per gallon for various degrees of Brix, and the pounds of sugar per gallon and the water per gallon for various degrees ranging from 60 to 90 degrees of Brix. This table may be used with the formula prescribed in § 240.978b for determining the quantity of liquid sugar (sucrose solution) of any degrees of Brix required to correct natural deficiencies in the juice of fruit or berries. This table also may be, but it is not required to be, used with the formula prescribed in § 240.978b for determining the quantity of liquid sugar, other than sucrose solution, required to correct natural deficiencies in the juice of fruit or berries.

§ 240.978b FORMULA FOR DETERMINING THE REQUIRED QUANTITY OF LIQUID SUGAR TO CORRECT NATURAL DEFICIENCIES IN THE JUICE OF FRUIT OR BERRIES.—(a) *Formula.*—The pounds of liquid sugar of any degree of Brix required to raise the degrees of Brix in one gallon of juice to the desired degrees of Brix shall be determined by the following formula:

$$X=\frac{W(C-A)}{(B-C)}$$

where:

A=the Brix of the juice before correction;
B=the Brix of the liquid sugar to be used;
C=the desired Brix of the juice after correction;
W=the weight per gallon of the juice before correction; and
X=the pounds of liquid sugar to be added per gallon of juice to be corrected.

(b) *Example of use of formula.*—Find the quantity of liquid sugar of 60 degrees Brix required to raise the total solids content of 500 gallons of juice from 12 degrees Brix to 25 degrees Brix.

(1) A=0.12
B=0.60
C=0.25
W=8.72443 (weight from Table IVa)

$$X=\frac{8.72443\ (0.25-0.12)}{(0.60-0.25)}=3.2405 \text{ lbs. liquid sugar;}$$

thus

(2) 3.2405×500 gallons juice=1620.25 lbs. liquid sugar; or

(3) $\frac{1620.25}{10.725278}$ (weight of liquid sugar at 60° Brix. Table IVa) =151.05 gallons of liquid sugar

§ 240.978c TABLE IVa, SHOWING SPECIFIC GRAVITY AND WEIGHT OF ONE GALLON OF SUCROSE SOLUTION AT 15.56° C. CORRESPONDING TO DEGREES OF BRIX, AND THE POUNDS OF SUGAR PER GALLON AND GALLONS OF WATER PER GALLON FOR 60 THROUGH 90 DEGREES OF BRIX.

Table I Va

Degrees Brix	Specific gravity [1]	Pounds per gallon	Sugar per gallon (lb.)	Water per gallon (gal.)
0	1. 000000	8. 32823		
1	1. 003184	8. 35475		
2	1. 007083	8. 38722		
3	1. 011007	8. 41990		
4	1. 014958	8. 45280		
5	1. 018935	8. 48592		
6	1. 022940	8. 51928		
7	1. 026974	8. 55288		
8	1. 031036	8. 58670		
9	1. 035127	8. 62078		
10	1. 039246	8. 65508		
11	1. 043395	8. 68963		
12	1. 047573	8. 72443		
13	1. 051781	8. 75947		
14	1. 056020	8. 79478		
15	1. 060290	8. 83034		
16	1. 064589	8. 86614		
17	1. 068923	8. 90224		
18	1. 073286	8. 93857		
19	1. 077680	8. 97517		
20	1. 082107	9. 01804		
21	1. 086567	9. 04918		
22	1. 091058	9. 08658		
23	1. 095582	9. 12426		
24	1. 100138	9. 16220		
25	1. 104729	9. 20044		
60	1. 287822	10. 725278	6. 4352	0. 51513
61	1. 293726	10. 774448	6. 5724	0. 50455
62	1. 299670	10. 823951	6. 7108	0. 49387
63	1. 305652	10. 873770	6. 8505	0. 48309
64	1. 311674	10. 923923	6. 9913	0. 47220
65	1. 317732	10. 974375	7. 1333	0. 46121
66	1. 323829	11. 025152	7. 2766	0. 45010
67	1. 329965	11. 076254	7. 4211	0. 43889
68	1. 336139	11. 127673	7. 5668	0. 42756
69	1. 342352	11. 179416	7. 7138	0. 41613
70	1. 348605	11. 231493	7. 8620	0. 40458
71	1. 354893	11. 283860	8. 0115	0. 39292
72	1. 361222	11. 336570	8. 1623	0. 38114
73	1. 367590	11. 389604	8. 3144	0. 36925
74	1. 373994	11. 442938	8. 4678	0. 35724
75	1. 380435	11. 496580	8. 6224	0. 34512
76	1. 386917	11. 550564	8. 7784	0. 33286
77	1. 393434	11. 604839	8. 9357	0. 32049
78	1. 399990	11. 659439	9. 0944	0. 30800
79	1. 406583	11. 714347	9. 2543	0. 29538
80	1. 413214	11. 769571	9. 4157	0. 28264
81	1. 419880	11. 825087	9. 5783	0. 26978
82	1. 426585	11. 880928	9. 7424	0. 25679
83	1. 433327	11. 937077	9. 9078	0. 24367
84	1. 440106	11. 993534	10. 0746	0. 23042
85	1. 446923	12. 050308	10. 2428	0. 21704
86	1. 453774	12. 107364	10. 4123	0. 20353
87	1. 460664	12. 164746	10. 5833	0. 18989
88	1. 467589	12. 222419	10. 7557	0. 17611
89	1. 474550	12. 280392	10. 9295	0. 16220
90	1. 481547	12. 338664	11. 1048	0. 14815

[1] Specific gravity of a sucrose solution at 15.56°/15.56° C., calculated from Table 12 of Bureau of Standards Circular No. 19 with use of the factors given in Table 28 thereof.

Because this Treasury Decision implements those changes made in Chapter 51 of the Internal Revenue Code by sections 806(b) and (c) of the Excise Tax Reduction Act of 1965 (Public Law 89–44, 79 Stat. 136), effective January 1, 1966, it is found impracticable and contrary to the public interest to comply with the effective-date limitation of section 4(c) of the Administrative Procedure Act, approved June 11, 1946. Accordingly, this Treasury Decision shall become effective January 1, 1966.

(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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved February 28, 1966.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on Mar. 4, 1966, 8:47 a.m., and published in the issue of the Federal Register for Mar. 5, 1966, 31 F.R. 3451)

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26 CFR 240.364: Acids.

Use of acetic acid to correct natural deficiencies and to perfect standard natural grape wine. See Rev. Rul. 66–155, below.

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26 CFR 240.524: Finishing of wine. Rev. Rul. 66–155
(Also 240.364, 240.1051, 240.1052.)

The use of acetic acid to correct natural deficiencies in grape wine and to perfect such wine is considered as being consistent with good commercial practice. The use of acetic acid for such purpose shall not exceed 0.4 gallon of the equivalent of 100 percent pure acetic acid per 1,000 gallons of grape wine, and such acid shall not be added in a solution of less than 50 percent strength, but in no case shall the acetic acid in finished red grape wine exceed 0.14 gram per 100 cubic centimeters or 0.12 gram per 100 cubic centimeters in other finished grape wine. Further, the use of acetic acid to correct natural deficiencies in grape wine will also be subject to the limitations prescribed by 26 CFR 240.364.

Winemakers desiring to use acetic acid in grape wine for these purposes may obtain approval of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, by filing notice pursuant to the provisions of 26 CFR 240.1052.

Revenue Ruling 65–319, C.B. 1965–2, 513, which restricted the use of acetic acid to 0.2 gallon of the equivalent of 100 percent pure acetic acid per 1,000 gallons of grape wine, is hereby superseded.

(Also 240.1051, 240.1052.) Rev. Rul. 66–173

Polyvinylpolypyrrolidone (known as PVPP), an insoluble homopolymer of purified vinylpyrrolidone meeting the requirements of

21 CFR 121.1110, may be used within the general limitations of 26 CFR 240.524 as a clarifying and stabilizing agent in the cellar treatment of wine in amounts not to exceed six pounds per 1,000 gallons of wine, followed by removal of the material with filtration.

Winemakers desiring to use this material in the treatment of wine may obtain approval of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, by filing notice pursuant to the provisions of 26 CFR 240.1052.

Revenue Ruling 65–137, C.B. 1965–1, 590, which restricted the use of Polyvinylpolypyrrolidone to 2 pounds per 1,000 gallons of wine is hereby superseded.

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26 CFR 240.1051: Materials authorized for treatment of wine.

Use of acetic acid to correct natural deficiencies and to perfect standard natural grape wine. See Rev. Rul. 66–155, page 331.

Use of polyvinylpolypyrrolidone (PVPP) to clarify and stabilize wine. See Rev. Rul. 66–173, page 331.

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26 CFR 240.1052: Notice.

Use of acetic acid to correct natural deficiencies and to perfect standard natural grape wine. See Rev. Rul. 66–155, page 331.

Use of polyvinylpolypyrrolidone (PVPP) to clarify and stabilize wine. See Rev. Rul. 66–173, page 331.

SECTION 5383.—AMELIORATION AND SWEETENING LIMITATIONS FOR NATURAL GRAPE WINES

Procedures for sweetening natural grape wines by winemakers. See Rev. Proc. 66–2, page 599.

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26 CFR 240.366: Limitations on amelioration.

Ameliorating materials to be added to grape juice or wine. See T.D. 6880, page 318.

SECTION 5384.—AMELIORATION AND SWEETENING LIMITATIONS FOR NATURAL FRUIT AND BERRY WINES

Procedures for sweetening natural fruit and berry wines by winemakers. See Rev. Proc. 66–2, page 599.

26 CFR 240.406: Use of pure dry sugar or liquid sugar. Rev. Rul. 66–166

The final sweetening of natural fruit wine, produced under the provisions of 26 CFR 240.406, may be deferred until after wine spirits have been added. However, the quantity of pure dry sugar or liquid sugar that may be used for such sweetening must be calculated on the basis of the total solids content and volume of the wine before the addition of the wine spirits.

Revenue Ruling 64–38, C.B. 1964–1 (Part 1), 569, revoked.

Advice has been requested whether, in the production of natural fruit wine under the provisions of 26 CFR 240.406, the final sweetening of such wine may be deferred until after wine spirits have been added.

Section 5384(a) of the Internal Revenue Code of 1954 provides that to natural wine made from berries or fruit other than grapes, pure dry sugar or liquid sugar may be added to the juice in the fermenters, or to the wine after fermentation; but only if such wine has less than 14 percent alcohol by volume after complete fermentation, or after complete fermentation and sweetening, and a total solids content not in excess of 21 percent by weight.

The provisions of 26 CFR 240.406 implement section 5384(a) of the Code with respect to the production of a natural fruit wine, other than grape wine, with the use of pure dry sugar or liquid sugar. 26 CFR 240.406 provides, in part, that after complete fermentation of the wine, wine spirits may be added thereto in accordance with the provisions of regulations. It was not the intent of the regulations to preclude the final sweetening of wine after wine spirits have been added.

Accordingly, it is held that, in the production of a natural fruit wine under 26 CFR 240.406, the final sweetening of such wine may be deferred until after wine spirits have been added. However, the quantity of pure dry sugar or liquid sugar that may be used for such sweetening must be calculated on the basis of the total solids content and volume of the wine before the addition of any wine spirits.

Revenue Ruling 64–38, C.B. 1964–1 (Part 1), 569, which deals with the use of liquid sugar in the production of fruit and berry wines, is hereby revoked.

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26 CFR 240.409: Sweetening of natural fruit wine produced with the use of sugar.

Use of sugar to sweeten natural fruit wine and the percentage of total solids content in wine. See T.D. 6880, page 318.

SECTION 5385.—SPECIALLY SWEETENED NATURAL WINES

26 CFR 240.430: Production.

Addition of materials to obtain specially sweetened natural wine. See T.D. 6880, page 318.

PART IV.—GENERAL

SECTION 5392.—DEFINITIONS

26 CFR 240.354: Sugar.

Sugar in standard wine. See T.D. 6880, page 318.

SUBCHAPTER I.—MISCELLANEOUS GENERAL PROVISIONS

SECTION 5552.—INSTALLATION OF METERS, TANKS, AND OTHER APPARATUS

26 CFR 245.30: Meters required.

Fischer & Porter Company Magnetic Meter Monitoring System SE #5264. See Rev. Proc. 66–9, page 621.

Fischer & Porter Co. Magnetic Meter Monitoring System SE #5281. See Rev. Proc. 66–14, page 628.

SECTION 5555.—RECORDS, STATEMENTS, AND RETURNS

26 CFR 251.136: Filing.

Application to keep files at premises other than the importer's place of business. See T.D. 6875, page 312.

CHAPTER 65.—ABATEMENTS, CREDITS, AND REFUNDS

SUBCHAPTER A.—PROCEDURE IN GENERAL

SECTION 6401.—AMOUNTS TREATED AS OVERPAYMENTS

26 CFR 170.50: Computation of amount of tax to be paid by proprietor of bottling premises. Rev. Rul. 66–109

(Also Sections 6402, 6601, 6611.)

No interest is payable to the taxpayer on an excess payment of distilled spirits tax submitted with a return on Form 4077, Distilled Spirits Tax Return, Deferred Payment—Bottling Premises, unless the amount paid exceeds the taxpayer's entire liability. However, interest is due the Government on the deficiency where the amount paid with a return on Form 4077 is less than the amount due.

A question has arisen as to when interest is due or payable in connection with a remittance submitted by a proprietor of a distilled spirits plant in an amount other than the tax required to be shown on his return on Form 4077, Distilled Spirits Tax Return, Deferred Payment—Bottling Premises.

Section 6611 of the Internal Revenue Code of 1954 provides that "Interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the rate of 6 percent per annum." This section allows interest only upon "overpayments" of tax. To constitute an "overpayment" of tax a remittance must be made under such circumstances that the taxpayer would be entitled to a refund under the provisions of section 6402 of the Code. Section 6401 of the Code, concerned with "amounts treated as overpayments," does not clearly define "overpayment" but at subsection (c) makes it apparent that the term means, substantially, payment with respect to which no tax liability exists.

Under the provisions of Subpart C, 26 CFR Part 170, the remittance accompanying a return on Form 4077 is intended to satisfy only the matured portion of the taxpayer's liability. The remainder of the taxpayer's liability is deferred to a later return. While an amount paid in excess of that due with the return would overpay that return, it would not be an "overpayment" within the meaning of section 6401 or section 6611 of the Code when the amount paid does not exceed the taxpayer's entire liability. Since no "overpayment" would result, no interest would be payable. In the event the amount paid exceeds the taxpayer's entire liability, the excess amount would constitute an "overpayment" and interest would be payable on the excess amount.

As to the charging of interest on underpayments, section 6601 of the Code provides that if any amount of tax required to be shown on a return is not paid on or before the last date prescribed for payment, interest shall be paid on such amount at the rate of 6 percent per annum. Therefore, if the full amount of distilled spirits tax which has matured as of the close of a return period is not paid, the deficiency in payment would be subject to interest.

Accordingly, it is held that no interest is payable on an excess payment of distilled spirits tax submitted with a return on Form 4077, unless the amount paid exceeds the taxpayer's entire liability. It is also held that interest is due on a deficiency where the amount paid with a return on Form 4077 is less than the amount due.

SECTION 6402.—AUTHORITY TO MAKE CREDITS OR REFUNDS

Interest on overpayments and underpayments of tax reported on Form 4077, Distilled Spirits Tax Return, Deferred Payment—Bottling Premises. See Rev. Rul. 66–109, page 334.

CHAPTER 67.—INTEREST

SUBCHAPTER A.—INTEREST ON UNDERPAYMENTS

SECTION 6601.—INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX

Interest on overpayments and underpayments of tax reported on Form 4077, Distilled Spirits Tax Return, Deferred Payment—Bottling Premises. See Rev. Rul. 66–109, page 334.

SUBCHAPTER B.—INTEREST ON OVERPAYMENTS

SECTION 6611.—INTEREST ON OVERPAYMENTS

Interest on overpayments and underpayments of tax reported on Form 4077, Distilled Spirits Tax Return, Deferred Payment—Bottling Premises. See Rev. Rul. 66–109, page 334.

SUBPART B.—TOBACCO TAX RULINGS AND DECISIONS UNDER CHAPTER 52 OF THE INTERNAL REVENUE CODE OF 1954

CHAPTER 52.—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 5702.—DEFINITIONS

26 CFR 270.11: Meaning of terms. Rev. Rul. 66–122

Section 5702(a) of the Internal Revenue Code of 1954 defines a cigar as "any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco (other than any roll of tobacco which is a cigarette within the meaning of subsection (b)(2))." Section 5702(b) of the Code defines a cigarette as "(1) any roll of tobacco wrapped in paper or in any substance not containing tobacco, and (2) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in paragraph (1)." Similar definitions of "cigar" and "cigarette" are prescribed in 26 CFR 270.11.

It is held that the use of paper as a binder in the manufacture of cigars does not cause the finished product to be classified as a cigarette and subject to the rate of tax imposed on cigarettes.

Revenue Ruling 64–14, C.B. 1964–1 (Part 1), 575, is hereby superseded.

Rev. Rul. 66–123

The use of a paper band to join a cigar and tip does not preclude classification of the product as a cigar.
Revenue Ruling 65–56, C.B. 1965–1, 601, superseded.

Advice has been requested whether a cigar which has a tip attached by means of a paper band which overlaps the tip and wrapper and which is not removable can still be classified as a cigar.

Section 5702(a) of the Internal Revenue Code of 1954 defines a cigar as "any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco (other than any roll of tobacco which is a cigarette within the meaning of subsection (b)(2))." Section 5702(b) of the Code defines a cigarette as "(1) any roll of tobacco wrapped in paper or in any substance not containing tobacco, and (2) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in paragraph (1)." Similar definitions of "cigar" and "cigarette" are prescribed in 26 CFR 270.11.

It is held that where the paper band is used as a means of joining the cigar to the tip and is no larger than necessary for that purpose it is not a part of the wrapper and its use would not preclude classification of the product as a cigar.

Revenue Ruling 65–56, C.B. 1965–1, 601, is hereby superseded.

Requirements for submission of samples of reconstituted tobacco for use as a wrapper for rolls of tobacco, and of the finished product. See Rev. Proc. 66–5, page 614.

SECTION 5703.—LIABILITY FOR TAX AND METHOD OF PAYMENT

26 CFR 270.162: Semimonthly tax return.

Procedure for recording and reporting cigars and cigarettes removed subject to tax and treatment of tax determined (including taxpaid) cigars and cigarettes received into the factory. See Rev. Proc. 66–23, page 651.

SECTION 5704.—EXEMPTION FROM TAX

26 CFR 270.232: Experimental purposes. Rev. Rul. 66–124

Where cigars and cigarettes are to be removed for testing by a selected panel, primarily by human consumption, the results must serve a public interest with the detailed findings of the experiment made available to all interested persons in order that the removal may be considered as for experimental purposes and thus exempt from tax.

Revenue Ruling 65–71, C.B. 1965–1, 601, superseded.

Advice has been requested whether cigars and cigarettes to be removed from a factory for testing by a selected panel, primarily by human consumption, would be exempt from tax.

Section 5704(a) of the Internal Revenue Code of 1954 provides in pertinent part that cigars and cigarettes may be furnished by a manufacturer of such products, without payment of tax, for experimental purposes in such manner as the Secretary of the Treasury or his delegate shall by regulation prescribe.

26 CFR 270.232 prescribes that removal of cigars and cigarettes without determination and payment of tax will be authorized only for bona fide experimental purposes, such as for use by producers of machines designed to package such products for testing and experimenting in the operation of these machines, or for use in laboratories, hospitals, medical centers, institutes, colleges, and universities, for scientific, technical, or medical research. Further, cigars and cigarettes may not be removed without payment of tax for such purposes as advertising, salesmen's or customers' samples, or for consumer testing.

Accordingly, it is held that, where cigars and cigarettes are to be removed from a factory for testing by a selected panel, primarily by human consumption, the results must serve a public interest with the detailed findings of the experiment made available to all interested

persons in order that the removal may be considered as for experimental purposes and thus exempt from tax. Removals without payment of tax cannot be authorized where the results are primarily for the benefit of any particular person, such as through secret process, patent, copyright, or where findings, as a result of the human consumption, are used basically for commercial research and product development, rather than scientific or medical research.

Revenue Ruling 65–71, C.B. 1965–1, 601, is hereby superseded.

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26 CFR 270.233: Transfer in bond.

Manufacturer liable for the tax required to be identified in the mark. See Rev. Proc. 66–25, page 653.

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26 CFR 290.61: Removals, withdrawals, and shipments authorized. (Also Section 5706; 290.221.) — Rev. Rul. 66–127

Cigars and cigarettes may be removed, without payment of tax, or with drawback of tax, for shipment anywhere outside the United States.

Revenue Ruling 65–207, C.B. 1965–2, 538, superseded.

Advice has been requested whether cigars and cigarettes may be removed, without payment of tax, or with benefit of drawback of tax, for shipment to possessions of the United States or the various islands under the control of the United States.

Under the provisions of section 5704 of the Internal Revenue Code of 1954, cigars and cigarettes may be removed from a factory or export warehouse, without payment of tax, for shipment to a foreign country, Puerto Rico, the Virgin Islands, or a possession of the United States, or for consumption beyond the jurisdiction of the Internal Revenue laws of the United States. Section 5706 of the Code provides for allowance of drawback of tax paid on cigars and cigarettes when shipped from the United States.

Accordingly, it is held that cigars and cigarettes may be removed, without payment of tax, or with drawback of tax, for shipment to a destination outside the United States. "Since the United States, as defined in section 7701 of the Code, means the 50 States and the District of Columbia, such shipments may be made to any country, possession, island, etc., as long as such place is outside of the United States; that is, beyond the 3-mile limit or international boundary, as the case may be."

Revenue Ruling 65–207, C.B. 1965–2, 538, is hereby superseded.

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26 CFR 290.64: Responsibility for delivery or exportation of cigars, cigarettes, and cigarette papers and tubes. — Rev. Rul. 66–128

Cigars and cigarettes may not be removed from a domestic factory or an export warehouse, without payment of tax, for sale or delivery to diplomatic officers of foreign countries or to personnel of foreign embassies for consumption in the United States.

Revenue Ruling 65-138, C.B. 1965-1, 604, superseded; Revenue Ruling 296, C.B. 1953-2, 325, as amplified by Revenue Ruling 63-150, C.B. 1963-2, 477, distinguished.

Advice has been requested whether cigars and cigarettes may be removed from an export warehouse, without payment of tax, for sale or delivery to diplomatic officers of foreign countries or to personnel of foreign embassies, for consumption in the United States.

Revenue Ruling 296, C.B. 1953-2, 325, as amplified by Revenue Ruling 63-150, C.B. 1963-2, 477, provides, in part, that ambassadors, ministers, and other duly accredited diplomatic representatives of foreign governments (1) are not required to pay Federal excise taxes, the legal incidence of which would otherwise fall upon them, and (2) if any such person purchases from the manufacturer thereof an article otherwise subject to a Federal excise tax on sales by manufacturers, or purchases from a retailer an article otherwise subject to a Federal excise tax on sales by retailers, the transaction will not be taxed. Consular officers of foreign governments, and other officers (other than diplomatic representatives), as well as agencies and commissions, of foreign governments are not required to pay Federal excise taxes, the legal incidence of which would otherwise fall upon them in respect of transactions arising in the performance of their official functions for which payment is made by the foreign government.

The tax imposed on cigars and cigarettes by section 5701 of the Internal Revenue Code of 1954 does not fall within the coverage of Revenue Ruling 296. The legal incidence of the tax is not on the consumer or on the sale to him but upon its manufacture. See *Liggett & Myers Tobacco Co.* v. *United States*, 299 U.S. 383 (1937), Ct. D. 1192, C.B. 1937-1, 332. Moreover, section 5704 of the Code, which sets forth the exemptions from tax on cigars and cigarettes does not provide an exemption for diplomatic officers or personnel of foreign embassies in the United States. Accordingly, cigars and cigarettes of domestic manufacture may not be removed from a domestic factory or an export warehouse, without payment of tax, for sale or delivery to foreign diplomatic officers or to personnel of foreign embassies in the United States.

In addition, the exemptions from tax and duty in the Tariff Schedules of the United States (Schedule 8, Part 2, Subpart C—Personnel of Foreign Governments and International Organizations; Distinguished Visitors) are limited to articles which are imported into the United States. Therefore, these exemptions in the Tariff Schedules are not applicable to removals of cigars and cigarettes from a domestic factory or export warehouse.

Revenue Ruling 65-138, C.B. 1965-1, 604, is hereby superseded. Revenue Ruling 296, C.B. 1953-2, 325, as amplified by Revenue Ruling 63-150, C.B. 1963-2, 477, is distinguished.

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26 CFR 290.67: Payment of tax.

The date interest commences on the tax due on cigars and cigarettes removed without payment of tax for exportation but which are diverted by theft, before exportation. See Rev. Rul. 66-137, page 353.

26 CFR 290.198: Preparation.

Preparation of Form 2149, Notice of Removal of Cigars, Cigarettes, Cigarette Papers, Cigarette Tubes, from Factory for Export, regarding shipments to replace cigars and cigarettes lost, damaged, or destroyed in transit for exportation. See Rev. Proc. 66–22, page 649.

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26 CFR 295.31: Restrictions. Rev. Rul. 66–129

Cigars, cigarettes, and cigarette papers and tubes may not be removed exempt from tax for delivery to military and naval bases and establishments in this country for distribution to officers and enlisted personnel at special and holiday dinners or recreational activities, where the articles are purchased with funds derived from donations by officers and enlisted personnel to club or camp funds or from profits from post or base exchanges.

Revenue Ruling 64–17, C.B. 1964–1 (Part 1), 579, superseded.

Permission has been requested for the removal of cigars, cigarettes, and cigarette papers and tubes, without payment of tax, for delivery to military and naval bases and establishments in the United States for distribution to officers and enlisted personnel at special and holiday dinners and at recreational activities.

While such articles are intended for gratuitous distribution, the funds with which the articles would be purchased are derived from donations by officers and enlisted personnel to club or camp funds and from profits from post or base exchanges.

Section 7510 of the Internal Revenue Code of 1954 provides as follows:

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 or his delegate may prescribe, to all articles of domestic production which are subject to tax by the provisions of this title.

Section 5704(b) of the Code provides, in part, that a manufacturer may remove cigars, cigarettes, and cigarette papers and tubes, without payment of tax, for use of the United States, in accordance with such regulations and upon the filing of such bonds as the Secretary of the Treasury or his delegate shall prescribe.

26 CFR 295.31 provides that cigars, cigarettes, and cigarette papers and tubes purchased by a Federal agency with funds appropriated by the Congress of the United States may be removed, without payment of tax, in accordance with this part, for delivery to such Federal agency for gratuitous distribution under the supervision of such agency. Such articles purchased by a donor from a manufacturer, or donated directly by a manufacturer, may also be removed, without payment of tax, in accordance with this part, for delivery to a Federal agency for gratuitous distribution under the supervision of such agency to (1) charges of the United States, or (2) patients in a hospital or institution operated by the government of a State or the District of Columbia where the Federal agency maintains a program for such distribution to members or veterans of the armed forces of the United States in such hospital or institution. Cigars, cigarettes, and cigarette papers and tubes removed under the provisions of this part may not be sold subsequent to removal.

Since the cigars, cigarettes, and cigarette papers and tubes are neither purchased by a Federal agency with congressionally appropriated funds nor purchased by a donor and delivered to a Federal agency for gratuitous distribution under its supervision to charges of the United States or to patients, the removal of such articles for delivery to military and naval bases and establishments in this country for distribution to officers and enlisted personnel at special and holiday dinners and at recreational activities would not be "for use of the United States" within the meaning of section 5704(b) of the Code. Therefore, cigars, cigarettes, and cigarette papers and tubes may not be removed for such purposes.

Revenue Ruling 64–17, C.B. 1964–1 (Part 1), 579, is hereby superseded.

SECTION 5705.—CREDIT, REFUND, OR ALLOWANCE OF TAX

26 CFR 270.282: Allowance of tax.

Procedure for recording and reporting cigars and cigarettes removed subject to tax and treatment of tax determined (including taxpaid) cigars and cigarettes received into the factory. See Rev. Proc. 66–23, page 651.

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26 CFR 270.283: Credit or refund of tax. Rev. Rul. 66–125

A corporation which acquires all of the capital stock of a manufacturing company which was thereafter dissolved, is considered the "manufacturer" within the intent of section 5705(a) of the Internal Revenue Code of 1954 and, as such, is entitled to file a claim for credit or refund of the tax paid on cigars and cigarettes by the former company where such products are subsequently withdrawn from the market after acquisition by the successor corporation. Revenue Ruling 64–20, C.B. 1964–1 (Part 1), 580, superseded.

Advice has been requested whether a corporation which purchased all of the capital stock of a manufacturing corporation, after which the manufacturing corporation was dissolved, is entitled to file a claim for credit or refund of the tax on cigars and cigarettes withdrawn from the market where the tax was paid on the products removed from its factory by the manufacturing corporation prior to its sale.

The tax was paid by *X* company on cigars and cigarettes produced in and removed from its factory. Subsequent thereto, all of the capital stock of *X* company was transferred to *Y* corporation and *X* company was formally dissolved, at which time the assets of *X* company were distributed to *Y* corporation. The cigars and cigarettes were withdrawn from the market by *Y* corporation after dissolution of *X* company, and *Y* corporation filed a claim for refund of the tax paid on the products.

Section 5705(a) of the Internal Revenue Code of 1954 provides, in part, that a credit or refund of any tax imposed by chapter 52 thereof shall be allowed or made to the manufacturer on proof satisfactory to the Secretary of the Treasury or his delegate that the claimant manufacturer has paid the tax on cigars and cigarettes withdrawn by him from the market.

26 CFR 270.283 provides, in part, for the credit or refund to the manufacturer of the tax on cigars and cigarettes withdrawn from the market by the manufacturer.

It is held that the claimant manufacturer referred to in section 5705(a) of the Code and 26 CFR 270.283 covers not only the corporate entity which manufactured the product but also a corporation into which the manufacturing corporation was merged, a new corporation resulting from the consolidation of another corporation with the manufacturing corporation, and a corporation which acquires all of the corporate stock of the manufacturing corporation which is thereafter dissolved, as well as the transfer by operation of law of the control of the manufacturing corporation, such as through bankruptcy, the appointment of a receiver, or by other court order.

Accordingly, a corporation which acquires all of the capital stock of the manufacturing company, which was thereafter formally dissolved, should be considered the "manufacturer" within the intent of section 5705(a) of the Code since that corporation is the successor to the manufacturing company and, therefore, is entitled to file claim for credit or refund of tax on the cigars and cigarettes subsequently withdrawn from the market. On the other hand, if a corporation merely purchases the assets of a manufacturing company which continues in existence, then the purchasing corporation is not entitled to file a claim for credit or refund of the tax on the cigars and cigarettes produced and removed by the manufacturing company prior to the sale of its assets.

Revenue Ruling 64–20, C.B. 1964–1 (Part 1), 580, is hereby superseded.

(Also Section 275.163.) Rev. Rul. 66–126

Cigars and cigarettes which have been confiscated by State, county, or other local or municipal authorities may be purchased by the manufacturer thereof in order to claim credit or refund of tax paid on such products or by the importer thereof in order to claim refund of the tax paid. After filing a schedule on Form 3069, Schedule of Tobacco Products or Cigarette Papers or Tubes Withdrawn From the Market, for the cigars and cigarettes, the manufacturer or importer may destroy or reduce to tobacco such products, as authorized by the Assistant Regional Commissioner, Alcohol and Tobacco Tax, and, in the case of a manufacturer, file claim for credit or refund of the tax involved or, in the case of an importer, file a claim for refund of the tax. In such a case, a timely claim for credit or refund of the tax would be considered as covering cigars and cigarettes withdrawn from the market by the manufacturer or importer within the meaning of section 5705 of the Internal Revenue Code of 1954. Such schedules and claims should be filed in accordance with 26 CFR 270.283 or 275.163.

Revenue Ruling 64–21, C.B. 1964–1 (Part 1), 581, is hereby superseded.

The period of limitation for filing claims for credit or refund of tax on cigars and cigarettes withdrawn from the market. See Rev. Proc. 66–20, page 647.

Procedure for recording and reporting cigars and cigarettes removed subject to tax and treatment of tax determined (including tax-paid) cigars and cigarettes received into the factory. See Rev. Proc. 66–23, page 651.

Procedure to be followed in executing Form 3069 to support claims for credit or refund of tax on cigars and cigarettes withdrawn from the market. See Rev. Proc. 66–24, page 652.

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26 CFR 270.311: Action by claimant.

Procedure to be followed in executing Form 3069 to support claims for credit or refund of tax on cigars and cigarettes withdrawn from the market. See Rev. Proc. 66–24, page 652.

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26 CFR 275.163: Refund of tax.

Claim for refund of tax paid on cigars and cigarettes confiscated by State authorities where such products are purchased and withdrawn from the market by a tobacco products manufacturer. See Rev. Rul. 66–126, page 343.

The period of limitation for filing claims for refund of tax on cigars and cigarettes withdrawn from the market. See Rev. Proc. 66–20, page 647.

SECTION 5706.—DRAWBACK OF TAX

26 CFR 290.221: Application of drawback of tax.

Exportation of cigars and cigarettes with benefit of drawback of tax. See Rev. Rul. 66–127, page 339.

SUBCHAPTER B.—QUALIFICATION REQUIREMENTS FOR MANUFACTURERS OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES, AND EXPORT WAREHOUSE PROPRIETORS

SECTION 5712.—APPLICATION FOR PERMIT

26 CFR 270.47: Other businesses within factory. Rev. Rul. 66–130

(Also 270.72.)

(Also Section 5741; 270.184.)

The sale of cigars and cigarettes, subject to tax, on factory premises is not considered to be an "other business" within the meaning of 26 CFR 270.47. Also, sales of products other than cigars and cigarettes to employees of a manufacturer of tobacco products and operation of facilities such as cafeterias and vending machines on factory premises, even by other entities, are not considered to be an "other business" under the regulations, so long as such operations

are activities in connection with the cigar and cigarette business of the manufacturer.

Revenue Ruling 64–144, C.B. 1964–1 (Part 1), 584, superseded.

Advice has been requested whether the sale of cigars and cigarettes and products other than cigars and cigarettes on factory premises by a manufacturer of tobacco products to his employees constitutes an "other business" under the circumstances described below.

A manufacturer of tobacco products set up several small stores on the premises of his factories for the purpose of making available for sale to his employees, for personal consumption only, cigars and cigarettes of his manufacture and products other than cigars and cigarettes of subsidiaries and other divisions of the corporate manufacturer. In addition, cafeterias and vending machines are operated on the factory premises for the convenience of the employees.

26 CFR 270.47 provides that the Director, Alcohol and Tobacco Tax Division, may authorize other businesses within the factory as he finds will not jeopardize the revenue, will not hinder the effective administration of the regulations, and will not be contrary to law.

The sale of cigars and cigarettes by manufacturers of tobacco products on their factory premises is recognized in 26 CFR 270.184 subject, of course, to payment of the tax applicable to such products. These sales, however, need not be confined to the employees of the manufacturer operating the factory. Moreover, under 26 CFR 270.72, a manufacturer of tobacco products may carry on activities in connection with his business, such as may be conducted for the use and convenience of his employees.

Accordingly, it is held that the sale of cigars and cigarettes, subject to tax, by a manufacturer of tobacco products on factory premises to his employees is not considered to be an "other business" within the meaning of 26 CFR 270.47.

Furthermore, the sale of products other than cigars and cigarettes and the operation of cafeterias and vending machines on factory premises, even if operated by entities other than the manufacturer or subsidiaries or divisions thereof, are not considered to be an "other business" within the scope of 26 CFR 270.47, so long as such operations are activities in connection with the cigar and cigarette business of the manufacturer.

Revenue Ruling 64–144, C.B. 1964–1 (Part 1), 584, is hereby superseded.

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26 CFR 270.72: Use of factory premises.

Whether the sale of cigars and cigarettes and products other than cigars and cigarettes on factory premises by a manufacturer of tobacco products to his employees constitutes an "other business." See Rev. Rul. 66–130, page 344.

SECTION 5713.—PERMIT

26 CFR 270.75: Issuance of permit.

Method of showing the permit number of a tobacco products manufacturer on packages of cigars and cigarettes, and in reports, returns, and other documents. See Rev. Rul. 66–133, page 347.

26 CFR 290.93: Issuance of permit.

Method of showing the permit number of a tobacco products manufacturer on packages of cigars and cigarettes, and in reports, returns, and other documents. See Rev. Rul. 66–133, page 347.

SUBCHAPTER C.—OPERATIONS BY MANUFACTURERS AND IMPORTERS OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES AND EXPORT WAREHOUSE PROPRIETORS

SECTION 5723.—PACKAGES, MARKS, LABELS, NOTICES, AND STAMPS

26 CFR 270.211: Package. Rev. Rul. 66–131
(Also 275.71.)

26 CFR 270.211 and 275.71 do not prohibit the use of outer containers for packages of cigars or cigarettes. *Held*, packages of cigars or cigarettes bearing the required mark and notice may be enclosed in outer containers which may be sealed. Internal revenue officers are, of course, authorized to open such outer containers in the course of their inspection of cigars and cigarettes so packaged.

Revenue Ruling 64–22, C.B. 1964–1 (Part 1), 585, is hereby superseded.

Whether a wholesale or retail dealer in cigars and cigarettes may remove such products from the required packages (as put up by the manufacturer or importer) for transmission by mail or other method of delivery to prospective customers. See Rev. Rul. 66–135, page 351.

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26 CFR 270.212: Mark. Rev. Rul. 66–132
(Also 270.214, 270.215, 275.73, 275.74, 296.166.)

> The mark and notice required by regulations may appear on a cigar or cigarette package consisting of cellophane (or similar material) or on such material used to wrap a cigar or cigarette package. However, under the law and regulations, cigars and cigarettes must remain in the package bearing the required mark and notice from the time of removal of the products from the factory or release from customs custody to the time that the consumer acquires possession of such products.
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> Revenue Ruling 64–23, C.B. 1964–1 (Part 1), 586, superseded.

Advice has been requested whether the required mark and notice may appear on a cigar or cigarette package consisting of cellophane (or similar material) or on such material used to wrap a cigar or cigarette package. Advice has also been requested whether cigars and cigarettes possessed by the consumer must be in the package (as put up by the manufacturer or importer) bearing the required mark and notice.

Section 5723(b) of the Internal Revenue Code of 1954 provides, in part, that every package of cigars or cigarettes shall, before removal,

bear the marks, labels, notices, and stamps, if any, that the Secretary or his delegate by regulation prescribes.

26 CFR 270.212, 270.214, and 270.215, implementing section 5723(b) of the Code, set forth requirements that every package of cigars or cigarettes shall identify the manufacturer liable for payment of the tax and shall indicate the kind, quantity, and the classification of the product for tax purposes.

Section 5751(a)(3) of the Code provides that no person shall (even without intent to defraud the United States) purchase, receive, possess, offer for sale, or sell or otherwise dispose of, after removal, any cigars or cigarettes which are not put up in packages as required under section 5723 of the Code or which are put up in packages not bearing the marks, labels, notices, and stamps, if any, as required under such section. Section 5751(a)(3) of the Code further provides that the restrictions set forth therein shall not prevent the sale or delivery of cigars or cigarettes directly to consumers from proper packages, nor apply to such articles when so sold or delivered.

In addition, 26 CFR 296.166 provides that cigars and cigarettes may be sold, or offered for sale, at retail *from* such packages, provided the products remain in the packages until removed by the customer or in the presence of the customer.

Accordingly, it is held that the required mark and notice may appear on a cigar or cigarette package consisting of cellophane (or similar material). Similarly, such required mark and notice may appear on cellophane (or similar material) used to wrap a cigar or cigarette package where it is concluded from the type of package (e.g., 20-pack of cigarettes, 5-pack of cigars, specialty box for cigars such as a jewelry box or pocket case, etc.), and from the practice of marketing such package at retail, that it will be delivered to the consumer with the wrapping intact. However, under the law and regulations, the cigars and cigarettes must remain in the package (as put up by the manufacturer or importer) bearing the required mark and notice from the time of removal of the cigars and cigarettes from the factory (or their release from customs custody) to the time that the consumer acquires possession of such products. Consequently, where the consumer purchases a 5-pack of cigars, discards the package, and places the loose cigars in his pocket or in a cigar case, the restrictions in section 5751(a)(3) of the Code do not apply to such cigars.

Revenue Ruling 64–23, C.B. 1964–1 (Part 1), 586, is hereby superseded.

(Also 290.184, 295.42.) Rev. Rul. 66–133
(Also Section 5713; 270.75, 290.93.)

The use of permit numbers by manufacturers of tobacco products and proprietors of export warehouses is provided for in 26 CFR 270.75 and 290.93.

Wherever such a permit number is required to be shown on packages of cigars or cigarettes, and in reports, returns, and other documents filed with the Internal Revenue Service and other governmental agencies, it should be complete and should include (1) the letters TP or EW, as the case may be, (2) the number assigned by the Assistant Regional Commissioner, Alcohol and Tobacco Tax, and (3) the name of the

State or proper abbreviation thereof, in which the factory or export warehouse is located.

Revenue Ruling 64–24, C.B. 1964–1 (Part 1), 587, is hereby superseded.

Whether a wholesale or retail dealer in cigars and cigarettes may remove such products from the required packages (as put up by the manufacturer or importer) for transmission by mail or other method of delivery to prospective customers. See Rev. Rul. 66–135, page 351.

Whether a single cigar may be sold from a vending machine where it is put up by the manufacturer in a package (cellophane, tube, etc.) which bears the manufacturer's permit number and class designation of the cigar. See Rev. Rul. 66–136, page 352.

Manufacturer liable for the tax required to be identified in the mark. See Rev. Proc. 66–25, page 653.

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26 CFR 270.214: Notice for cigars.

Whether the required mark and notice may appear on a cigar or cigarette package consisting of cellophane (or similar material) or on such material used to wrap a cigar or cigarette package. See Rev. Rul. 66–132, page 346.

Whether a wholesale or retail dealer in cigars and cigarettes may remove such products from the required packages (as put by the manufacturer or importer) for transmission by mail or other method of delivery to prospective customers. See Rev. Rul. 66–135, page 351.

Whether a single cigar may be sold from a vending machine where it is put up by the manufacturer in a package (cellophane, tube, etc.) which bears the manufacturer's permit number and class designation of the cigar. See Rev. Rul. 66–136, page 352.

Appearance of the word "cigars" on packages of large cigars. See Rev. Proc. 66–21, page 648.

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26 CFR 270.215: Notice for cigarettes.

Whether the required mark and notice may appear on a cigar or cigarette package consisting of cellophane (or similar material) or on such material used to wrap a cigar or cigarette package. See Rev. Rul. 66–132, page 346.

Whether a wholesale or retail dealer in cigars and cigarettes may remove such products from the required packages (as put up by the

manufacturer or importer) for transmission by mail or other method of delivery to prospective customers. See Rev. Rul. 66–135, page 351.

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26 CFR 275.71: Package.

Whether packages of cigars or cigarettes bearing the required mark and notice may be enclosed in outer containers. See Rev. Rul. 66–131, page 346.

Whether a wholesale or retail dealer in cigars and cigarettes may remove such products from the required packages (as put up by the manufacturer or importer) for transmission by mail or other method of delivery to prospective customers. See Rev. Rul. 66–135, page 351.

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26 CFR 275.73: Notice for cigars.

Whether the required mark and notice may appear on a cigar or cigarette package consisting of cellophane (or similar material) or on such material used to wrap a cigar or cigarette package. See Rev. Rul. 66–132, page 346.

Whether a wholesale or retail dealer in cigars and cigarettes may remove such products from the required packages (as put up by the manufacturer or importer) for transmission by mail or other method of delivery to prospective customers. See Rev. Rul. 66–135, page 351.

Whether a single cigar may be sold from a vending machine where it is put up by the manufacturer in a package (cellophane, tube, etc.) which bears the manufacturer's permit number and class designation of the cigar. See Rev. Rul. 66–136, page 352.

Appearance of the word "cigars" on packages of large cigars. See Rev. Proc. 66–21, page 648.

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26 CFR 275.74: Notice for cigarettes.

Whether the required mark and notice may appear on a cigar or cigarette package consisting of cellophane (or similar material) or on such material used to wrap a cigar or cigarette package. See Rev. Rul. 66–132, page 346.

Whether a wholesale or retail dealer in cigars and cigarettes may remove such products from the required packages (as put up by the manufacturer or importer) for transmission by mail or other method of delivery to prospective customers. See Rev. Rul. 66–135, page 351.

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26 CFR 275.75: Exemptions.

Whether a wholesale or retail dealer in cigars and cigarettes may remove such products from the required packages (as put up by the

manufacturer or importer) for transmission by mail or other method of delivery to prospective customers. See Rev. Rul. 66–135, page 351.

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26 CFR 290.184: Mark.

Method of showing the permit number of a tobacco products manufacturer on packages of cigars and cigarettes, and in reports, returns, and other documents. See Rev. Rul. 66–133, page 347.

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26 CFR 290.185: Label or notice. Rev. Rul. 66–134

The label or notice required on packages of tax-exempt cigars and cigarettes removed for export cannot be placed inside packages made of nontransparent plastic material where it would not be visible.

Revenue Ruling 63–143, C.B. 1963–2, 684, superseded.

Advice has been requested by a manufacturer of tobacco products whether the label or notice, required by regulations to be on packages of tax-exempt cigars and cigarettes removed for export, may be placed inside packages made of nontransparent plastic material.

Section 5723(b) of the Internal Revenue Code of 1954 provides that every package of cigars and cigarettes shall, before removal, bear the marks, labels, notices, etc., that the Secretary of the Treasury or his delegate by regulations prescribes.

26 CFR 290.185 provides, in part, that every package of cigars and cigarettes shall, before removal from the factory for export without payment of tax, have adequately imprinted thereon, or on a label securely affixed thereto, the words "Tax-exempt. For use outside U.S." or the words "U.S. Tax-exempt. For use outside U.S.", except where a stamp, sticker, or notice, required by a foreign country or a possession of the United States, which identifies such country or possession, is so imprinted or affixed.

The marks, labels, notices, etc., required by section 5723 of the Code, must be visible on packages of cigars and cigarettes in order to fulfill the purpose of the law to protect the revenue. Accordingly, 26 CFR 290.185 requires a label or notice on packages of tax-exempt cigars and cigarettes for use outside the United States to readily distinguish such packages from packages of taxpaid cigars and cigarettes for domestic consumption.

In view of the foregoing, it is held that the label or notice required by 26 CFR 290.185 to distinguish tax-exempt cigars and cigarettes from taxpaid products cannot be placed inside packages made of nontransparent plastic material where it would not be visible.

Revenue Ruling 63–143, C.B. 1963–2, 684, is hereby superseded.

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26 CFR 295.42: Mark.

Method of showing the permit number of a tobacco products manufacturer on packages of cigars and cigarettes, and in reports, returns, and other documents. See Rev. Rul. 66–133, page 347.

26 CFR 296.166: Dealing in cigars and cigarettes.

Whether the required mark and notice may appear on a cigar or cigarette package consisting of cellophane (or similar material) or on such material used to wrap a cigar or cigarette package. See Rev. Rul. 66–132, page 346.

SUBCHAPTER D.—RECORDS OF MANUFACTURERS OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES, AND EXPORT WAREHOUSE PROPRIETORS

SECTION 5741.—RECORDS TO BE MAINTAINED

26 CFR 270.183: Record of cigars and cigarettes.

Procedure for recording and reporting cigars and cigarettes removed subject to tax and treatment of tax determined (including taxpaid) cigars and cigarettes received into the factory. See Rev. Proc. 66–23, page 651.

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26 CFR 270.184: Record in support of removals subject to tax.

Whether the sale of cigars and cigarettes and products other than cigars and cigarettes on factory premises by a manufacturer of tobacco products to his employees constitutes an "other business". See Rev. Rul. 66–130, page 344.

Procedure for recording and reporting cigars and cigarettes removed subject to tax and treatment of tax determined (including taxpaid) cigars and cigarettes received into the factory. See Rev. Proc. 66–23, page 651.

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26 CFR 270.202: Reports.

Procedure for recording and reporting cigars and cigarettes removed subject to tax and treatment of tax determined (including taxpaid) cigars and cigarettes received into the factory. See Rev. Proc. 66–23, page 651.

SUBCHAPTER E.—GENERAL PROVISIONS

SECTION 5751.—PURCHASE, RECEIPT, POSSESSION, OR SALE OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES, AFTER REMOVAL

26 CFR 296.166: Dealing in cigars and cigarettes. Rev. Rul. 66–135

(Also Section 5723; 270.211, 270.212, 270.214, 270.215, 275.71, 275.73, 275.74, 275.75.)

A dealer in cigars and cigarettes (wholesale or retail) may not remove cigars or cigarettes from the required packages (as put up

by the manufacturer or importer), for transmission by mail, express, or other similar method to prospective customers, either as free samples to solicit trade or for sale.
Revenue Ruling 64–28, C.B. 1964–1 (Part 1), 594, superseded.

Advice has been requested whether cigars may be removed from a taxpaid package by a dealer for delivery by mail to customers as free samples. Advice has also been requested whether sample packages may be made up of cigars from taxpaid packages of more than one manufacturer for sale through the mail to customers.

Under section 5751(a)(3) of the Internal Revenue Code of 1954 and 26 CFR 296.166, all cigars and cigarettes purchased, received, possessed, offered for sale, sold or otherwise disposed of, by a dealer (wholesale or retail) must be in proper packages (as put up by the manufacturer or importer) which bear the mark and notice as prescribed in 26 CFR 270.211 through 270.215 and 275.71 through 275.75. Cigars and cigarettes may be sold or offered for sale at retail from such packages, provided the products remain in the packages until removed by the customer or in the presence of the customer.

A dealer in cigars and cigarettes (wholesale or retail) may not remove such products from the required packages (as put up by the manufacturer or importer) for transmission by mail, express, or other similar method to prospective customers, either as free samples to solicit trade or for sale.

Revenue Ruling 64–28, C.B. 1964–1 (Part 1), 594, is hereby superseded.

(Also Section 5723; 270.212, 270.214, 275.73.) Rev. Rul. 66–136

A single cigar put up by a manufacturer in a package (cellophane, tube, etc.) which bears the manufacturer's permit number and the class designation of the cigar may be sold from a vending machine, since the package substantially satisfies the requirements with respect to mark and notice.
Revenue Ruling 64–133, C.B. 1964–1 (Part 1), 594, superseded.

Advice has been requested whether a single cigar may be sold from a vending machine if the cigar is put up by the manufacturer in a package (cellophane, tube, etc.) which bears the manufacturer's permit number and the class designation "E, the ordinary retail price of this cigar is intended by the manufacturer to be more than 8 cents and not more than 15 cents."

26 CFR 296.166 provides that all cigars and cigarettes purchased, received, possessed, offered for sale, sold or otherwise disposed of, by any dealer must be in proper packages which bear the prescribed mark and notice. Cigars and cigarettes may be sold, or offered for sale, at retail *from* such packages, provided the products remain in the packages until removed by the customer or in the presence of the customer. Where a vending machine is used, cigars and cigarettes must similarly be vended in proper packages or *directly from* such packages.

26 CFR 270.212 provides, in pertinent part, that every package of cigars or cigarettes packed in a domestic factory shall, before removal subject to tax, have adequately printed thereon, or on a label securely affixed thereto, certain specified information, or the permit number of the factory from which such products are to be so removed.

In accordance with 26 CFR 270.214, every package of cigars shall, before removal subject to tax, have adequately imprinted thereon, or on a label securely affixed thereto, the designation "cigars," the quantity of such product contained therein, and the classification of the product for tax purposes. 26 CFR 275.73 provides similar requirements with respect to the notice on imported cigars.

Although the package containing the cigar in the instant case does not express the quantity and the word "cigar" separately from the class designation, the package substantially complies with the requirements of the regulations, since such expressions are not needed where a package contains only a single visible cigar.

Accordingly, it is held that where a single cigar is put up by a manufacturer in a package (cellophane, tube, etc.) so that the cigar is visible and the package bears the manufacturer's permit number and the class designation of the cigar, such cigars may be sold from a vending machine since the package substantially satisfies the requirements with respect to mark and notice.

Revenue Ruling 64–133, C.B. 1964–1 (Part 1), 594, is hereby superseded.

SUBTITLE F.—PROCEDURE AND ADMINISTRATION

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. Rev. Rul. 66–137

(Also Section 5704; 290.67.)

> When a theft of cigars and cigarettes, removed without payment of tax for export, occurs during a specific tax return period the last date for payment of the tax due is the last date for filing that return. If the tax is not paid with that return, interest commences with that filing date and continues to accrue until the tax is paid. Revenue Ruling 64–83, C.B. 1964–1 (Part 1), 595, superseded.

Advice has been requested concerning the date that interest should commence on the tax on cigars and cigarettes removed without payment of tax for exportation but which are diverted, by theft, before exportation.

In the case here involved, 400,000 cigarettes were removed from the factory, in bond, without payment of tax, for export. However, 230,000 of the cigarettes were stolen while the cigarettes were on the pier awaiting lading on the exporting vessel. The manufacturer of the cigarettes assumed liability for the tax but questioned the payment of interest on such tax. The specific question is the date interest should commence on the tax due on the diverted cigarettes.

Section 6601(a) of the Internal Revenue Code of 1954 provides, in part, that if any amount of tax imposed by the Code 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.

Section 6601(c) of the Code prescribes that the last date for payment of tax shall be determined under chapter 62 of the Code and the rules in this subsection. (The rules stated in this subsection are not pertinent to this matter.)

Section 6151(c), a section in chapter 62 of the Code, provides that in any case in which a tax is required to be paid on or before a certain date, or within a certain period, any reference in this title to the date fixed for payment of such tax shall be deemed a reference to the last day fixed for such payment (determined without regard to any extension of time for paying the tax).

Section 6601(f)(4) of the Code provides that if notice and demand is made for payment of any amount, and if such amount is paid within 10 days after the date of such notice and demand, interest under this section on the amount so paid shall not be imposed for the period after the date of such notice and demand.

In the instant case, the cigarettes were removed from the factory in bond, without payment of tax, for exportation under section 5704(b) of the Code. The tax became due and payable by the manufacturer when the cigarettes were removed from bond as a result of theft. This liability should have been included in the tax return covering the period during which the theft occurred.

Accordingly, it is held that when a theft is known to have occurred during a specific return period, the last date for payment of tax, within the meaning of sections 6601(c) and 6151(c) of the Code, is the last date for filing that return. If the tax is not paid with that return, interest on such tax, under section 6601(a) of the Code, commences from such filing date. The interest continues to accrue until the tax is paid. However, if the tax and the interest on such tax are paid within 10 days from the date of a notice and demand for payment, no interest is imposed for the period after the date of the notice and demand.

Revenue Ruling 64–83, C.B. 1964–1 (Part 1), 595, is hereby superseded.

CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

26 CFR 301.7805–1: Rules and regulations. Rev. Rul. 66–22

List of 7 obsolete Revenue Rulings and 5 obsolete Revenue Procedures concerning tobacco materials, tobacco products, and cigarette papers and tubes, published in C.B. 1962–1 through C.B. 1964–2.

Revenue Ruling 62–172, C.B. 1962–2, 352, supplemented.

Because of changes in the law and regulations relating to tobacco under Chapter 52 of the Internal Revenue Code of 1954, a review of the tobacco Revenue Rulings and Revenue Procedures has been made.

Special consideration has been given to the effect of the Excise Tax Reduction Act of 1965, Public Law 89–44, C.B. 1965–2, 568, which, in part, repealed the tax on manufactured tobacco and discontinued controls on tobacco materials effective January 1, 1966.

On the basis of the review, it has been determined that the following Revenue Rulings and Procedures have no applications to the law and regulations now in effect, or the situation no longer exists, or they are unnecessary since the subject matter of the Ruling or Procedures is now specifically covered by regulations. These Revenue Rulings and Revenue Procedures are therefore found to be no longer in effect and are hereby declared to be obsolete, as follows:

Revenue Ruling Number	Cumulative Bulletin Citation	Revenue Ruling Number	Cumulative Bulletin Citation
62–64	C.B. 1962–1, 280.	64–25	C.B. 1964–1 (Part 1), 591.
64–15	C.B. 1964–1, (Part 1), 576.	64–26	C.B. 1964–1 (Part 1), 592.
64–18	C.B. 1964–1 (Part 1), 577.	64–27	C.B. 1964–1 (Part 1), 593.
64–19	C.B. 1964–1 (Part 1), 578.		

Revenue Procedure Number	Cumulative Bulletin Citation	Revenue Procedure Number	Cumulative Bulletin Citation
62–6	C.B. 1962–1, 427.	64–9	C.B. 1964–1 (Part 1), 666.
64–7	C.B. 1964–1 (Part 1), 665.	64–33	C.B. 1964–2, 958.
64–8	C.B. 1964–1 (Part 1), 666.		

Revenue Ruling 62–172, C.B. 1962–2, 352, is hereby supplemented.

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PART IV

LEGISLATION AND TREATIES

SUBPART A.—TAX CONVENTIONS

UNITED STATES-AUSTRALIA GIFT TAX CONVENTION

Rev. Rul. 66–119

Where a donor, a citizen and resident of the United States, made a gift of securities which are deemed to be situated in Australia, under Article III(1)(d) of the United States-Australia gift tax convention, and the Commonwealth gift duty imposed by Australia with respect to the gift exceeds the Federal gift tax imposed by the United States, under paragraph (1) of Article V of the convention a credit against the Federal gift tax is allowable for the full amount of the Federal gift tax imposed.

Advice has been requested as to the application, under the circumstances indicated below, of the convention between the Government of the United States of America and the Government of the Commonwealth of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Gifts, May 14, 1953, 4 UST 2264, C.B. 1957–1, 637.

The donor, a citizen and resident of the United States, executed an irrevocable deed of trust on April 26, 1962, by which she transferred certain securities for the benefit of relatives in Australia. Article III(1)(d) of the convention provides that bonds, stocks, debentures, and other debts being securities, issued by any government, municipality, or public authority shall be deemed to be situated at the place where that government, municipality, or public authority is located. As the securities transferred were obligations of the Australian Government, they are deemed to have been situated in Australia under Article III(1)(d) of the convention.

The Commonwealth gift duty imposed by Australia, because the property transferred was situated there, amounted to 3 x dollars. The Federal gift tax which would be imposed by the United States because the donor was domiciled in and a citizen of the United States amounted to 2 x dollars.

Credit against the Federal gift tax is allowable under paragraph (1) of Article V of the convention which states, in part:

> Where a Contracting State imposes tax by reason of a donor's being domiciled in some part of its territory or being its citizen, that State shall allow against so much of its tax (as otherwise computed) as is attributable to property situated in the territory

of the other Contracting State, a credit (not exceeding the amount of the tax so attributable) equal to so much of the tax imposed by that other Contracting State as is attributable to that property; * * *.

Accordingly, it is held that a credit in the amount of 2 x dollars is allowable in computing the Federal gift tax liability of the present donor, under Article V of the gift tax convention between Australia and the United States.

UNITED STATES-FINLAND INCOME TAX CONVENTION

T.D. 6202, C.B. 1956–2, 1067, Section 511.103: Exemption from United States tax.
(Also Part I, Sections 1441, 1442; 26 CFR 1.1441–1, 1.1442–1.)

Rev. Rul. 66–55

Article VIII of the United States-Finland Income Tax Convention, T.D. 6202, C.B. 1956–2, 1067, provides that royalties for the right to use copyrights or in respect of the right to produce any literary, dramatic, musical, or artistic work (but not inclusive of rents or royalties in respect of motion picture films) derived from sources within the United States by a resident, corporation, or other entity of Finland, not engaged in trade or business in the United States through a permanent establishment in the United States, are exempt from United States tax.

The term royalties, within the purview of Article VIII of the convention, does not include industrial royalties.

Revenue Ruling 60–288, C.B. 1960–2, 265, is hereby clarified to show, in the case of Finland, that industrial royalties are not exempt from United States tax, and that tax is to be withheld at the statutory rate prescribed by sections 1441 and 1442 of the Internal Revenue Code of 1954. This Revenue Ruling is not determinative with respect to industrial royalties under income tax conventions with other countries enumerated in Revenue Ruling 60–288.

UNITED STATES—FEDERAL REPUBLIC OF GERMANY PROTOCOL MODIFYING INCOME TAX CONVENTION

A protocol modifying the Convention of July 22, 1954, between the United States and the Federal Republic of Germany for the avoidance of double taxation with respect to income was signed at Bonn on September 17, 1965. Ratification was advised by the United States Senate [1] on October 22, 1965, and the Protocol was ratified by the President on November 15, 1965. It was ratified by the Federal Republic of Germany on December 27, 1965. The instruments of ratification were exchanged at Bonn on December 27, 1965, and the President proclaimed the Protocol on December 30, 1965. It was entered into force on December 27, 1965.

[1] Senate Executive Report No. 7, page 543, this Bulletin.

The official text of the Protocol is contained in the pamphlet of the Treaties and Other International Acts Series (TIAS) designated as TIAS 5920. The English text of the Protocol follows:

The United States of America and the Federal Republic of Germany,

Desiring to modify the Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with respect to Taxes on Income, signed on July 22, 1954 [C.B. 1955–1, 635], and to extend it to certain other taxes, the Convention bearing the title

"Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with respect to Taxes on Income and to certain other Taxes"

have agreed as follows:

Article 1

Article I of the Convention shall be deleted and replaced by the following:

"Article I

(1) The taxes referred to in this Convention are:

(a) In the case of the United States of America:
The Federal income taxes, including surtaxes
(hereinafter referred to as "United States tax");

(b) In the case of the Federal Republic of Germany:
The Einkommensteuer (income tax),
the Körperschaftsteuer (corporation tax),
the Gewerbesteuer (trade tax), and
the Vermögensteuer (capital tax)
(hereinafter referred to as "Federal Republic tax").

(2) The present Convention shall also apply to any other tax of a substantially similar character which may be imposed by one of the contracting States after the date of signature of the present Convention.

(3) The provisions of the present Convention in respect to the taxation of profits shall likewise apply to the Federal Republic trade tax (Gewerbesteuer) computed on a basis other than profits or capital."

Article 2

Article II(1)(c) of the Convention shall be deleted and replaced by:

"(c) (aa) The term "permanent establishment" means a fixed place of business in which the business of an enterprise of one of the contracting States is wholly or partly carried on.

(bb) A permanent establishment shall include especially:
a place of management;
a branch;
an office;
a store or other sales outlet;

a factory;

a workshop;

a mine, quarry or other place of extraction of natural resources;

a building site or construction or assembly project which exists for more than twelve months.

(cc) Notwithstanding subparagraph (c) (aa) of this paragraph a permanent establishment shall be deemed not to include one or more of the following activities:

the use of facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

the maintenance of a stock of goods or merchandise belonging to the enterprise for the purpose of storage, display or delivery;

the maintenance of a stock of goods or merchandise belonging to the enterprise for the purpose of processing by another enterprise;

the maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

the maintenance of a fixed place of business for the purpose of advertising, for the supply of information, for scientific research or for similar activities, if they have a preparatory or auxiliary character, for the enterprise.

(dd) Even if an enterprise of one of the contracting States does not have a permanent establishment in the other State under subparagraph (c) (aa) to (cc) of this paragraph, nevertheless it shall be deemed to have a permanent establishment in the latter State if it is engaged in trade or business in that State through an agent who has an authority to conclude contracts in the name of the enterprise and regularly exercises that authority in that State, unless the exercise of authority is limited to the purchase of goods or merchandise for the account of the enterprise.

(ee) An enterprise of one of the contracting States shall not be deemed to have a permanent establishment in the other State merely because it is engaged in trade or business in that other State through a broker, general commission agent or any other agent of an independent status, where such person is acting in the ordinary course of business.

(ff) The fact that a resident or a corporation of one of the contracting States controls, is controlled by, or is under common control with, (i) a corporation of the other State or (ii) a corporation which engages in trade or business in that other State (whether through a permanent establishment or otherwise) shall not be taken into account in determining whether such resident or corporation has a permanent establishment in that other State."

Article 3

Article III of the Convention shall be deleted and replaced by the following:

"Article III

(1) Industrial or commercial profits of an enterprise of one of the contracting States shall be exempt from tax by the other State unless the enterprise is engaged in trade or business in such other State through a permanent establishment situated therein. If such enterprise is so engaged, tax may be imposed by such other State on the industrial or commercial profits of the enterprise but only on so much of them as are attributable to the permanent establishment or are derived from sources within such other State from sales of goods or merchandise of the same kind as those sold, or from other business transactions of the same kind as those effected, through the permanent establishment.

(2) Where an enterprise of one of the contracting States is engaged in trade or business in the other State through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment. Where the enterprise, in addition to the profits derived through the permanent establishment, derives other profits of the kind referred to in paragraph (1), such other profits shall be treated as if they were derived through the permanent establishment.

(3) In determining the industrial or commercial profits of an enterprise of one of the contracting States which are taxable in the other State in accordance with paragraphs (1) and (2), there shall be allowed as deductions all expenses, wherever incurred, which are reasonably connected with the profits so taxable, including executive and general administrative expenses.

(4) No profits shall be deemed to be derived from sources within one of the contracting States by an enterprise of the other State merely by reason of the purchase of goods or merchandise by a permanent establishment of the enterprise, or by the enterprise itself, for the account of the enterprise.

(5) The term "industrial or commercial profits" means income derived by an enterprise from the active conduct of a trade or business, including income derived by an enterprise from the furnishing of services of employees or other personnel, but does not include income dealt with in Article VI paragraphs (1) to (6) (dividends), Article VII paragraphs (1) and (2) (interest), Article VIII paragraphs (1) to (3) (royalties), Article IX (income from real property and natural resources), Article IX A paragraphs (1), (2) and (4) (capital gains) and Article X (labor and personal services)."

Article 4

Article VI of the Convention shall be deleted and replaced by the following:

"Article VI

(1) Except as otherwise provided in this Article, United States tax on dividends received by a natural person resident in the Federal Republic or by a German company from a United States corporation shall not exceed 15 percent of the gross amount of the dividends.

(2) Except as otherwise provided in this Article, Federal Republic tax on dividends received by a resident or corporation or other entity of the United States from a German company shall not exceed 15 percent of the gross amount of the dividends.

(3) Notwithstanding paragraph (2) of this Article, Federal Republic tax on dividends received by a United States corporation or other entity from a German company at least 10 percent of the voting shares of which are owned directly by the former corporation or entity may exceed 15 percent but shall not exceed 25 percent of that portion of any dividend which, under paragraph (5) of this Article, is deemed reinvested. The foregoing provision shall apply only if at the time the dividend is distributed the Federal Republic imposes a corporation tax on the distributed profits of the German company at a rate at least 20 percentage points lower than the corporation tax imposed upon its undistributed profits.

(4) The provisions of paragraph (3) of this Article shall apply, *mutatis mutandis*, to United States tax imposed on dividends received by a German company from a United States corporation.

(5) For purposes of paragraph (3) of this Article, if the United States corporation transfers money or other property directly or indirectly, to the German company as a loan or as an increase in the equity capital of the German company, or as any other form of investment in such company, and if the amount so transferred exceeds 7.5 percent of the dividends received by the United States corporation from the German company in the calendar year in which such transfer is made, then the entire amount transferred shall be deemed to be a reinvestment of dividends received from the German company

(a) in the calendar year preceding the year in which the amount is transferred,

(b) in the calendar year in which the amount is transferred, and

(c) in the following calendar year,

in that order and to the extent of such dividends. With respect to dividends paid in any year there shall first be taken into account the amounts transferred in the preceding year to the extent that such amounts were deemed to be reinvestments and did not result in the imposition of tax under paragraph (3) of this Article on any prior dividend.

(6) Any reduction in withholding or refund of tax withheld on dividends to which paragraph (3) or paragraph (4) is applicable is subject to recapture if tax becomes due by reason of transfers that are deemed reinvestments under paragraph (5), the corporation receiving and that paying the dividend being jointly and severally liable for such recapture.

(7) The foregoing provisions shall not apply, if the recipient of the dividends has a permanent establishment in the United States, for the purposes of paragraphs (1) and (4), or in the Federal Republic,

for the purposes of paragraphs (2) and (3), and the holding giving rise to the dividends is effectively connected with such permanent establishment.

(8) The term "dividends" shall include in the case of the Federal Republic, in addition to distributions by an "Aktiengesellschaft" (stock corporation), distributions with respect to shares in a "Gesellschaft mit beschränkter Haftung" (private limited company), in a "Kapitalanlagegesellschaft" (investment trust) or in a "Kommanditgesellschaft auf Aktien" (partnership limited by shares) and income derived from "Kuxe" (mining shares), from "Genußscheine" (profit participation certificates), or by a "stiller Gesellschafter" (sleeping partner) from his participation as such."

Article 5

Article VII of the Convention shall be deleted and replaced by the following:

"Article VII

(1) Interest on bonds, notes, debentures, securities or on any other form of indebtedness (including debts secured by mortgages or other encumbrances on real property) derived by a natural person resident in the Federal Republic or by a German company shall be exempt from tax by the United States.

(2) Interest on bonds, notes, debentures, securities or on any other form of indebtedness (including debts secured by mortgages or other encumbrances on real property) derived by a resident or corporation or other entity of the United States shall be exempt from tax by the Federal Republic.

(3) Paragraph (1) or paragraph (2) of this Article shall not apply if the recipient of the interest has a permanent establishment in the United States, for purposes of paragraph (1), or in the Federal Republic, for purposes of paragraph (2), and the debt-claim giving rise to the interest is effectively connected with such permanent establishment.

(4) Where, owing to a special relationship between the payer and the recipient or between both of them and some other person, the amount of the interest paid, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the recipient in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case the excess part of the payments shall remain taxable according to the law of each contracting State, due regard being had to the other provisions of this Convention."

Article 6

Article VIII of the Convention shall be deleted and replaced by the following:

"Article VIII

(1) Royalties derived by a natural person resident in the Federal Republic or by a German company shall be exempt from tax by the United States.

(2) Royalties derived by a resident or corporations or other entity of the United States shall be exempt from tax by the Federal Republic.

(3) The term "royalties", as used in this Article,

(a) means any royalties, rentals or other amounts paid as consideration for the use of, or the right to use, copyrights, artistic or scientific works (including motion picture films, or films or tapes for radio or television broadcasting), patents, designs, plans, secret processes or formulae, trademarks, or other like property or rights, or for industrial, commercial or scientific equipment, or for knowledge, experience or skill (know-how) and

(b) shall include gains derived from the alienation of any right or property giving rise to such royalties.

(4) Paragraph (1) or paragraph (2) of this Article shall not apply if the recipient of the royalties has a permanent establishment in the United States, for purposes of paragraph (1), or in the Federal Republic, for purposes of paragraph (2), and the right or property giving rise to the royalties is effectively connected with such permanent establishment.

(5) Where, owing to a special relationship between the payer and the recipient or between both of them and some other person, the amount of the royalties paid, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the recipient in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each contracting State, due regard being had to the other provisions of this Convention."

Article 7

Article IX of the Convention shall be deleted and replaced by the following:

"Article IX

(1) Income from real property situated in one of the contracting States and royalties in respect of the operation of mines, quarries or other natural resources located within that State, including gains derived from the alienation of items of the aforementioned property, may be taxed by that State.

(2) A natural person resident in the Federal Republic or a German company subject to tax in the United States, or a resident or corporation or other entity of the United States subject to tax in the Federal Republic, on any income mentioned in paragraph (1) of this Article may elect for any taxable year to compute tax on such income on a net basis at the tax rates that would apply to a resident or company of the contracting State in which the property is situated."

Article 8

The following new Article shall be inserted immediately after Article IX of the Convention:

"Article IX A

(1) Gain derived by a natural person resident in the Federal Republic or by a German company from the alienation of a capital asset (other than gain from the alienation of property referred to in Article IX of this Convention) shall be exempt from tax by the United States.

(2) Gain derived by a resident or corporation or other entity of the United States from the alienation of a capital asset (other than gain from the alienation of property referred to in Article IX of this Convention) shall be exempt from tax by the Federal Republic.

(3) Paragraph (1) or paragraph (2) of this Article shall not apply if the person deriving the gain has a permanent establishment in the United States, for purposes of paragraph (1), or in the Federal Republic, for purposes of paragraph (2), and the gain is derived from the alienation of a capital asset which is effectively connected with such permanent establishment.

(4) Paragraph (1) of this Article shall not apply if:

(a) the person deriving the gain is a natural person resident in the Federal Republic who is present in the United States for a period equal to or exceeding an aggregate of 183 days during the taxable year, and

(b) the asset alienated was held by such person for six months or less."

Article 9

Article X of the Convention shall be deleted and replaced by the following:

"Article X

(1) Compensation for labor or personal services (including compensation derived from the practice of a liberal profession and the rendition of services as a director) performed outside the United States by a natural person resident in the Federal Republic shall be exempt from tax by the United States.

(2) Compensation for labor or personal services (including compensation derived from the practice of a liberal profession and the rendition of services as a director) performed in the United States by a natural person resident in the Federal Republic shall be exempt from tax by the United States if—

(a) he is present in the United States for a period or periods not exceeding a total of 183 days during a taxable year,

(b) such labor or personal services are performed as an employee of, or under contract with, a natural person resident in the Federal Republic or a German company, and such compensation is borne by such resident or company, and

(c) such compensation is not borne by a permanent establishment which such resident or company has in the United States.

(3) Compensation for labor or personal services (including compensation derived from the practice of a liberal profession and the rendition of services as a director) performed outside the Federal

Republic by a resident of the United States shall be exempt from tax by the Federal Republic.

(4) Compensation for labor or personal services (including compensation derived from the practice of a liberal profession and the rendition of services as a director) performed in the Federal Republic by a resident of the United States shall be exempt from tax by the Federal Republic if—

(a) he is present in the Federal Republic for a period or periods not exceeding a total of 183 days during a taxable year,

(b) such labor or personal services are performed as an employee of, or under contract with, a resident or corporation or other entity of the United States and such compensation is borne by such resident or corporation or other entity, and

(c) such compensation is not borne by a permanent establishment which such resident or corporation or other entity has in the Federal Republic."

Article 10

Article XI of the Convention shall be deleted and replaced by the following:

"Article XI

(1) (a) Wages, salaries and similar compensation and pensions paid by the United States or by its states, territories or political subdivisions, to a natural person, other than a German citizen, shall be exempt from tax by the Federal Republic.

(b) Wages, salaries and similar compensation and pensions paid by the Federal Republic or by its Laender or by municipalities, or by a public pension fund thereof, to a natural person, other than a citizen of the United States and other than an individual who has been admitted to the United States for permanent residence therein, shall be exempt from tax by the United States.

(c) Pensions, annuities and other amounts paid by one of the contracting States or by a juridical person organized under the public laws of that State as compensation for an injury or damage sustained as a result of hostilities or political persecution shall be exempt from tax by the other State.

(d) For the purposes of this paragraph the term "pensions" shall be deemed to include annuities paid to a retired civilian government employee.

(2) Private pensions and private life annuities which are derived from sources within one of the contracting States and are paid to a natural person resident in the other State shall be exempt from taxation by the former State.

(3) The term "pensions", as used in this Article, means periodic payments made in consideration for services rendered or by way of compensation for injuries received.

(4) The term "life annuities", as used in this Article, means a stated sum payable periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration in money or money's worth."

Article 11

The following new Article shall be inserted immediately after Article XIV of the Convention:

"Article XIV A

With respect to taxes on capital, the following provisions shall apply:

(1) Capital represented by property mentioned in Article IX may be taxed in the contracting State in which such property is situated.

(2) Subject to the provisions of paragraph (3) below, capital represented by assets, other than property referred to in paragraph (1), which are effectively connected with a permanent establishment of an enterprise of one of the contracting States may be taxed in the State in which the permanent establishment is situated and assets, other than property referred to in paragraph (1), pertaining to the operation of such ships or aircraft shall be exempt from tax by the other State.

(3) Ships and aircraft of an enterprise of one of the contracting States

(4) (a) All other elements of capital of a natural person resident in the Federal Republic or of a German company shall be exempt from tax by the United States.

(b) All other elements of capital of a resident or corporation or other entity of the United States shall be exempt from tax by the Federal Republic."

Article 12

Article XV(1) of the Convention shall be deleted and replaced by the following:

"(1) It is agreed that double taxation shall be avoided in the following manner:

(a) The United States, in determining United States tax in the case of its citizens, residents or corporations, may, regardless of any other provision of this Convention, include in the basis upon which such tax is imposed all items of income taxable under the revenue laws of the United States as if this Convention had not come into effect. The United States shall, however, allow to a citizen, resident or corporation of the United States as a credit against United States tax the appropriate amount of Federal Republic tax paid, other than the Vermögensteuer (capital tax) and that portion of the Gewerbesteuer (trade tax) computed on a basis other than profits. Such appropriate amount shall be based upon the amount of Federal Republic tax paid but shall not exceed that portion of the United States tax which net income from sources within the Federal Republic bears to the entire net income. It is agreed, that, by virtue of the provisions of this Article, the Federal Republic satisfies

the similar credit requirement of the Internal Revenue Code with respect to Federal Republic tax.

(b) 1. Federal Republic tax shall be determined in the case of a natural person resident in the Federal Republic or of a German company as follows:

(aa) Unless the provisions of subparagraph (bb) below apply, there shall be excluded from the basis upon which Federal Republic tax is imposed, any item of income from sources within the United States or any item of capital situated within the United States which, according to this Convention, is not exempt from tax by the United States. The Federal Republic, however, retains the right to take into account in the determination of its rate of tax the items of income or capital so excluded. The first sentence shall, in the case of income from dividends, apply only to such dividends subject to tax under United States law as are paid to a German company limited by shares (Kapitalgesellschaft) by a United States corporation, at least 25 percent of the voting shares of which are owned directly by the first-mentioned company. There shall also be excluded from the basis upon which Federal Republic tax is imposed any participation the dividends on which are excluded, or if paid would be excluded, from the tax basis according to the foregoing sentence.

(bb) United States tax payable under the laws of the United States and in accordance with this Convention on the following items of income shall be allowed as a credit against such Federal Republic tax on income as is payable in respect of the following items of income:

(i) dividends not dealt with in subparagraph (aa) above;

(ii) wages, salaries, pensions and similar compensation paid by the United States or by its states, territories or political subdivisions, not being exempt from Federal Republic tax under Article XI, paragraph (1), subparagraph (a) of this Convention.

Such credit shall not exceed that portion of the Federal Republic tax which such items of income bear to the total amount of all items of income.

2. Where a natural person subject to unlimited tax liability in the Federal Republic is also a resident of the United States for purposes of United States tax or a citizen of the United States, subparagraph 1(aa) shall apply to those items of income from sources within the United States and those items of capital situated within the United States which, according to that subparagraph, are exempt from Federal Republic tax when received or owned by a natural person who is not a resident of the United States for

the purposes of United States tax nor a citizen of the United States. All other items of income and capital shall be included in the basis upon which Federal Republic tax is imposed as if this Convention had not come into force. There shall, however, subject to paragraph 34c of the German Income Tax Act, as amended, be allowed as a credit against Federal Republic income tax the United States tax on such other income from sources within the United States."

Article 13

The following new Article shall be inserted immediately after Article XV of the Convention:

"Article XV A

(1) A German company or organization operated exclusively for religious, charitable, scientific, educational or public purposes shall be exempt from tax by the United States, if and to the extent that—

(a) such company or organization is exempt from tax in the Federal Republic, and

(b) such company or organization would be exempt from tax in the United States if it were organized, and carried on all its activities, in the United States.

(2) A United States corporation or organization operated exclusively for religious, charitable, scientific, educational or public purposes shall be exempt from tax by the Federal Republic, if and to the extent that—

(a) such corporation or organization is exempt from tax in the United States, and

(b) such corporation or organization would be exempt from tax in the Federal Republic if it were a German company or organization and carried on all its activities in the Federal Republic."

Article 14

Article XVI paragraph (1) of the Convention shall be deleted and replaced by:

"(1) The competent authorities of the contracting States shall exchange such information (being information available under the respective taxation laws of the contracting States) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or the like in relation to the taxes which are the subject of the present Convention. Any information so exchanged shall be treated as secret but may be disclosed to persons (including a court or administrative body) concerned with assessment, collection, enforcement or prosecution in respect of taxes which are the subject of the present Convention. No information shall be exchanged which would disclose any trade, business, industrial or professional secret or any trade process."

Article 15

Article XVII of the Convention shall be deleted and replaced by the following:

"Article XVII

(1) Where a taxpayer shows proof that the action of the tax authorities of the contracting States has resulted or will result in double taxation contrary to the provisions of the present Convention, he shall be entitled to present his case to the State of which he is a citizen or a resident, or, if the taxpayer is a company or a corporation of one of the contracting States, to that State. Should the taxpayer's claim be deemed worthy of consideration, the competent authority of the State to which the claim is made shall endeavor to come to an agreement with the competent authority of the other State with a view to avoidance of double taxation.

(2) The competent authorities of the contracting States may communicate with each other directly to implement the provisions of the present Convention. Should any difficulty or doubt arise as to the interpretation or application of the present Convention, or its relationship to conventions between one of the contracting States and any other state, the competent authorities shall endeavor to settle the question as quickly as possible by mutual agreement.

(3) In particular, the competent authorities of the contracting States may consult together to endeavor to agree

(a) to the same attribution of industrial or commercial profits to an enterprise of one of the contracting States and to its permanent establishment situated in the other State,

(b) to the same allocation of profits between related enterprises as provided for in Article IV, or

(c) to the same determination of the source of particular items of income.

In the event that the competent authorities reach such an agreement taxes shall be imposed on such income, and refund or credit of taxes shall be allowed, by the contracting States in accordance with such agreement."

Article 16

This Protocol shall also apply to Land Berlin, provided that the Government of the Federal Republic of Germany has not delivered a contrary declaration to the Government of the United States of America within three months from the date of entry into force of this Protocol.

Article 17

(1) The present Protocol shall be ratified and the instruments of ratification shall be exchanged at Bonn as soon as possible.

(2) The present Protocol shall come into force on the date of the exchange of instruments of ratification; and the articles thereof shall have effect for taxable years beginning on or after the first day of January in the year in which such exchange takes place, except that

(a) Article 4 shall have effect with respect to dividends paid on or after January 1, 1965, and paragraph (3) thereof shall apply to investments, made on or after that date,

(b) Article 6 shall have effect with respect to any payment made on or after January 1, 1963.

Article 18

(1) This Protocol shall form an integral part of the Convention of July 22, 1954, and shall continue in force as long as that Convention remains effective.

(2) The competent authorities of the contracting States are authorized to publish the text of the Convention, as modified by this Protocol, after this Protocol comes into force.

DONE at Bonn in four originals, two each in the English and German languages, all four texts being equally authentic, this seventeenth day of September, 1965.

For the
United States of America:
G... C. MCGHEE

For the
Federal Republic of Germany:
CARSTENS
GRUND

MEMORANDUM OF UNDERSTANDING BETWEEN TAX DELEGATIONS OF GERMANY AND THE UNITED STATES CONCERNING THE PROTOCOL SIGNED SEPTEMBER 17, 1965, TO MODIFY THE INCOME TAX CONVENTION OF JULY 22, 1954

The representatives of the German Ministry of Finance and of the United States Treasury Department hereby agree that the Protocol modifying the Income Tax Convention of July 22, 1954, between Germany and the United States of America shall be applied in accordance with the following principles:

1. In the application of Article II of the Convention a hotel room or similar place temporarily occupied by officials of an enterprise exercising management functions shall not be interpreted to constitute "a place of management".

2. For purposes of determining whether a corporation that has received a dividend has made a reinvestment in the corporation paying the dividend so that paragraph (3) of Article VI of the Convention applies to the dividend deemed to have been reinvested, paragraph (5) of that Article shall be interpreted so that loans which do not constitute more than a temporary addition to the capital of the corporation paying the dividend, as for example trade credit extended in accordance with the general credit practices followed in the trade or business concerned, shall not be deemed to constitute reinvestments. The renewal or conversion into equity capital of loans outstanding as of December 31, 1964, other than those mentioned in the foregoing sentence, shall not be deemed to constitute a reinvestment.

3. The term "effectively connected" as used in Articles VI, VII and VIII of the Convention shall be so construed that items of income referred to in the respective Articles will be considered to be effectively connected with a permanent establishment if such items of income accrue to the recipient by virtue of assets (a) held by the permanent establishment or (b) held by the recipient specifically to promote the business activities of the permanent establishment, or if the activities of the permanent establishment are a material factor in realizing such

items of income. As used in Article IX A of the Convention, the term "effectively connected" shall be so construed that gain to which the Article applies will be considered to be effectively connected with a permanent establishment if the gain is derived from the alienation of property (a) held by such permanent establishment or (b) held specifically to promote its business activities.

4. Both delegations agree that the amendment effected by Article 6 of the Protocol shall not influence the interpretation to be given to Article VIII of the Convention prior to the amendment.

5. The exemption of capital gains provided by Article IX A of the Convention is understood to apply to the sale, liquidation or other alienation of a "wesentliche Beteiligung" (substantial participation) in a company.

6. In the event that either the United States income tax or Federal Republic tax, as it applies to corporations, is substantially changed, or if experience in individual cases indicates that the application of Article VI leads to effects that are not in accordance with the basic principles underlying this Article, the competent authorities of the contracting States shall consult together for the purpose of ascertaining whether it is necessary to amend Article VI.

BONN, *October 19, 1965*

For the
United States Treasury
Department
ARTHUR F. BLASER, Jr.

For the
Ministry of Finance of the
Federal Republic of Germany
FALK

SUBPART B.—LEGISLATION

PUBLIC LAW 89-352
EIGHTY-NINTH CONGRESS, FEBRUARY 2, 1966
H.R. 327 [1]

An Act to amend section 501(c) of the Internal Revenue Code of 1954 to exempt from taxation certain nonprofit corporations and associations operated to provide reserve funds for domestic building and loan associations, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 501 (c)(14) of the Internal Revenue Code of 1954 (relating to certain organizations exempt from Federal income tax) is amended to read as follows:

(14)(A) Credit unions without capital stock organized and operated for mutual purposes and without profit.

(B) Corporations or associations without capital stock organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for, and insurance of shares or deposits in—

(i) domestic building and loan associations,

(ii) cooperative banks without capital stock organized and operated for mutual purposes and without profit, or

(iii) mutual savings banks not having capital stock represented by shares.

(C) Corporations or associations organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for associations or banks described in clause (i), (ii), or (iii) of subparagraph (B); but only if 85 percent or more of the income is attributable to providing such reserve funds and to investments. This subparagraph shall not apply to any corporation or association entitled to exemption under subparagraph (B).

SEC. 2. Section 511(a)(2)(A) of such Code (relating to organizations subject to tax) is amended by inserting "(14) (B) or (C)," after "(6)," in the heading and in the text.

SEC. 3. The amendment made by the first section of this Act shall apply to taxable years ending after the date of the enactment of this Act. The amendment made by section 2 shall apply to taxable years beginning after the date of the enactment of this Act.

Approved February 2, 1966.

[1] Senate Report No. 945, page 425, this Bulletin: since House Report No. 1078 is substantially the same as the Senate Report, it is not published herein.

PUBLIC LAW 89-354
EIGHTY-NINTH CONGRESS, FEBRUARY 2, 1966
H.R. 8445 [1]

An Act to amend the Internal Revenue Code of 1939 and the Internal Revenue Code of 1954 to change the method of computing the retired pay of judges of the Tax Court of the United States

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 1106 (d) of the Internal Revenue Code of 1939 (relating to retired pay of judges of the Tax Court of the United States) and section 7447(d) of the Internal Revenue Code of 1954 (relating to retired pay of judges of the Tax Court of the United States) are amended by striking out in each such section "at a rate which bears the same ratio to the rate of the salary payable to him as judge at the time he ceases to be a judge" and inserting in lieu thereof in each such section "during any period at a rate which bears the same ratio to the rate of the salary payable to a judge during such period"; and by striking out in each such section "the rate of such salary" each place it appears and by inserting in lieu thereof in each such place "the rate of such salary for such period".

SEC. 2. The amendments made by the first section of this Act shall apply with respect to retired pay accruing under section 1106 of the Internal Revenue Code of 1939 or section 7447 of the Internal Revenue Code of 1954 on or after the first day of the first calendar month, which begins after the date of enactment of this Act.

Approved February 2, 1966.

PUBLIC LAW 89-359
EIGHTY-NINTH CONGRESS, MARCH 7, 1966
H.R. 10185 [2]

An Act amending certain estate tax provisions of the Internal Revenue Code of 1939.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) the last sentence of section 894(a) of the Internal Revenue Code of 1939 (relating to the penalty in the case of a false or fraudulent estate tax return) is amended to read as follows: "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 assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2)."

(b) Section 871(i) of such code (relating to method of assessment) is amended by striking out "section 3612(d)(2)" and inserting in lieu thereof "section 894(a)".

(c) The amendments made by this Act shall be applicable with respect to estates of decedents subject to the provisions of chapter 3

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[1] Senate Report No. 947, page 427, this Bulletin: since House Report No. 959 is substantially the same as the Senate Report, it is not published herein.

[2] Senate Report No. 956, page 428, this Bulletin: since House Report No. 1222 is substantially the same as the Senate Report, it is not published herein.

of the Internal Revenue Code of 1939. No interest shall be paid or allowed on any refund or credit of any overpayment attributable to such amendments.

Approved March 7, 1966.

PUBLIC LAW 89-365
EIGHTY-NINTH CONGRESS, MARCH 8, 1966
H.R. 10625 [1]

An Act relating to the tax treatment of certain amounts paid to certain members and former members of the uniformed services and to their survivors.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a)(1) part III of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to items specifically excluded from gross income) is amended by redesignating section 122 as section 123, and by inserting after section 121 the following new section:

SEC. 122. CERTAIN REDUCED UNIFORMED SERVICES RETIREMENT PAY.

(a) GENERAL RULE.—In the case of a member or former member of the uniformed services of the United States who has made an election under chapter 73 of title 10 of the United States Code to receive a reduced amount of retired or retainer pay, gross income does not include the amount of any reduction after December 31, 1965, in his retired or retainer pay by reason of such election.

(b) SPECIAL RULE.—

(1) AMOUNT EXCLUDED FROM GROSS INCOME.—In the case of any individual referred to in subsection (a), all amounts received after December 31, 1965, as retired or retainer pay shall be excluded from gross income until there has been so excluded an amount equal to the consideration for the contract. The preceding sentence shall apply only to the extent that the amounts received would, but for such sentence, be includible in gross income.

(2) CONSIDERATION FOR THE CONTRACT.—For purposes of paragraph (1) and section 72(o), the term "consideration for the contract" means, in respect of any individual, the sum of—

(A) the total amount of the reductions before January 1, 1966, in his retired or retainer pay by reason of an election under chapter 73 of title 10 of the United States Code, and

(B) any amounts deposited at any time by him pursuant to section 1438 of such title 10.

(2) The table of sections for such part III is amended by striking out the item relating to section 122 and inserting in lieu thereof the following:

Sec. 122. Certain reduced uniformed services retirement pay.
Sec. 123. Cross references to other Acts.

(b) Section 72 of such Code (relating to tax treatment of annuities) is amended by redesignating subsection (o) as subsection (p), and by inserting after subsection (n) the following new subsection:

(o) ANNUITIES UNDER RETIRED SERVICEMAN'S FAMILY PROTECTION PLAN.—Subsections (b) and (d) shall not apply in the case of amounts received after December 31, 1965, as an annuity under chapter 73 of title 10 of the United

[1] House Report No. 1118, page 429, this Bulletin: since Senate Report No. 1004 is substantially the same as the House Report, it is not published herein.

States Code, but all such amounts shall be excluded from gross income until there has been so excluded (under section 122(b)(1) or this section, including amounts excluded before January 1, 1966) an amount equal to the consideration for the contract (as defined by section 122(b)(2)), plus any amount treated pursuant to section 101(b)(2)(D) as additional consideration paid by the employee. Thereafter all amounts so received shall be included in gross income.

(c) Section 101(b)(2)(D) of such Code (relating to special rules for employees' death benefits) is amended by adding at the end thereof the following new sentence: "Paragraph (1) shall not apply in the case of an annuity under chapter 73 of title 10 of the United States Code if the individual who made the election under such chapter died after attaining retirement age."

(d) The amendments made by subsections (a) and (b) shall apply with respect to taxable years ending after December 31, 1965. The amendment made by subsection (c) shall apply with respect to individuals making an election under chapter 73 of title 10 of the United States Code who die after December 31, 1965.

SEC. 2. (a) Section 2039(c) of the Internal Revenue Code of 1954 (relating to exclusion from gross estate of annuities under certain trusts and plans) is amended—

(1) by striking out "or" at the end of paragraph (2), by striking out the period at the end of paragraph (3) and inserting in lieu thereof "; or", and by adding at the end thereof the following new paragraph:

(4) chapter 73 of title 10 of the United States Code.

(2) by striking out "or under a contract described in paragraph (3)" in the second sentence and inserting in lieu thereof ", under a contract described in paragraph (3), or under chapter 73 of title 10 of the United States Code"; and

(3) by inserting at the end thereof the following new sentence: "For purposes of this subsection, amounts payable under chapter 73 of title 10 of the United States Code are attributable to payments or contributions made by the decedent only to the extent of amounts deposited by him pursuant to section 1438 of such title 10."

(b)(1) Section 2517(a) of such Code (relating to gift tax treatment of certain annuities under qualified plans) is amended by striking out "or" at the end of paragraph (2), by striking out the period at the end of paragraph (3) and inserting in lieu thereof "; or", and by adding at the end thereof the following new paragraph:

(4) chapter 73 of title 10 of the United States Code.

(2) The first sentence of section 2517(b) of such Code (relating to transfers attributable to employee contributions) is amended by inserting "(other than paragraph (4))" after "referred to in subsection (a)".

(c) The amendments made by subsection (a) shall apply with respect to decedents dying after December 31, 1965. The amendments made by subsection (b) shall apply with respect to calendar years after 1965.

Approved March 8, 1966.

PUBLIC LAW 89-368
EIGHTY-NINTH CONGRESS, MARCH 15, 1966
H.R. 12752 [1]

An Act to provide for graduated withholding of income tax from wages, to require declarations of estimated tax with respect to self-employment income, to accelerate current payments of estimated income tax by corporations, to postpone certain excise tax rate reductions, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE, ETC.

(a) SHORT TITLE.—This Act may be cited as the "Tax Adjustment Act of 1966".

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

TITLE I—ADJUSTMENT OF CERTAIN COLLECTION PROCEDURES

SECTION 101. INCOME TAX COLLECTED AT SOURCE.

(a) PERCENTAGE METHOD OF WITHHOLDING.—Subsection (a) of section 3402 (relating to requirement of withholding) is amended to read as follows:

(a) REQUIREMENT OF WITHHOLDING.—Every employer making payment of wages shall deduct and withhold upon such wages (except as otherwise provided in this section) a tax determined in accordance with the following tables. For purposes of applying such tables, the term "the amount of wages" means the amount by which the wages exceed the number of withholding exemptions claimed, multiplied by the amount of one such exemption as shown in the table in subsection (b) (1):

Table 1—If the payroll period with respect to an employee is WEEKLY

(a) Single Person—Including Head of Household:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $4	0.
Over $4 but not over $13	14% of excess over $4.
Over $13 but not over $23	$1.26 plus 15% of excess over $13.
Over $23 but not over $85	$2.76 plus 17% of excess over $23.
Over $85 but not over $169	$13.30 plus 20% of excess over $85.
Over $169 but not over $212	$30.10 plus 25% of excess over $169.
Over $212	$40.85 plus 30% of excess over $212.

[1] Senate Report No. 1010, page 476, this Bulletin: House Report No. 1285, page 436, this Bulletin; Conference Report No. 1323, page 512, this Bulletin.

(b) Married Person:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $4	0.
Over $4 but not over $23	14% of excess over $4.
Over $23 but not over $85	$2.66 plus 15% of excess over $23.
Over $85 but not over $169	$11.96 plus 17% of excess over $85.
Over $169 but not over $340	$26.24 plus 20% of excess over $169.
Over $340 but not over $423	$60.44 plus 25% of excess over $340.
Over $423	$81.19 plus 30% of excess over $423.

Table 2—If the payroll period with respect to an employee is BIWEEKLY

(a) Single Person—Including Head of Household:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $8	0.
Over $8 but not over $27	14% of excess over $8.
Over $27 but not over $46	$2.66 plus 15% of excess over $27.
Over $46 but not over $169	$5.51 plus 17% of excess over $46.
Over $169 but not over $338	$26.42 plus 20% of excess over $169.
Over $338 but not over $423	$60.22 plus 25% of excess over $338.
Over $423	$81.47 plus 30% of excess over $423.

(b) Married Person:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $8	0.
Over $8 but not over $46	14% of excess over $8.
Over $46 but not over $169	$5.32 plus 15% of excess over $46.
Over $169 but not over $338	$23.77 plus 17% of excess over $169.
Over $338 but not over $681	$52.50 plus 20% of excess over $338.
Over $681 but not over $846	$121.10 plus 25% of excess over $681.
Over $846	$162.35 plus 30% of excess over $846.

Table 3—If the payroll period with respect to an employee is SEMIMONTHLY

(a) Single Person—Including Head of Household:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $8	0.
Over $8 but not over $29	14% of excess over $8.
Over $29 but not over $50	$2.94 plus 15% of excess over $29.
Over $50 but not over $183	$6.09 plus 17% of excess over $50.
Over $183 but not over $367	$28.70 plus 20% of excess over $183.
Over $367 but not over $458	$65.50 plus 25% of excess over $367.
Over $458	$88.25 plus 30% of excess over $458.

(b) Married Person:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $8	0.
Over $8 but not over $50	14% of excess over $8.
Over $50 but not over $183	$5.88 plus 15% of excess over $50.
Over $183 but not over $367	$25.83 plus 17% of excess over $183.
Over $367 but not over $733	$57.11 plus 20% of excess over $367.
Over $738 but not over $917	$131.31 plus 25% of excess over $738.
Over $917	$176.06 plus 30% of excess over $917.

Table 4—If the payroll period with respect to an employee is MONTHLY

(a) Single Person—Including Head of Household:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $17	0.
Over $17 but not over $58	14% of excess over $17.
Over $58 but not over $100	$5.74 plus 15% of excess over $58.
Over $100 but not over $367	$12.04 plus 17% of excess over $100.
Over $367 but not over $733	$57.43 plus 20% of excess over $367.
Over $733 but not over $917	$130.63 plus 25% of excess over $733.
Over $917	$176.63 plus 30% of excess over $917.

(b) Married Person:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $17	0.
Over $17 but not over $100	14% of excess over $17.
Over $100 but not over $367	$11.62 plus 15% of excess over $100.
Over $367 but not over $733	$51.67 plus 17% of excess over $367.
Over $733 but not over $1,475	$113.89 plus 20% of excess over $733.
Over $1,475 but not over $1,833	$262.29 plus 25% of excess over $1,475.
Over $1,833	$351.79 plus 30% of excess over $1,833.

Table 5—If the payroll period with respect to an employee is QUARTERLY

(a) Single Person—Including Head of Household:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $50	0.
Over $50 but not over $175	14% of excess over $50.
Over $175 but not over $300	$17.50 plus 15% of excess over $175.
Over $300 but not over $1,100	$36.25 plus 17% of excess over $300.
Over $1,100 but not over $2,200	$172.25 plus 20% of excess over $1,100.
Over $2,200 but not over $2,750	$392.25 plus 25% of excess over $2,200.
Over $2,750	$529.75 plus 30% of excess over $2,750.

(b) Married Person:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $50	0.
Over $50 but not over $300	14% of excess over $50.
Over $300 but not over $1,100	$35.00 plus 15% of excess over $300.
Over $1,100 but not over $2,200	$155 plus 17% of excess over $1,100.
Over $2,200 but not over $4,425	$342 plus 20% of excess over $2,200.
Over $4,425 but not over $5,500	$787 plus 25% of excess over $4,425.
Over $5,500	$1,055.75 plus 30% of excess over $5,500.

Table 6—If the payroll period with respect to an employee is SEMIANNUAL

(a) Single Person—Including Head of Household:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $100	0.
Over $100 but not over $350	14% of excess over $100.
Over $350 but not over $600	$35.00 plus 15% of excess over $350.
Over $600 but not over $2,200	$72.50 plus 17% of excess over $600.
Over $2,200 but not over $4,400	$344.50 plus 20% of excess over $2,200.
Over $4,400 but not over $5,500	$784.50 plus 25% of excess over $4,400.
Over $5,500	$1,059.50 plus 30% of excess over $5,500.

(b) Married Person:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $100	0.
Over $100 but not over $600	14% of excess over $100.
Over $600 but not over $2,200	$70 plus 15% of excess over $600.
Over $2,200 but not over $4,400	$310 plus 17% of excess over $2,200.
Over $4,400 but not over $8,850	$684 plus 20% of excess over $4,400.
Over $8,850 but not over $11,000	$1,574 plus 25% of excess over $8,850.
Over $11,000	$2,111.50 plus 30% of excess over $11,000.

Table 7—If the payroll period with respect to an employee is ANNUAL

(a) Single Person—Including Head of Household:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $200	0.
Over $200 but not over $700	14% of excess over $200.
Over $700 but not over $1,200	$70 plus 15% of excess over $700.
Over $1,200 but not over $4,400	$145 plus 17% of excess over $1,200.
Over $4,400 but not over $8,800	$689 plus 20% of excess over $4,400.
Over $8,800 but not over $11,000	$1,569 plus 25% of excess over $8,800.
Over $11,000	$2,119 plus 30% of excess over $11,000.

(b) Married Person:

If the amount of wages is:	The amount of income tax to be withheld shall be:
Not over $200	0.
Over $200 but not over $1,200	14% of excess over $200.
Over $1,200 but not over $4,400	$140 plus 15% of excess over $1,200.
Over $4,400 but not over $8,800	$620 plus 17% of excess over $4,400.
Over $8,800 but not over $17,700	$1,368 plus 20% of excess over $8,800.
Over $17,700 but not over $22,000	$3,148 plus 25% of excess over $17,700.
Over $22,000	$4,223 plus 30% of excess over $22,000.

Table 8—If the payroll period with respect to an employee is a DAILY payroll period or a miscellaneous payroll period

(a) Single Person—Including Head of Household:

If the amount of wages divided by the number of days in the payroll period is:	The amount of income tax to be withheld shall be the following amount multiplied by the number of days in such period:
Not over $0.50	0.
Over $0.50 but not over $1.90	14% of excess over $0.50.
Over $1.90 but not over $3.30	$0.20 plus 15% of excess over $1.90.
Over $3.30 but not over $12.10	$0.41 plus 17% of excess over $3.30.
Over $12.10 but not over $24.10	$1.91 plus 20% of excess over $12.10.
Over $24.10 but not over $30.10	$4.31 plus 25% of excess over $24.10.
Over $30.10	$5.81 plus 30% of excess over $30.10.

(b) Married Person:

If the amount of wages divided by the number of days in the payroll period is:	The amount of income tax to be withheld shall be the following amount multiplied by the number of days in such period:
Not over $0.50	0.
Over $0.50 but not over $3.30	14% of excess over $0.50.
Over $3.30 but not over $12.10	$0.39 plus 15% of excess over $3.30.
Over $12.10 but not over $24.10	$1.71 plus 17% of excess over $12.10.
Over $24.10 but not over $48.50	$3.75 plus 20% of excess over $24.10.
Over $48.50 but not over $60.30	$8.63 plus 25% of excess over $48.50.
Over $60.30	$11.58 plus 30% of excess over $60.30.

(b) AMOUNT OF WITHHOLDING EXEMPTION.—Paragraph (1) of section 3402(b) (relating to percentage method withholding table) is amended by striking out the table set forth therein and inserting the following table in lieu thereof:

Percentage Method Withholding Table

Payroll period:	Amount of one withholding exemption:
Weekly	$13.50.
Biweekly	$26.90.
Semimonthly	$29.20.
Monthly	$58.30.
Quarterly	$175.00.
Semiannual	$350.00.
Annual	$700.00.
Daily or miscellaneous (per day of such period).	$1.90.

(c) WAGE BRACKET WITHHOLDING.—Paragraph (1) of section 3402(c) (relating to wage bracket withholding) is amended by striking out the tables set forth therein and inserting the following tables in lieu thereof:

If the payroll period with respect to an employee is weekly and he is not married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$4	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$4	$5	.10	0	0	0	0	0	0	0	0	0	0
$5	$6	.20	0	0	0	0	0	0	0	0	0	0
$6	$7	.40	0	0	0	0	0	0	0	0	0	0
$7	$8	.50	0	0	0	0	0	0	0	0	0	0
$8	$9	.70	0	0	0	0	0	0	0	0	0	0
$9	$10	.80	0	0	0	0	0	0	0	0	0	0
$10	$11	.90	0	0	0	0	0	0	0	0	0	0
$11	$12	1.10	0	0	0	0	0	0	0	0	0	0
$12	$13	1.20	0	0	0	0	0	0	0	0	0	0
$13	$14	1.40	0	0	0	0	0	0	0	0	0	0
$14	$15	1.50	0	0	0	0	0	0	0	0	0	0
$15	$16	1.70	0	0	0	0	0	0	0	0	0	0
$16	$17	1.80	0	0	0	0	0	0	0	0	0	0
$17	$18	2.00	0	0	0	0	0	0	0	0	0	0
$18	$19	2.10	.20	0	0	0	0	0	0	0	0	0
$19	$20	2.30	.30	0	0	0	0	0	0	0	0	0
$20	$21	2.40	.40	0	0	0	0	0	0	0	0	0
$21	$22	2.60	.60	0	0	0	0	0	0	0	0	0
$22	$23	2.70	.70	0	0	0	0	0	0	0	0	0
$23	$24	2.90	.90	0	0	0	0	0	0	0	0	0
$24	$25	3.00	1.00	0	0	0	0	0	0	0	0	0

If the payroll period with respect to an employee is **weekly** and he is not married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$25	$26	$3.20	$1.10	$0	$0	$0	$0	$0	$0	$0	$0	$0
$26	$27	3.40	1.30	0	0	0	0	0	0	0	0	0
$27	$28	3.50	1.40	0	0	0	0	0	0	0	0	0
$28	$29	3.70	1.60	0	0	0	0	0	0	0	0	0
$29	$30	3.90	1.70	0	0	0	0	0	0	0	0	0
$30	$31	4.10	1.90	0	0	0	0	0	0	0	0	0
$31	$32	4.20	2.00	.10	0	0	0	0	0	0	0	0
$32	$33	4.40	2.20	.20	0	0	0	0	0	0	0	0
$33	$34	4.60	2.30	.40	0	0	0	0	0	0	0	0
$34	$35	4.70	2.50	.50	0	0	0	0	0	0	0	0
$35	$36	4.90	2.60	.70	0	0	0	0	0	0	0	0
$36	$37	5.10	2.80	.80	0	0	0	0	0	0	0	0
$37	$38	5.20	3.00	.90	0	0	0	0	0	0	0	0
$38	$39	5.40	3.10	1.10	0	0	0	0	0	0	0	0
$39	$40	5.60	3.30	1.20	0	0	0	0	0	0	0	0
$40	$41	5.80	3.50	1.40	0	0	0	0	0	0	0	0
$41	$42	5.90	3.60	1.50	0	0	0	0	0	0	0	0
$42	$43	6.10	3.80	1.70	0	0	0	0	0	0	0	0
$43	$44	6.30	4.00	1.80	0	0	0	0	0	0	0	0
$44	$45	6.40	4.10	2.00	0	0	0	0	0	0	0	0
$45	$46	6.60	4.30	2.10	.20	0	0	0	0	0	0	0
$46	$47	6.80	4.50	2.30	.30	0	0	0	0	0	0	0
$47	$48	6.90	4.70	2.40	.50	0	0	0	0	0	0	0
$48	$49	7.10	4.80	2.60	.60	0	0	0	0	0	0	0
$49	$50	7.30	5.00	2.70	.70	0	0	0	0	0	0	0
$50	$51	7.50	5.20	2.90	.90	0	0	0	0	0	0	0
$51	$52	7.60	5.30	3.00	1.00	0	0	0	0	0	0	0
$52	$53	7.80	5.50	3.20	1.20	0	0	0	0	0	0	0
$53	$54	8.00	5.70	3.40	1.30	0	0	0	0	0	0	0
$54	$55	8.10	5.80	3.60	1.40	0	0	0	0	0	0	0
$55	$56	8.30	6.00	3.70	1.60	0	0	0	0	0	0	0
$56	$57	8.50	6.20	3.90	1.70	0	0	0	0	0	0	0
$57	$58	8.60	6.40	4.10	1.90	0	0	0	0	0	0	0
$58	$59	8.80	6.50	4.20	2.00	.10	0	0	0	0	0	0
$59	$60	9.00	6.70	4.40	2.20	.30	0	0	0	0	0	0
$60	$62	9.20	6.90	4.70	2.40	.50	0	0	0	0	0	0
$62	$64	9.60	7.30	5.00	2.70	.70	0	0	0	0	0	0
$64	$66	9.90	7.60	5.30	3.10	1.00	0	0	0	0	0	0
$66	$68	10.30	8.00	5.70	3.40	1.30	0	0	0	0	0	0
$68	$70	10.60	8.30	6.00	3.70	1.60	0	0	0	0	0	0
$70	$72	10.90	8.60	6.40	4.10	1.90	0	0	0	0	0	0
$72	$74	11.30	9.00	6.70	4.40	2.20	.30	0	0	0	0	0
$74	$76	11.60	9.30	7.00	4.80	2.50	.50	0	0	0	0	0
$76	$78	12.00	9.70	7.40	5.10	2.80	.80	0	0	0	0	0
$78	$80	12.30	10.00	7.70	5.40	3.10	1.10	0	0	0	0	0
$80	$82	12.60	10.30	8.10	5.80	3.50	1.40	0	0	0	0	0
$82	$84	13.00	10.70	8.40	6.10	3.80	1.70	0	0	0	0	0
$84	$86	13.30	11.00	8.70	6.50	4.20	2.00	.10	0	0	0	0
$86	$88	13.70	11.40	9.10	6.80	4.50	2.30	.30	0	0	0	0
$88	$90	14.10	11.70	9.40	7.10	4.80	2.60	.60	0	0	0	0
$90	$92	14.50	12.00	9.80	7.50	5.20	2.90	.90	0	0	0	0
$92	$94	14.90	12.40	10.10	7.80	5.50	3.20	1.20	0	0	0	0
$94	$96	15.30	12.70	10.40	8.20	5.90	3.60	1.50	0	0	0	0
$96	$98	15.70	13.10	10.80	8.50	6.20	3.90	1.80	0	0	0	0
$98	$100	16.10	13.40	11.10	8.80	6.50	4.30	2.10	.10	0	0	0
$100	$105	16.80	14.10	11.70	9.40	7.10	4.80	2.60	.60	0	0	0
$105	$110	17.80	15.10	12.60	10.30	8.00	5.70	3.40	1.30	0	0	0
$110	$115	18.80	16.10	13.40	11.10	8.80	6.50	4.30	2.10	.10	0	0
$115	$120	19.80	17.10	14.40	12.00	9.70	7.40	5.10	2.80	.80	0	0
$120	$125	20.80	18.10	15.40	12.80	10.50	8.10	6.00	3.70	1.50	0	0
$125	$130	21.80	19.10	16.40	13.80	11.40	9.10	6.80	4.50	2.30	.40	0
$130	$135	22.80	20.10	17.40	14.80	12.20	9.90	7.70	5.40	3.10	1.10	0
$135	$140	23.80	21.10	18.40	15.80	13.10	10.80	8.50	6.20	3.90	1.80	0
$140	$145	24.80	22.10	19.40	16.80	14.10	11.60	9.40	7.10	4.80	2.50	.60
$145	$150	25.80	23.10	20.40	17.80	15.10	12.50	10.20	7.90	5.60	3.30	1.30
$150	$160	27.30	24.60	21.90	19.30	16.60	13.90	11.50	9.20	6.90	4.60	2.40
$160	$170	29.30	26.60	23.90	21.30	18.60	15.90	13.20	10.90	8.60	6.30	4.00
$170	$180	31.60	28.60	25.90	23.30	20.60	17.90	15.20	12.60	10.30	8.00	5.70
$180	$190	34.10	30.80	27.90	25.30	22.60	19.90	17.20	14.50	12.00	9.70	7.40
$190	$200	36.60	33.30	29.90	27.30	24.60	21.90	19.20	16.50	13.80	11.40	9.10
$200	$210	39.10	35.80	32.40	29.30	26.60	23.90	21.20	18.50	15.80	13.10	10.80
$210	$220	41.80	38.30	34.90	31.50	28.60	25.90	23.20	20.50	17.80	15.10	12.50
$220	$230	44.80	40.80	37.40	34.00	30.70	27.90	25.20	22.50	19.80	17.10	14.40

If the payroll period with respect to an employee is weekly and he is not married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$230	$240	$47.80	$43.80	$39.90	$36.50	$33.20	$29.90	$27.20	$24.50	$21.80	$19.10	$16.40
$240	$250	50.80	46.80	42.70	39.00	35.70	32.30	29.20	26.50	23.80	21.10	18.40
$250	$260	53.80	49.80	45.70	41.70	38.20	34.80	31.40	28.50	25.80	23.10	20.40
$260	$270	56.80	52.80	48.70	44.70	40.70	37.30	33.90	30.60	227.80	25.10	22.40
$270	$280	59.80	55.80	51.70	47.70	43.60	39.80	36.40	33.10	29.80	27.10	24.40
$280	$290	62.80	58.80	54.70	50.70	46.60	42.60	38.90	35.60	32.20	29.10	26.40
$290	$300	65.80	61.80	57.70	53.70	49.60	45.60	41.60	38.10	34.70	31.30	28.40
$300	$310	68.80	64.80	60.70	56.70	52.60	48.60	44.60	40.60	37.20	33.80	30.50
$310	$320	71.80	67.80	63.70	59.70	55.60	51.60	47.60	43.50	39.70	36.30	33.00
$320	$330	74.80	70.80	66.70	62.70	58.60	54.60	50.60	46.50	42.50	38.80	35.50
$330	$340	77.80	73.80	69.70	65.70	61.60	57.60	53.60	49.50	45.50	41.40	38.00
$340	$350	80.80	76.80	72.70	68.70	64.60	60.60	56.60	52.50	48.50	44.40	40.50
$350	$360	83.80	79.80	75.70	71.70	67.60	63.60	59.60	55.50	51.50	47.40	43.40
		30 percent of the excess over $360 plus—										
$360 and over		85.30	81.30	77.20	73.20	69.10	65.10	61.10	57.00	53.00	48.90	44.90

If the payroll period with respect to an employee is weekly and he is married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$4	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$4	$5	.10	0	0	0	0	0	0	0	0	0	0
$5	$6	.20	0	0	0	0	0	0	0	0	0	0
$6	$7	.40	0	0	0	0	0	0	0	0	0	0
$7	$8	.50	0	0	0	0	0	0	0	0	0	0
$8	$9	.70	0	0	0	0	0	0	0	0	0	0
$9	$10	.80	0	0	0	0	0	0	0	0	0	0
$10	$11	.90	0	0	0	0	0	0	0	0	0	0
$11	$12	1.10	0	0	0	0	0	0	0	0	0	0
$12	$13	1.20	0	0	0	0	0	0	0	0	0	0
$13	$14	1.40	0	0	0	0	0	0	0	0	0	0
$14	$15	1.50	0	0	0	0	0	0	0	0	0	0
$15	$16	1.60	0	0	0	0	0	0	0	0	0	0
$16	$17	1.80	0	0	0	0	0	0	0	0	0	0
$17	$18	1.90	0	0	0	0	0	0	0	0	0	0
$18	$19	2.10	.20	0	0	0	0	0	0	0	0	0
$19	$20	2.20	.30	0	0	0	0	0	0	0	0	0
$20	$21	2.30	.40	0	0	0	0	0	0	0	0	0
$21	$22	2.50	.60	0	0	0	0	0	0	0	0	0
$22	$23	2.60	.70	0	0	0	0	0	0	0	0	0
$23	$24	2.80	.90	0	0	0	0	0	0	0	0	0
$24	$25	2.90	1.00	0	0	0	0	0	0	0	0	0
$25	$26	3.10	1.10	0	0	0	0	0	0	0	0	0
$26	$27	3.20	1.30	0	0	0	0	0	0	0	0	0
$27	$28	3.40	1.40	0	0	0	0	0	0	0	0	0
$28	$29	3.50	1.60	0	0	0	0	0	0	0	0	0
$29	$30	3.70	1.70	0	0	0	0	0	0	0	0	0
$30	$31	3.80	1.80	0	0	0	0	0	0	0	0	0
$31	$32	4.00	2.00	.10	0	0	0	0	0	0	0	0
$32	$33	4.10	2.10	.20	0	0	0	0	0	0	0	0
$33	$34	4.30	2.30	.40	0	0	0	0	0	0	0	0
$34	$35	4.40	2.40	.50	0	0	0	0	0	0	0	0
$35	$36	4.60	2.50	.70	0	0	0	0	0	0	0	0
$36	$37	4.70	2.70	.80	0	0	0	0	0	0	0	0
$37	$38	4.90	2.80	0.90	0	0	0	0	0	0	0	0
$38	$39	5.00	3.00	1.10	0	0	0	0	0	0	0	0
$39	$40	5.20	3.10	1.20	0	0	0	0	0	0	0	0
$40	$41	5.30	3.30	1.40	0	0	0	0	0	0	0	0
$41	$42	5.50	3.40	1.50	0	0	0	0	0	0	0	0
$42	$43	5.60	3.60	1.60	0	0	0	0	0	0	0	0
$43	$44	5.80	3.70	1.80	0	0	0	0	0	0	0	0

If the payroll period with respect to an employee is weekly and he is married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$44	$45	$5.90	$3.90	$1.90	$0	$0	$0	$0	$0	$0	$0	$0
$45	$46	6.10	4.00	2.10	.20	0	0	0	0	0	0	0
$46	$47	6.20	4.20	2.20	.30	0	0	0	0	0	0	0
$47	$48	6.40	4.30	2.30	.50	0	0	0	0	0	0	0
$48	$49	6.50	4.50	2.50	.60	0	0	0	0	0	0	0
$49	$50	6.70	4.60	2.60	.70	0	0	0	0	0	0	0
$50	$51	6.80	4.80	2.80	.90	0	0	0	0	0	0	0
$51	$52	7.00	4.90	2.90	1.00	0	0	0	0	0	0	0
$52	$53	7.10	5.10	3.10	1.20	0	0	0	0	0	0	0
$53	$54	7.30	5.20	3.20	1.30	0	0	0	0	0	0	0
$54	$55	7.40	5.40	3.40	1.40	0	0	0	0	0	0	0
$55	$56	7.60	5.50	3.50	1.60	0	0	0	0	0	0	0
$56	$57	7.70	5.70	3.70	1.70	0	0	0	0	0	0	0
$57	$58	7.90	5.80	3.80	1.90	0	0	0	0	0	0	0
$58	$59	8.00	6.00	4.00	2.00	.10	0	0	0	0	0	0
$59	$60	8.20	6.10	4.10	2.10	.30	0	0	0	0	0	0
$60	$62	8.40	6.40	4.30	2.30	.50	0	0	0	0	0	0
$62	$64	8.70	6.70	4.60	2.60	.70	0	0	0	0	0	0
$64	$66	9.00	7.00	4.90	2.90	1.00	0	0	0	0	0	0
$66	$68	9.30	7.30	5.20	3.20	1.30	0	0	0	0	0	0
$68	$70	9.60	7.60	5.50	3.50	1.60	0	0	0	0	0	0
$70	$72	9.90	7.90	5.80	3.80	1.90	0	0	0	0	0	0
$72	$74	10.20	8.20	6.10	4.10	2.10	.30	0	0	0	0	0
$74	$76	10.50	8.50	6.40	4.40	2.40	.50	0	0	0	0	0
$76	$78	10.80	8.80	6.70	4.70	2.70	.80	0	0	0	0	0
$78	$80	11.10	9.10	7.00	5.00	3.00	1.10	0	0	0	0	0
$80	$82	11.40	9.40	7.30	5.30	3.30	1.40	0	0	0	0	0
$82	$84	11.70	9.70	7.60	5.60	3.60	1.70	0	0	0	0	0
$84	$86	12.00	10.00	7.90	5.90	3.90	1.90	.10	0	0	0	0
$86	$88	12.30	10.30	8.20	6.20	4.20	2.20	.30	0	0	0	0
$88	$90	12.70	10.60	8.50	6.50	4.50	2.50	.60	0	0	0	0
$90	$92	13.00	10.90	8.80	6.80	4.80	2.80	.90	0	0	0	0
$92	$94	13.30	11.20	9.10	7.10	5.10	3.10	1.20	0	0	0	0
$94	$96	13.70	11.50	9.40	7.40	5.40	3.40	1.50	0	0	0	0
$96	$98	14.00	11.80	9.70	7.70	5.70	3.70	1.70	0	0	0	0
$98	$100	14.40	12.10	10.00	8.00	6.00	4.00	2.00	.10	0	0	0
$100	$105	15.00	12.70	10.60	8.50	6.50	4.50	2.50	.60	0	0	0
$105	$110	15.80	13.50	11.30	9.30	7.30	5.30	3.20	1.30	0	0	0
$110	$115	16.70	14.40	12.10	10.00	8.00	6.00	4.00	2.00	.10	0	0
$115	$120	17.50	15.20	12.90	10.80	8.80	6.80	4.70	2.70	.80	0	0
$120	$125	18.40	16.10	13.80	11.50	9.50	7.50	5.50	3.50	1.50	0	0
$125	$130	19.20	16.90	14.60	12.30	10.30	8.30	6.20	4.20	2.20	.40	0
$130	$135	20.10	17.80	15.50	13.20	11.00	9.00	7.00	5.00	3.00	1.10	0
$135	$140	20.90	18.60	16.30	14.00	11.80	9.80	7.70	5.70	3.70	1.80	0
$140	$145	21.80	19.50	17.20	14.90	12.60	10.50	8.50	6.50	4.50	2.50	.60
$145	$150	22.60	20.30	18.00	15.70	13.50	11.30	9.20	7.20	5.20	3.20	1.30
$150	$160	23.90	21.60	19.30	17.00	14.70	12.40	10.40	8.30	6.30	4.30	2.30
$160	$170	25.60	23.30	21.00	18.70	16.40	14.10	11.90	9.80	7.80	5.80	3.80
$170	$180	27.50	25.00	22.70	20.40	18.10	15.80	13.60	11.30	9.30	7.30	5.30
$180	$190	29.50	26.80	24.40	22.10	19.80	17.50	15.30	13.00	10.80	8.80	6.80
$190	$200	31.50	28.80	26.10	23.80	21.50	19.20	17.00	14.70	12.40	10.30	8.30
$200	$210	33.50	30.80	28.10	25.50	23.20	20.90	18.70	16.40	14.10	11.80	9.80
$210	$220	35.50	32.80	30.10	27.40	24.90	22.60	20.40	18.10	15.80	13.50	11.30
$220	$230	37.50	34.80	32.10	29.40	26.70	24.30	22.10	19.80	17.50	15.20	12.90
$230	$240	39.50	36.80	34.10	31.40	28.70	26.00	23.80	21.50	19.20	16.90	14.60
$240	$250	41.50	38.80	36.10	33.40	30.70	28.00	25.50	23.20	20.90	18.60	16.30
$250	$260	43.50	40.80	38.10	35.40	32.70	30.00	27.30	24.90	22.60	20.30	18.00
$260	$270	45.50	42.80	40.10	37.40	34.70	32.00	29.30	26.60	24.30	22.00	19.70
$270	$280	47.50	44.80	42.10	39.40	36.70	34.00	31.30	28.60	26.00	23.70	21.40
$280	$290	49.50	46.80	44.10	41.40	38.70	36.00	33.30	30.60	27.90	25.40	23.10
$290	$300	51.50	48.80	46.10	43.40	40.70	38.00	35.30	32.60	29.90	27.20	24.80
$300	$310	53.50	50.80	48.10	45.40	42.70	40.00	37.30	34.60	31.90	29.20	26.50
$310	$320	55.50	52.80	50.10	47.40	44.70	42.00	39.30	36.60	33.90	31.20	28.50
$320	$330	57.50	54.80	52.10	49.40	46.70	44.00	41.30	38.60	35.90	33.20	30.50
$330	$340	59.50	56.80	54.10	51.40	48.70	46.00	43.30	40.60	37.90	35.20	32.50
$340	$350	61.70	58.80	56.10	53.40	50.70	48.00	45.30	42.60	39.90	37.20	34.50
$350	$360	64.20	60.80	58.10	55.40	52.70	50.00	47.30	44.60	41.90	39.20	36.50
$360	$370	66.70	63.30	60.10	57.40	54.70	52.00	49.30	46.60	43.90	41.20	38.50
$370	$380	69.20	65.80	62.50	59.40	56.70	54.00	51.30	48.60	45.90	43.20	40.50
$380	$390	71.70	68.30	65.00	61.60	58.70	56.00	53.30	50.60	47.90	45.20	42.50
$390	$400	74.20	70.80	67.50	64.10	60.70	58.00	55.30	52.60	49.90	47.20	44.50
$400	$410	76.70	73.30	70.00	66.60	63.20	60.00	57.30	54.60	51.90	49.20	46.50
$410	$420	79.20	75.80	72.50	69.10	65.70	62.40	59.30	56.60	53.90	51.20	48.50
$420	$430	81.80	78.30	75.00	71.60	68.20	64.90	61.50	58.60	55.90	53.20	50.50
$430	$440	84.80	80.80	77.50	74.10	70.70	67.40	64.00	60.60	57.90	55.20	52.50
$440	$450	87.80	83.80	80.00	76.60	73.20	69.90	66.50	63.10	59.90	57.20	54.50

If the payroll period with respect to an employee is weekly and he is married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$450	$460	$90.80	$86.80	$82.70	$79.10	$75.70	$72.40	$69.00	$65.60	$62.30	$59.20	$56.50
$460	$470	93.80	89.80	85.70	81.70	78.20	74.90	71.50	68.10	64.80	61.40	58.50
$470	$480	96.80	92.80	88.70	84.70	80.70	77.40	74.00	70.60	67.30	63.90	60.50
$480	$490	99.80	95.80	91.70	87.70	83.60	79.90	76.50	73.10	69.80	66.40	63.00
$490	$500	102.80	98.80	94.70	90.70	86.60	82.60	79.00	75.60	72.30	68.90	65.50
$500	$510	105.80	101.80	97.70	93.70	89.60	85.60	81.60	78.10	74.80	71.40	68.00
$510	$520	108.80	104.80	100.70	96.70	92.60	88.60	84.60	80.60	77.30	73.90	70.50
$520	$530	111.80	107.80	103.70	99.70	95.60	91.60	87.60	83.50	79.80	76.40	73.00
$530	$540	114.80	110.80	106.70	102.70	98.60	94.60	90.60	86.50	82.50	78.90	75.50
$540	$550	117.80	113.80	109.70	105.70	101.60	97.60	93.60	89.50	85.50	81.40	78.00
$550	$560	120.80	116.80	112.70	108.70	104.60	100.60	96.60	92.50	88.50	84.40	80.50
$560	$570	123.80	119.80	115.70	111.70	107.60	103.60	99.60	95.50	91.50	87.40	83.40
		30 percent of the excess over $570 plus—										
$570 and over		125.30	121.30	117.20	113.20	109.10	105.10	101.10	97.00	93.00	88.90	84.90

If the payroll period with respect to an employee is biweekly and he is not married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$8	$0	$0	$0	0$	$0	$0	$0	$0	$0	$0	$0
$8	$10	.20	0	0	0	0	0	0	0	0	0	0
$10	$12	.50	0	0	0	0	0	0	0	0	0	0
$12	$14	.70	0	0	0	0	0	0	0	0	0	0
$14	$16	1.00	0	0	0	0	0	0	0	0	0	0
$16	$18	1.30	0	0	0	0	0	0	0	0	0	0
$18	$20	1.60	0	0	0	0	0	0	0	0	0	0
$20	$22	1.90	0	0	0	0	0	0	0	0	0	0
$22	$24	2.10	0	0	0	0	0	0	0	0	0	0
$24	$26	2.40	0	0	0	0	0	0	0	0	0	0
$26	$28	2.70	0	0	0	0	0	0	0	0	0	0
$28	$30	3.00	0	0	0	0	0	0	0	0	0	0
$30	$32	3.30	0	0	0	0	0	0	0	0	0	0
$32	$34	3.60	0	0	0	0	0	0	0	0	0	0
$34	$36	3.90	.10	0	0	0	0	0	0	0	0	0
$36	$38	4.20	.30	0	0	0	0	0	0	0	0	0
$38	$40	4.50	.60	0	0	0	0	0	0	0	0	0
$40	$42	4.80	.90	0	0	0	0	0	0	0	0	0
$42	$44	5.10	1.20	0	0	0	0	0	0	0	0	0
$44	$46	5.40	1.50	0	0	0	0	0	0	0	0	0
$46	$48	5.70	1.70	0	0	0	0	0	0	0	0	0
$48	$50	6.10	2.00	0	0	0	0	0	0	0	0	0
$50	$52	6.40	2.30	0	0	0	0	0	0	0	0	0
$52	$54	6.70	2.60	0	0	0	0	0	0	0	0	0
$54	$56	7.10	2.90	0	0	0	0	0	0	0	0	0
$56	$58	7.40	3.20	0	0	0	0	0	0	0	0	0
$58	$60	7.80	3.50	0	0	0	0	0	0	0	0	0
$60	$62	8.10	3.80	0	0	0	0	0	0	0	0	0
$62	$64	8.40	4.10	.20	0	0	0	0	0	0	0	0
$64	$66	8.80	4.40	.50	0	0	0	0	0	0	0	0
$66	$68	9.10	4.70	.80	0	0	0	0	0	0	0	0
$68	$70	9.50	5.00	1.00	0	0	0	0	0	0	0	0
$70	$72	9.80	5.30	1.30	0	0	0	0	0	0	0	0
$72	$74	10.10	5.60	1.60	0	0	0	0	0	0	0	0
$74	$76	10.50	5.90	1.90	0	0	0	0	0	0	0	0
$76	$78	10.80	6.20	2.20	0	0	0	0	0	0	0	0
$78	$80	11.20	6.60	2.40	0	0	0	0	0	0	0	0
$80	$82	11.50	6.90	2.70	0	0	0	0	0	0	0	0
$82	$84	11.80	7.30	3.00	0	0	0	0	0	0	0	0
$84	$86	12.20	7.60	3.30	0	0	0	0	0	0	0	0
$86	$88	12.50	7.90	3.60	0	0	0	0	0	0	0	0

If the payroll period with respect to an employee is biweekly and he is not married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$88	$90	$12.90	$8.30	$3.90	$0.10	$0	$0	$0	$0	$0	$0	$0
$90	$92	13.20	8.60	4.20	.40	0	0	0	0	0	0	0
$92	$94	13.50	9.00	4.50	.60	0	0	0	0	0	0	0
$94	$96	13.90	9.30	4.80	.90	0	0	0	0	0	0	0
$96	$98	14.20	9.60	5.10	1.20	0	0	0	0	0	0	0
$98	$100	14.60	10.00	5.40	1.50	0	0	0	0	0	0	0
$100	$102	14.90	10.30	5.70	1.80	0	0	0	0	0	0	0
$102	$104	15.20	10.70	6.10	2.00	0	0	0	0	0	0	0
$104	$106	15.60	11.00	6.40	2.30	0	0	0	0	0	0	0
$106	$108	15.90	11.30	6.80	2.60	0	0	0	0	0	0	0
$108	$110	16.30	11.70	7.10	2.90	0	0	0	0	0	0	0
$110	$112	16.60	12.00	7.40	3.20	0	0	0	0	0	0	0
$112	$114	16.90	12.40	7.80	3.50	0	0	0	0	0	0	0
$114	$116	17.30	12.70	8.10	3.80	0	0	0	0	0	0	0
$116	$118	17.60	13.00	8.50	4.10	.20	0	0	0	0	0	0
$118	$120	18.00	13.40	8.80	4.40	.50	0	0	0	0	0	0
$120	$124	18.50	13.90	9.30	4.80	.90	0	0	0	0	0	0
$124	$128	19.20	14.60	10.00	5.40	1.50	0	0	0	0	0	0
$128	$132	19.80	15.30	10.70	6.10	2.00	0	0	0	0	0	0
$132	$136	20.50	15.90	11.40	6.80	2.60	0	0	0	0	0	0
$136	$140	21.20	16.60	12.00	7.50	3.20	0	0	0	0	0	0
$140	$144	21.90	17.30	12.70	8.10	3.80	0	0	0	0	0	0
$144	$148	22.60	18.00	13.40	8.80	4.40	.50	0	0	0	0	0
$148	$152	23.20	18.70	14.10	9.50	5.00	1.10	0	0	0	0	0
$152	$156	23.90	19.30	14.80	10.20	5.60	1.60	0	0	0	0	0
$156	$160	24.60	20.00	15.40	10.90	6.30	2.20	0	0	0	0	0
$160	$164	25.30	20.70	16.10	11.50	7.00	2.80	0	0	0	0	0
$164	$168	26.00	21.40	16.80	12.20	7.60	3.40	0	0	0	0	0
$168	$172	26.70	22.10	17.50	12.90	8.30	4.00	.10	0	0	0	0
$172	$176	27.50	22.70	18.20	13.60	9.00	4.60	.70	0	0	0	0
$176	$180	28.30	23.40	18.80	14.30	9.70	5.20	1.20	0	0	0	0
$180	$184	29.10	24.10	19.50	14.90	10.40	5.80	1.80	0	0	0	0
$184	$188	29.90	24.80	20.20	15.60	11.00	6.50	2.30	0	0	0	0
$188	$192	30.70	25.50	20.90	16.30	11.70	7.10	2.90	0	0	0	0
$192	$196	31.50	26.10	21.60	17.00	12.40	7.80	3.50	0	0	0	0
$196	$200	32.30	26.90	22.20	17.70	13.10	8.50	4.10	.30	0	0	0
$200	$210	33.70	28.30	23.40	18.90	14.30	9.70	5.20	1.20	0	0	0
$210	$220	35.70	30.30	25.10	20.60	16.00	11.40	6.80	2.60	0	0	0
$220	$230	37.70	32.30	26.90	22.30	17.70	13.10	8.50	4.10	.30	0	0
$230	$240	39.70	34.30	28.90	24.00	19.40	14.80	10.20	5.60	1.70	0	0
$240	$250	41.70	36.30	30.90	25.70	21.10	16.50	11.90	7.30	3.10	0	0
$250	$260	43.70	38.30	32.90	27.50	22.80	18.20	13.60	9.00	4.60	.70	0
$260	$270	45.70	40.30	34.90	29.50	24.50	19.90	15.30	10.70	6.20	2.10	0
$270	$280	47.70	42.30	36.90	31.50	26.20	21.60	17.00	12.40	7.90	3.60	0
$280	$290	49.70	44.30	38.90	33.50	28.10	23.30	18.70	14.10	9.60	5.10	1.10
$290	$300	51.70	46.30	40.90	35.50	30.10	25.00	20.40	15.80	11.30	6.70	2.50
$300	$320	54.70	49.30	43.90	38.50	33.10	27.70	23.00	18.40	13.80	9.20	4.80
$320	$340	58.70	53.30	47.90	42.50	37.10	31.70	26.40	21.80	17.20	12.60	8.10
$340	$360	63.20	57.30	51.90	46.50	41.10	35.70	30.30	25.20	20.60	16.00	11.50
$360	$380	68.20	61.50	55.90	50.50	45.10	39.70	34.30	29.00	24.00	19.40	14.90
$380	$400	73.20	66.50	59.90	54.50	49.10	43.70	38.30	33.00	27.60	22.80	18.30
$400	$420	78.20	71.50	64.80	58.50	53.10	47.70	42.30	37.00	31.60	26.20	21.70
$420	$440	83.60	76.50	69.80	63.00	57.10	51.70	46.30	41.00	35.60	30.20	25.10
$440	$460	89.60	81.50	74.80	68.00	61.30	55.70	50.30	45.00	39.60	34.20	28.80
$460	$480	95.60	87.50	79.80	73.00	66.30	59.70	54.30	49.00	43.60	38.20	32.80
$480	$500	101.60	93.50	85.40	78.00	71.30	64.60	58.30	53.00	47.60	42.20	36.80
$500	$520	107.60	99.50	91.40	83.30	76.30	69.60	62.80	57.00	51.60	46.20	40.80
$520	$540	113.60	105.50	97.40	89.30	81.30	74.60	67.80	61.10	55.60	50.20	44.80
$540	$560	119.60	111.50	103.40	95.30	87.30	79.60	72.80	66.10	59.60	54.20	48.80
$560	$580	125.60	117.50	109.40	101.30	93.30	85.20	77.80	71.10	64.40	58.20	52.80
$580	$600	131.60	123.50	115.40	107.30	99.30	91.20	83.10	76.10	69.40	62.70	56.80
$600	$620	137.60	129.50	121.40	113.30	105.30	97.20	89.10	81.10	74.40	67.70	60.90
$620	$640	143.60	135.50	127.40	119.30	111.30	103.20	95.10	87.00	79.40	72.70	65.90
$640	$660	149.60	141.50	133.40	125.30	117.30	109.20	101.10	93.00	85.00	77.70	70.90
$660	$680	155.60	147.50	139.40	131.30	123.30	115.20	107.10	99.00	91.00	82.90	75.90
$680	$700	161.60	153.50	145.40	137.30	129.30	121.30	113.10	105.00	97.00	88.90	80.90
$700	$720	167.60	159.50	151.40	143.30	135.30	127.20	119.10	111.00	103.00	94.90	86.80
		30 percent of the excess over $720 plus—										
$720 and over		170.60	162.50	154.40	146.30	138.30	130.20	122.10	114.00	106.00	97.90	89.80

If the payroll period with respect to an employee is biweekly and he is married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$8	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$8	$10	.20	0	0	0	0	0	0	0	0	0	0
$10	$12	.60	0	0	0	0	0	0	0	0	0	0
$12	$14	.70	0	0	0	0	0	0	0	0	0	0
$14	$16	1.00	0	0	0	0	0	0	0	0	0	0
$16	$18	1.30	0	0	0	0	0	0	0	0	0	0
$18	$20	1.60	0	0	0	0	0	0	0	0	0	0
$20	$22	1.90	0	0	0	0	0	0	0	0	0	0
$22	$24	2.10	0	0	0	0	0	0	0	0	0	0
$24	$26	2.40	0	0	0	0	0	0	0	0	0	0
$26	$28	2.70	0	0	0	0	0	0	0	0	0	0
$28	$30	3.00	0	0	0	0	0	0	0	0	0	0
$30	$32	3.30	0	0	0	0	0	0	0	0	0	0
$32	$34	3.50	0	0	0	0	0	0	0	0	0	0
$34	$36	3.80	.10	0	0	0	0	0	0	0	0	0
$36	$38	4.10	.30	0	0	0	0	0	0	0	0	0
$38	$40	4.40	.60	0	0	0	0	0	0	0	0	0
$40	$42	4.70	.90	0	0	0	0	0	0	0	0	0
$42	$44	4.90	1.20	0	0	0	0	0	0	0	0	0
$44	$46	5.20	1.50	0	0	0	0	0	0	0	0	0
$46	$48	5.50	1.70	0	0	0	0	0	0	0	0	0
$48	$50	5.80	2.00	0	0	0	0	0	0	0	0	0
$50	$52	6.10	2.30	0	0	0	0	0	0	0	0	0
$52	$54	6.40	2.60	0	0	0	0	0	0	0	0	0
$54	$56	6.70	2.90	0	0	0	0	0	0	0	0	0
$56	$58	7.00	3.10	0	0	0	0	0	0	0	0	0
$58	$60	7.30	3.40	0	0	0	0	0	0	0	0	0
$60	$62	7.60	3.70	0	0	0	0	0	0	0	0	0
$62	$64	7.90	4.00	.20	0	0	0	0	0	0	0	0
$64	$66	8.20	4.30	.50	0	0	0	0	0	0	0	0
$66	$68	8.50	4.50	.80	0	0	0	0	0	0	0	0
$68	$70	8.80	4.80	1.00	0	0	0	0	0	0	0	0
$70	$72	9.10	5.10	1.30	0	0	0	0	0	0	0	0
$72	$74	9.40	5.40	1.60	0	0	0	0	0	0	0	0
$74	$76	9.70	5.70	1.90	0	0	0	0	0	0	0	0
$76	$78	10.00	6.00	2.20	0	0	0	0	0	0	0	0
$78	$80	10.30	6.30	2.40	0	0	0	0	0	0	0	0
$80	$82	10.60	6.60	2.70	0	0	0	0	0	0	0	0
$82	$84	10.90	6.90	3.00	0	0	0	0	0	0	0	0
$84	$86	11.20	7.20	3.30	0	0	0	0	0	0	0	0
$86	$88	11.50	7.50	3.60	0	0	0	0	0	0	0	0
$88	$90	11.80	7.80	3.80	.10	0	0	0	0	0	0	0
$90	$92	12.10	8.10	4.10	.40	0	0	0	0	0	0	0
$92	$94	12.40	8.40	4.40	.60	0	0	0	0	0	0	0
$94	$96	12.70	8.70	4.70	.90	0	0	0	0	0	0	0
$96	$98	13.00	9.00	5.00	1.20	0	0	0	0	0	0	0
$98	$100	13.30	9.30	5.20	1.50	0	0	0	0	0	0	0
$100	$102	13.60	9.60	5.50	1.80	0	0	0	0	0	0	0
$102	$104	13.90	9.90	5.80	2.00	0	0	0	0	0	0	0
$104	$106	14.20	10.20	6.10	2.30	0	0	0	0	0	0	0
$106	$108	14.50	10.50	6.40	2.60	0	0	0	0	0	0	0
$108	$110	14.80	10.80	6.70	2.90	0	0	0	0	0	0	0
$110	$112	15.10	11.10	7.00	3.20	0	0	0	0	0	0	0
$112	$114	15.40	11.40	7.30	3.40	0	0	0	0	0	0	0
$114	$116	15.70	11.70	7.60	3.70	0	0	0	0	0	0	0
$116	$118	16.00	12.00	7.90	4.00	.20	0	0	0	0	0	0
$118	$120	16.30	12.30	8.20	4.30	.50	0	0	0	0	0	0
$120	$124	16.80	12.70	8.70	4.70	.90	0	0	0	0	0	0
$124	$128	17.40	13.30	9.30	5.30	1.50	0	0	0	0	0	0
$128	$132	18.00	13.90	9.90	5.80	2.00	0	0	0	0	0	0
$132	$136	18.60	14.50	10.50	6.40	2.60	0	0	0	0	0	0
$136	$140	19.20	15.10	11.10	7.00	3.20	0	0	0	0	0	0
$140	$144	19.80	15.70	11.70	7.60	3.70	0	0	0	0	0	0
$144	$148	20.40	16.30	12.30	8.20	4.30	.50	0	0	0	0	0
$148	$152	21.00	16.90	12.90	8.80	4.80	1.10	0	0	0	0	0
$152	$156	21.60	17.50	13.50	9.40	5.40	1.60	0	0	0	0	0
$156	$160	22.20	18.10	14.10	10.00	6.00	2.20	0	0	0	0	0
$160	$164	22.80	18.70	14.70	10.60	6.60	2.80	0	0	0	0	0
$164	$168	23.40	19.30	15.30	11.20	7.20	3.30	0	0	0	0	0
$168	$172	24.00	19.90	15.90	11.80	7.80	3.90	.10	0	0	0	0
$172	$176	24.70	20.50	16.50	12.40	8.40	4.40	.70	0	0	0	0
$176	$180	25.30	21.10	17.10	13.00	9.00	5.00	1.20	0	0	0	0
$180	$184	26.00	21.70	17.70	13.60	9.60	5.60	1.80	0	0	0	0
$184	$188	26.70	22.30	18.30	14.20	10.20	6.20	2.30	0	0	0	0

If the payroll period with respect to an employee is biweekly and he is married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$188	$192	$27.40	$22.90	$18.90	$14.80	$10.80	$6.80	$2.90	$0	$0	$0	$0
$192	$196	28.10	23.50	19.50	15.40	11.40	7.40	3.50	0	0	0	0
$196	$200	28.70	24.20	20.10	16.00	12.00	8.00	4.00	.30	0	0	0
$200	$210	29.90	25.40	21.10	17.10	13.10	9.00	5.00	1.20	0	0	0
$210	$220	31.60	27.10	22.60	18.60	14.60	10.50	6.50	2.60	0	0	0
$220	$230	33.30	28.80	24.20	20.10	16.10	12.00	8.00	4.00	.30	0	0
$230	$240	35.00	30.50	25.90	21.60	17.60	13.60	9.50	5.40	1.70	0	0
$240	$250	36.70	32.20	27.60	23.10	19.10	15.00	11.00	6.90	3.10	0	0
$250	$260	38.40	33.90	29.30	24.70	20.60	16.50	12.50	8.40	4.50	.70	0
$260	$270	40.10	35.60	31.00	26.40	22.10	18.00	14.00	9.90	5.90	2.10	0
$270	$280	41.80	37.30	32.70	28.10	23.60	19.50	15.50	11.40	7.40	3.50	0
$280	$290	43.50	39.00	34.40	29.80	25.20	21.00	17.00	12.90	8.90	4.90	1.10
$290	$300	45.20	40.70	36.10	31.50	26.90	22.50	18.50	14.40	10.40	6.40	2.50
$300	$320	47.80	43.20	38.60	34.00	29.50	24.90	20.70	16.70	12.70	8.60	4.60
$320	$340	51.20	46.60	42.00	37.40	32.90	28.30	23.70	19.70	15.70	11.60	7.60
$340	$360	54.90	50.00	45.40	40.80	36.30	31.70	27.10	22.70	18.70	14.60	10.60
$360	$380	58.90	53.50	48.80	44.20	39.70	35.10	30.50	25.90	21.70	17.60	13.60
$380	$400	62.90	57.50	52.20	47.60	43.10	38.50	33.90	29.30	24.80	20.60	16.60
$400	$420	66.90	61.50	56.20	51.00	46.50	41.90	37.30	32.70	28.20	23.60	19.60
$420	$440	70.90	65.50	60.20	54.80	49.90	45.30	40.70	36.10	31.60	27.00	22.60
$440	$460	74.90	69.50	64.20	58.80	53.40	48.70	44.10	39.50	35.00	30.40	25.80
$460	$480	78.90	73.50	68.20	62.80	57.40	52.10	47.50	42.90	38.40	33.80	29.20
$480	$500	82.90	77.50	72.20	66.80	61.40	56.00	50.90	46.30	41.80	37.20	32.60
$500	$520	86.90	81.50	76.20	70.80	65.40	60.00	54.60	49.70	45.20	40.60	36.00
$520	$540	90.90	85.50	80.20	74.80	69.40	64.00	58.60	53.20	48.60	44.00	39.40
$540	$560	94.90	89.50	84.20	78.80	73.40	68.00	62.60	57.20	52.00	47.40	42.80
$560	$580	98.90	93.50	88.20	82.80	77.40	72.00	66.60	61.20	55.80	50.80	46.20
$580	$600	102.90	97.50	92.20	86.80	81.40	76.00	70.60	65.20	59.80	54.50	49.60
$600	$620	106.90	101.50	96.20	90.80	85.40	80.00	74.60	69.20	63.80	58.50	53.10
$620	$640	110.90	105.50	100.20	94.80	89.40	84.00	78.60	73.20	67.80	62.50	57.10
$640	$660	114.90	109.50	104.20	98.80	93.40	88.00	82.60	77.20	71.80	66.50	61.10
$660	$680	118.90	113.50	108.20	102.80	97.40	92.00	86.60	81.20	75.80	70.50	65.10
$680	$700	123.40	117.50	112.20	106.80	101.40	96.00	90.60	85.20	79.80	74.50	69.10
$700	$720	128.40	121.70	116.20	110.80	105.40	100.00	94.60	89.20	83.80	78.50	73.10
$720	$740	133.40	126.70	120.20	114.80	109.40	104.00	98.60	93.20	87.80	82.50	77.10
$740	$760	138.40	131.70	124.90	118.80	113.40	108.00	102.60	97.20	91.80	86.50	81.10
$760	$780	143.40	136.70	129.90	123.20	117.40	112.00	106.60	101.20	95.80	90.50	85.10
$780	$800	148.40	141.70	134.90	128.20	121.50	116.00	110.60	105.20	99.80	94.50	89.10
$800	$820	153.40	146.70	139.90	133.20	126.50	120.00	114.60	109.20	103.80	98.50	93.10
$820	$840	158.40	151.70	144.90	138.20	131.50	124.70	118.60	113.20	107.80	102.50	97.10
$840	$860	163.60	156.70	149.90	143.20	136.50	129.70	123.00	117.20	111.80	106.50	101.10
$860	$880	169.60	161.70	154.90	148.20	141.50	134.70	128.00	121.30	115.80	110.50	105.10
$880	$900	175.60	167.50	159.90	153.20	146.50	139.70	133.00	126.30	119.80	114.50	109.10
$900	$920	181.60	173.50	165.40	158.20	151.50	144.70	138.00	131.30	124.50	118.50	113.10
$920	$940	187.60	179.50	171.40	163.30	156.50	149.70	143.00	136.30	129.50	122.80	117.10
$940	$960	193.60	185.50	177.40	169.30	161.50	154.70	148.00	141.30	134.50	127.80	121.10
$960	$980	199.60	191.50	183.40	175.30	167.30	159.70	153.00	146.30	139.50	132.80	126.10
$980	$1,000	205.60	197.50	189.40	181.30	173.30	165.20	158.00	151.30	144.50	137.80	131.10
$1,000	$1,020	211.60	203.50	195.40	187.30	179.30	171.20	163.10	156.30	149.50	142.80	136.10
$1,020	$1,040	217.60	209.50	201.40	193.30	185.30	177.20	169.10	161.30	154.50	147.80	141.10
$1,040	$1,060	223.60	215.50	207.40	199.30	191.30	183.20	175.10	167.00	159.50	152.80	146.10
$1,060	$1,080	229.60	221.50	213.40	205.30	197.30	189.20	181.10	173.00	165.00	157.80	151.10
$1,080	$1,100	235.60	227.50	219.40	211.30	203.30	195.20	187.10	179.00	171.00	162.90	156.10
$1,100	$1,120	241.60	233.50	225.40	217.30	209.30	201.20	193.10	185.00	177.00	168.90	161.10
$1,120	$1,140	247.60	239.50	231.40	223.30	215.30	207.20	199.10	191.00	183.00	174.90	166.80
		30 percent of the excess over $1,140 plus—										
$1,140 and over		250.60	242.50	234.40	226.30	218.30	210.20	202.10	194.00	186.00	177.90	169.80

If the payroll period with respect to an employee is semimonthly and he is not married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$8	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$8	$10	.10	0	0	0	0	0	0	0	0	0	0
$10	$12	.40	0	0	0	0	0	0	0	0	0	0
$12	$14	.70	0	0	0	0	0	0	0	0	0	0
$14	$16	.90	0	0	0	0	0	0	0	0	0	0
$16	$18	1.20	0	0	0	0	0	0	0	0	0	0
$18	$20	1.50	0	0	0	0	0	0	0	0	0	0
$20	$22	1.80	0	0	0	0	0	0	0	0	0	0
$22	$24	2.10	0	0	0	0	0	0	0	0	0	0
$24	$26	2.30	0	0	0	0	0	0	0	0	0	0
$26	$28	2.60	0	0	0	0	0	0	0	0	0	0
$28	$30	2.90	0	0	0	0	0	0	0	0	0	0
$30	$32	3.20	0	0	0	0	0	0	0	0	0	0
$32	$34	3.50	0	0	0	0	0	0	0	0	0	0
$34	$36	3.80	0	0	0	0	0	0	0	0	0	0
$36	$38	4.10	0	0	0	0	0	0	0	0	0	0
$38	$40	4.40	.20	0	0	0	0	0	0	0	0	0
$40	$42	4.70	.50	0	0	0	0	0	0	0	0	0
$42	$44	5.00	.80	0	0	0	0	0	0	0	0	0
$44	$46	5.30	1.10	0	0	0	0	0	0	0	0	0
$46	$48	5.60	1.30	0	0	0	0	0	0	0	0	0
$48	$50	5.90	1.60	0	0	0	0	0	0	0	0	0
$50	$52	6.20	1.90	0	0	0	0	0	0	0	0	0
$52	$54	6.60	2.20	0	0	0	0	0	0	0	0	0
$54	$56	6.90	2.50	0	0	0	0	0	0	0	0	0
$56	$58	7.20	2.70	0	0	0	0	0	0	0	0	0
$58	$60	7.60	3.00	0	0	0	0	0	0	0	0	0
$60	$62	7.90	3.30	0	0	0	0	0	0	0	0	0
$62	$64	8.30	3.60	0	0	0	0	0	0	0	0	0
$64	$66	8.60	3.90	0	0	0	0	0	0	0	0	0
$66	$68	8.90	4.20	0	0	0	0	0	0	0	0	0
$68	$70	9.30	4.50	.30	0	0	0	0	0	0	0	0
$70	$72	9.60	4.80	.60	0	0	0	0	0	0	0	0
$72	$74	10.00	5.10	.90	0	0	0	0	0	0	0	0
$74	$76	10.30	5.40	1.20	0	0	0	0	0	0	0	0
$76	$78	10.60	5.70	1.40	0	0	0	0	0	0	0	0
$78	$80	11.00	6.00	1.70	0	0	0	0	0	0	0	0
$80	$82	11.30	6.40	2.00	0	0	0	0	0	0	0	0
$82	$84	11.70	6.70	2.30	0	0	0	0	0	0	0	0
$84	$86	12.00	7.00	2.60	0	0	0	0	0	0	0	0
$86	$88	12.30	7.40	2.80	0	0	0	0	0	0	0	0
$88	$90	12.70	7.70	3.10	0	0	0	0	0	0	0	0
$90	$92	13.00	8.10	3.40	0	0	0	0	0	0	0	0
$92	$94	13.40	8.40	3.70	0	0	0	0	0	0	0	0
$94	$96	13.70	8.70	4.00	0	0	0	0	0	0	0	0
$96	$98	14.00	9.10	4.30	.20	0	0	0	0	0	0	0
$98	$100	14.40	9.40	4.60	.40	0	0	0	0	0	0	0
$100	$102	14.70	9.80	4.90	.70	0	0	0	0	0	0	0
$102	$104	15.10	10.10	5.20	1.00	0	0	0	0	0	0	0
$104	$106	15.40	10.40	5.50	1.30	0	0	0	0	0	0	0
$106	$108	15.70	10.80	5.80	1.60	0	0	0	0	0	0	0
$108	$110	16.10	11.10	6.20	1.80	0	0	0	0	0	0	0
$110	$112	16.40	11.50	6.50	2.10	0	0	0	0	0	0	0
$112	$114	16.80	11.80	6.80	2.40	0	0	0	0	0	0	0
$114	$116	17.10	12.10	7.20	2.70	0	0	0	0	0	0	0
$116	$118	17.40	12.50	7.50	3.00	0	0	0	0	0	0	0
$118	$120	17.80	12.80	7.90	3.30	0	0	0	0	0	0	0
$120	$124	18.30	13.30	8.40	3.70	0	0	0	0	0	0	0
$124	$128	19.00	14.00	9.00	4.30	.10	0	0	0	0	0	0
$128	$132	19.60	14.70	9.70	4.90	.70	0	0	0	0	0	0
$132	$136	20.30	15.40	10.40	5.50	1.30	0	0	0	0	0	0
$136	$140	21.00	16.00	11.10	6.10	1.80	0	0	0	0	0	0
$140	$144	21.70	16.70	11.80	6.80	2.40	0	0	0	0	0	0
$144	$148	22.40	17.40	12.40	7.50	2.90	0	0	0	0	0	0
$148	$152	23.00	18.10	13.10	8.20	3.50	0	0	0	0	0	0
$152	$156	23.70	18.80	13.80	8.80	4.10	0	0	0	0	0	0
$156	$160	24.40	19.40	14.50	9.50	4.70	.50	0	0	0	0	0
$160	$164	25.10	20.10	15.20	10.20	5.30	1.10	0	0	0	0	0
$164	$168	25.80	20.80	15.80	10.90	5.90	1.70	0	0	0	0	0
$168	$172	26.40	21.50	16.50	11.60	6.60	2.20	0	0	0	0	0
$172	$176	27.10	22.20	17.20	12.20	7.30	2.80	0	0	0	0	0
$176	$180	27.80	22.80	17.90	12.90	8.00	3.40	0	0	0	0	0
$180	$184	28.50	23.50	18.60	13.60	8.60	4.00	0	0	0	0	0
$184	$188	29.20	24.20	19.20	14.30	9.30	4.60	.40	0	0	0	0

If the payroll period with respect to an employee is semimonthly and he is not married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$188	$192	$30.00	$24.90	$19.90	$15.00	$10.00	$5.20	$.90	$0	$0	$0	$0
$192	$196	30.80	25.60	20.60	15.60	10.70	5.80	1.50	0	0	0	0
$196	$200	31.60	26.20	21.30	16.30	11.40	6.40	2.10	0	0	0	0
$200	$210	33.00	27.40	22.50	17.50	12.60	7.60	3.00	0	0	0	0
$210	$220	35.00	29.20	24.20	19.20	14.30	9.30	4.50	.40	0	0	0
$220	$230	37.00	31.20	25.90	20.90	16.00	11.00	6.00	1.80	0	0	0
$230	$240	39.00	33.20	27.60	22.60	17.70	12.70	7.70	3.20	0	0	0
$240	$250	41.00	35.20	29.40	24.30	19.40	14.40	9.40	4.70	.50	0	0
$250	$260	43.00	37.20	31.40	26.00	21.10	16.10	11.10	6.20	1.90	0	0
$260	$270	45.00	39.20	33.40	27.70	22.80	17.80	12.80	7.90	3.30	0	0
$270	$280	47.00	41.20	35.40	29.50	24.50	19.50	14.50	9.60	4.80	.60	0
$280	$290	49.00	43.20	37.40	31.50	26.20	21.20	16.20	11.30	6.30	2.00	0
$290	$300	51.00	45.20	39.40	33.50	27.90	22.90	17.90	13.00	8.00	3.40	0
$300	$320	54.00	48.20	42.40	36.50	30.70	25.50	20.50	15.50	10.60	5.70	1.40
$320	$340	58.00	52.20	46.40	40.50	34.70	28.90	23.90	18.90	14.00	9.00	4.30
$340	$360	62.00	56.20	50.40	44.50	38.70	32.90	27.30	22.30	17.40	12.40	7.50
$360	$380	66.20	60.20	54.40	48.50	42.70	36.90	31.00	25.70	20.80	15.80	10.90
$380	$400	71.20	64.20	58.40	52.50	46.70	40.90	35.00	29.20	24.20	19.20	14.30
$400	$420	76.20	68.90	62.40	56.50	50.70	44.90	39.00	33.20	27.60	22.60	17.70
$420	$440	81.20	73.90	66.60	60.50	54.70	48.90	43.00	37.20	31.40	26.00	21.10
$440	$460	86.20	78.90	71.60	64.50	58.70	52.90	47.00	41.20	35.40	29.50	24.50
$460	$480	91.80	83.90	76.60	69.30	62.70	56.90	51.00	45.20	39.40	33.50	27.90
$480	$500	97.80	89.00	81.60	74.30	67.00	60.90	55.00	49.20	43.40	37.50	31.70
$500	$520	103.80	95.00	86.60	79.30	72.00	64.90	59.00	53.20	47.40	41.50	35.70
$520	$540	109.80	101.00	92.30	84.30	77.00	69.80	63.00	57.20	51.40	45.50	39.70
$540	$560	115.80	107.00	98.30	89.50	82.00	74.80	67.50	61.20	55.40	49.50	43.70
$560	$580	121.80	113.00	104.30	95.50	87.00	79.80	72.50	65.20	59.40	53.50	47.70
$580	$600	127.80	119.00	110.30	101.50	92.80	84.80	77.50	70.20	63.40	57.50	51.70
$600	$620	133.80	125.00	116.30	107.50	98.80	90.00	82.50	75.20	67.90	61.50	55.70
$620	$640	139.80	131.00	122.30	113.50	104.80	96.00	87.50	80.20	72.90	65.60	59.70
$640	$660	145.80	137.00	128.30	119.50	110.80	102.00	93.30	85.20	77.90	70.60	63.70
$660	$680	151.80	143.00	134.30	125.50	116.80	108.00	99.30	90.50	82.90	75.60	68.30
$680	$700	157.80	149.00	140.30	131.50	122.80	114.00	105.30	96.50	87.90	80.60	73.30
$700	$720	163.80	155.00	149.30	137.50	128.80	120.00	111.30	102.50	93.80	85.60	78.30
$720	$740	169.80	161.00	152.30	143.50	134.80	126.00	117.30	108.50	99.80	91.00	83.30
$740	$760	175.80	167.00	158.30	149.50	140.80	132.00	123.30	114.50	105.80	97.00	88.30
		30 percent of the excess over $760 plus—										
$760 and over		178.80	170.00	161.30	152.50	143.80	135.00	126.30	117.50	108.80	100.00	91.30

If the payroll period with respect to an employee is semimonthly and he is married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$8	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$8	$10	.10	0	0	0	0	0	0	0	0	0	0
$10	$12	.40	0	0	0	0	0	0	0	0	0	0
$12	$14	.70	0	0	0	0	0	0	0	0	0	0
$14	$16	.90	0	0	0	0	0	0	0	0	0	0
$16	$18	1.20	0	0	0	0	0	0	0	0	0	0
$18	$20	1.50	0	0	0	0	0	0	0	0	0	0
$20	$22	1.80	0	0	0	0	0	0	0	0	0	0
$22	$24	2.10	0	0	0	0	0	0	0	0	0	0
$24	$26	2.30	0	0	0	0	0	0	0	0	0	0
$26	$28	2.60	0	0	0	0	0	0	0	0	0	0
$28	$30	2.90	0	0	0	0	0	0	0	0	0	0
$30	$32	3.20	0	0	0	0	0	0	0	0	0	0
$32	$34	3.50	0	0	0	0	0	0	0	0	0	0
$34	$36	3.70	0	0	0	0	0	0	0	0	0	0

If the payroll period with respect to an employee is semimonthly and he is married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$36	$38	$4.00	$0	$0	$0	$0	$0	$0	$0	$0	$0	0
$38	$40	4.30	.20	0	0	0	0	0	0	0	0	0
$40	$42	4.60	.50	0	0	0	0	0	0	0	0	0
$42	$44	4.90	.80	0	0	0	0	0	0	0	0	0
$44	$46	5.10	1.10	0	0	0	0	0	0	0	0	0
$46	$48	5.40	1.30	0	0	0	0	0	0	0	0	0
$48	$50	5.70	1.60	0	0	0	0	0	0	0	0	0
$50	$52	6.00	1.90	0	0	0	0	0	0	0	0	0
$52	$54	6.30	2.20	0	0	0	0	0	0	0	0	0
$54	$56	6.60	2.50	0	0	0	0	0	0	0	0	0
$56	$58	6.90	2.70	0	0	0	0	0	0	0	0	0
$58	$60	7.20	3.00	0	0	0	0	0	0	0	0	0
$60	$62	7.50	3.30	0	0	0	0	0	0	0	0	0
$62	$64	7.80	3.60	0	0	0	0	0	0	0	0	0
$64	$66	8.10	3.90	0	0	0	0	0	0	0	0	0
$66	$68	8.40	4.10	0	0	0	0	0	0	0	0	0
$68	$70	8.70	4.40	.30	0	0	0	0	0	0	0	0
$70	$72	9.00	4.70	.60	0	0	0	0	0	0	0	0
$72	$74	9.30	5.00	0.90	0	0	0	0	0	0	0	0
$74	$76	9.60	5.30	1.20	0	0	0	0	0	0	0	0
$76	$78	9.90	5.50	1.40	0	0	0	0	0	0	0	0
$78	$80	10.20	5.80	1.70	0	0	0	0	0	0	0	0
$80	$82	10.50	6.10	2.00	0	0	0	0	0	0	0	0
$82	$84	10.80	6.40	2.30	0	0	0	0	0	0	0	0
$84	$86	11.10	6.70	2.60	0	0	0	0	0	0	0	0
$86	$88	11.40	7.00	2.80	0	0	0	0	0	0	0	0
$88	$90	11.70	7.30	3.10	0	0	0	0	0	0	0	0
$90	$92	12.00	7.60	3.40	0	0	0	0	0	0	0	0
$92	$94	12.30	7.90	3.70	0	0	0	0	0	0	0	0
$94	$96	12.60	8.20	4.00	0	0	0	0	0	0	0	0
$96	$98	12.90	8.50	4.20	.20	0	0	0	0	0	0	0
$98	$100	13.20	8.80	4.50	.40	0	0	0	0	0	0	0
$100	$102	13.50	9.10	4.80	.70	0	0	0	0	0	0	0
$102	$104	13.80	9.40	5.10	1.00	0	0	0	0	0	0	0
$104	$106	14.10	9.70	5.40	1.30	0	0	0	0	0	0	0
$106	$108	14.40	10.00	5.60	1.60	0	0	0	0	0	0	0
$108	$110	14.70	10.30	5.90	1.80	0	0	0	0	0	0	0
$110	$112	15.00	10.60	6.20	2.10	0	0	0	0	0	0	0
$112	$114	15.30	10.90	6.50	2.40	0	0	0	0	0	0	0
$114	$116	15.60	11.20	6.80	2.70	0	0	0	0	0	0	0
$116	$118	15.90	11.50	7.10	3.00	0	0	0	0	0	0	0
$118	$120	16.20	11.80	7.40	3.20	0	0	0	0	0	0	0
$120	$124	16.60	12.30	7.90	3.70	0	0	0	0	0	0	0
$124	$128	17.20	12.90	8.50	4.20	.10	0	0	0	0	0	0
$128	$132	17.80	13.50	9.10	4.80	.70	0	0	0	0	0	0
$132	$136	18.40	14.10	9.70	5.30	1.30	0	0	0	0	0	0
$136	$140	19.00	14.70	10.30	5.90	1.80	0	0	0	0	0	0
$140	$144	19.60	15.30	10.90	6.50	2.40	0	0	0	0	0	0
$144	$148	20.20	15.90	11.50	7.10	2.90	0	0	0	0	0	0
$148	$152	20.80	16.50	12.10	7.70	3.50	0	0	0	0	0	0
$152	$156	21.40	17.10	12.70	8.30	4.10	0	0	0	0	0	0
$156	$160	22.00	17.70	13.30	8.90	4.60	.50	0	0	0	0	0
$160	$164	22.60	18.30	13.90	9.50	5.20	1.10	0	0	0	0	0
$164	$168	23.20	18.90	14.50	10.10	5.70	1.70	0	0	0	0	0
$168	$172	23.80	19.50	15.10	10.70	6.30	2.20	0	0	0	0	0
$172	$176	24.40	20.10	15.70	11.30	6.90	2.80	0	0	0	0	0
$176	$180	25.00	20.70	16.30	11.90	7.50	3.30	0	0	0	0	0
$180	$184	25.60	21.30	16.90	12.50	8.10	3.90	0	0	0	0	0
$184	$188	26.30	21.90	17.50	13.10	8.70	4.50	.40	0	0	0	0
$188	$192	27.00	22.50	18.10	13.70	9.30	5.00	.90	0	0	0	0
$192	$196	27.60	23.10	18.70	14.30	9.90	5.60	1.50	0	0	0	0
$196	$200	28.30	23.70	19.30	14.90	10.50	6.20	2.10	0	0	0	0
$200	$210	29.50	24.70	20.30	16.00	11.60	7.20	3.00	0	0	0	0
$210	$220	31.20	26.30	21.80	17.50	13.10	8.70	4.40	.40	0	0	0
$220	$230	32.90	28.00	23.30	19.00	14.60	10.20	5.80	1.80	0	0	0
$230	$240	34.60	29.70	24.80	20.50	16.10	11.70	7.30	3.20	0	0	0
$240	$250	36.30	31.40	26.40	22.00	17.60	13.20	8.80	4.60	.50	0	0
$250	$260	38.00	33.10	28.10	23.50	19.10	14.70	10.30	6.00	1.90	0	0
$260	$270	39.70	34.80	29.80	25.00	20.60	16.20	11.80	7.50	3.30	0	0
$270	$280	41.40	36.50	31.50	26.50	22.10	17.70	13.30	9.00	4.70	.60	0
$280	$290	43.10	38.20	33.20	28.20	23.60	19.20	14.80	10.50	6.10	2.00	0
$290	$300	44.80	39.90	34.90	29.90	25.10	20.70	16.30	12.00	7.60	3.40	0

If the payroll period with respect to an employee is semimonthly and he is married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$300	$320	$47.40	$42.40	$37.50	$32.50	$27.50	$23.00	$18.60	$14.20	$9.80	$5.50	$1.40
$320	$340	50.80	45.80	40.90	35.90	30.90	26.00	21.60	17.20	12.80	8.50	4.20
$340	$360	54.20	49.20	44.30	39.30	34.30	29.40	24.60	20.20	15.80	11.50	7.10
$360	$380	57.70	52.60	47.70	42.70	37.70	32.80	27.80	23.20	18.80	14.50	10.10
$380	$400	61.70	56.00	51.10	46.10	41.10	36.20	31.20	26.30	21.80	17.50	13.10
$400	$420	65.70	59.80	54.50	49.50	44.50	39.60	34.60	29.70	24.80	20.50	16.10
$420	$440	69.70	63.80	58.00	52.90	47.90	43.00	38.00	33.10	28.10	23.50	19.10
$440	$460	73.70	67.80	62.00	56.30	51.30	46.40	41.40	36.50	31.50	26.50	22.10
$460	$480	77.70	71.80	66.00	60.20	54.70	49.80	44.80	39.90	34.90	29.90	25.10
$480	$500	81.70	75.80	70.00	64.20	58.30	53.20	48.20	43.30	38.30	33.30	28.40
$500	$520	85.70	79.80	74.00	68.20	62.30	56.60	51.60	46.70	41.70	36.70	31.80
$520	$540	89.70	83.80	78.00	72.20	66.30	60.50	55.00	50.10	45.10	40.10	35.20
$540	$560	93.70	87.80	82.00	76.20	70.30	64.50	58.70	53.50	48.50	43.50	38.60
$560	$580	97.70	91.80	86.00	80.20	74.30	68.50	62.70	56.90	51.90	46.90	42.00
$580	$600	101.70	95.80	90.00	84.20	78.30	72.50	66.70	60.80	55.30	50.30	45.40
$600	$620	105.70	99.80	94.00	88.20	82.30	76.50	70.70	64.80	59.00	53.70	48.80
$620	$640	109.70	103.80	98.00	92.20	86.30	80.50	74.70	68.80	63.00	57.20	52.20
$640	$660	113.70	107.80	102.00	96.20	90.30	84.50	78.70	72.80	67.00	61.20	55.60
$660	$680	117.70	111.80	106.00	100.20	94.30	88.50	82.70	76.80	71.00	65.20	59.30
$680	$700	121.70	115.80	110.00	104.20	98.30	92.50	86.70	80.80	75.00	69.20	63.30
$700	$720	125.70	119.80	114.00	108.20	102.30	96.50	90.70	84.80	79.00	73.20	67.30
$720	$740	129.70	123.80	118.00	112.20	106.30	100.50	94.70	88.80	83.00	77.20	71.30
$740	$760	134.30	127.80	122.00	116.20	110.30	104.50	98.70	92.80	87.00	81.20	75.30
$760	$780	139.30	132.00	126.00	120.20	114.30	108.50	102.70	96.80	91.00	85.20	79.30
$780	$800	144.30	137.00	130.00	124.20	118.30	112.50	106.70	100.80	95.00	89.20	83.30
$800	$820	149.30	142.00	134.70	128.20	122.30	116.50	110.70	104.80	99.00	93.20	87.30
$820	$840	154.30	147.00	139.70	132.40	126.30	120.50	114.70	108.80	103.00	97.20	91.30
$840	$860	159.30	152.00	144.70	137.40	130.30	124.50	118.70	112.80	107.00	101.20	95.30
$860	$880	164.30	157.00	149.70	142.40	135.10	128.50	122.70	116.80	111.00	105.20	99.30
$880	$900	169.30	162.00	154.70	147.40	140.10	132.80	126.70	120.80	115.00	109.20	103.30
$900	$920	174.30	167.00	159.70	152.40	145.10	137.80	130.70	124.80	119.00	113.20	107.30
$920	$940	180.00	172.00	164.70	157.40	150.10	142.80	135.50	128.80	123.00	117.20	111.30
$940	$960	186.00	177.20	169.70	162.40	155.10	147.80	140.50	133.30	127.00	121.20	115.30
$960	$980	192.00	183.20	174.70	167.40	160.10	152.80	145.50	138.30	131.00	125.20	119.30
$980	$1,000	198.00	189.20	180.50	172.40	165.10	157.80	150.50	143.30	136.00	129.20	123.30
$1,000	$1,020	204.00	195.20	186.50	177.70	170.10	162.80	155.50	148.30	141.00	133.70	127.30
$1,020	$1,040	210.00	201.20	192.50	183.70	175.10	167.80	160.50	153.30	146.00	138.70	131.40
$1,040	$1,060	216.00	207.20	198.50	189.70	181.00	172.80	165.50	158.30	151.00	143.70	136.40
$1,060	$1,080	222.00	213.20	204.50	195.70	187.00	178.20	170.50	163.30	156.00	148.70	141.40
$1,080	$1,100	228.00	219.20	210.50	201.70	193.00	184.20	175.50	168.30	161.00	153.70	146.40
$1,100	$1,200	234.00	225.20	216.50	207.70	199.00	190.20	181.50	173.30	166.00	158.20	151.40
$1,120	$1,140	240.00	231.20	222.50	213.70	205.00	196.20	187.50	178.70	171.00	163.70	156.40
$1,140	$1,160	246.00	237.20	228.50	219.70	211.00	202.20	193.50	184.70	176.00	168.70	161.40
$1,160	$1,180	252.00	243.20	234.50	225.70	217.00	208.20	199.50	190.70	182.00	173.70	166.40
$1,180	$1,200	258.00	249.20	240.50	231.70	223.00	214.20	205.50	196.70	188.00	179.20	171.40
$1,200	$1,220	264.00	255.20	246.50	237.70	229.00	220.20	211.50	202.70	194.00	185.20	176.50
		30 percent of the excess over $1,220 plus—										
$1,220 and over		267.00	258.20	249.50	240.70	232.00	223.20	214.50	205.70	197.00	188.20	179.50

If the payroll period with respect to an employee is monthly and he is not married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$16	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$16	$20	.20	0	0	0	0	0	0	0	0	0	0
$20	$24	.70	0	0	0	0	0	0	0	0	0	0
$24	$28	1.30	0	0	0	0	0	0	0	0	0	0
$28	$32	1.90	0	0	0	0	0	0	0	0	0	0
$32	$36	2.40	0	0	0	0	0	0	0	0	0	0
$36	$40	3.00	0	0	0	0	0	0	0	0	0	0
$40	$44	3.50	0	0	0	0	0	0	0	0	0	0
$44	$48	4.10	0	0	0	0	0	0	0	0	0	0
$48	$52	4.70	0	0	0	0	0	0	0	0	0	0
$52	$56	5.20	0	0	0	0	0	0	0	0	0	0
$56	$60	5.80	0	0	0	0	0	0	0	0	0	0
$60	$64	6.40	0	0	0	0	0	0	0	0	0	0
$64	$68	7.00	0	0	0	0	0	0	0	0	0	0
$68	$72	7.60	0	0	0	0	0	0	0	0	0	0
$72	$76	8.20	0	0	0	0	0	0	0	0	0	0
$76	$80	8.80	.40	0	0	0	0	0	0	0	0	0
$80	$84	9.40	1.00	0	0	0	0	0	0	0	0	0
$84	$88	10.00	1.50	0	0	0	0	0	0	0	0	0
$88	$92	10.60	2.10	0	0	0	0	0	0	0	0	0
$92	$96	11.20	2.70	0	0	0	0	0	0	0	0	0
$96	$100	11.80	3.20	0	0	0	0	0	0	0	0	0
$100	$104	12.40	3.80	0	0	0	0	0	0	0	0	0
$104	$108	13.10	4.30	0	0	0	0	0	0	0	0	0
$108	$112	13.80	4.90	0	0	0	0	0	0	0	0	0
$112	$116	14.50	5.50	0	0	0	0	0	0	0	0	0
$116	$120	15.10	6.00	0	0	0	0	0	0	0	0	0
$120	$124	15.80	6.60	0	0	0	0	0	0	0	0	0
$124	$128	16.50	7.20	0	0	0	0	0	0	0	0	0
$128	$132	17.20	7.80	0	0	0	0	0	0	0	0	0
$132	$136	17.90	8.40	.10	0	0	0	0	0	0	0	0
$136	$140	18.50	9.00	.70	0	0	0	0	0	0	0	0
$140	$144	19.20	9.60	1.20	0	0	0	0	0	0	0	0
$144	$148	19.90	10.20	1.80	0	0	0	0	0	0	0	0
$148	$152	20.60	10.80	2.30	0	0	0	0	0	0	0	0
$152	$156	21.30	11.40	2.90	0	0	0	0	0	0	0	0
$156	$160	21.90	12.00	3.50	0	0	0	0	0	0	0	0
$160	$164	22.60	12.70	4.00	0	0	0	0	0	0	0	0
$164	$168	23.30	13.40	4.60	0	0	0	0	0	0	0	0
$168	$172	24.00	14.10	5.10	0	0	0	0	0	0	0	0
$172	$176	24.70	14.70	5.70	0	0	0	0	0	0	0	0
$176	$180	25.30	15.40	6.30	0	0	0	0	0	0	0	0
$180	$184	26.00	16.10	6.90	0	0	0	0	0	0	0	0
$184	$188	26.70	16.80	7.50	0	0	0	0	0	0	0	0
$188	$192	27.40	17.50	8.10	0	0	0	0	0	0	0	0
$192	$196	28.10	18.10	8.70	.30	0	0	0	0	0	0	0
$196	$200	28.70	18.80	9.30	.90	0	0	0	0	0	0	0
$200	$204	29.40	19.50	9.90	1.40	0	0	0	0	0	0	0
$204	$208	30.10	20.20	10.50	2.00	0	0	0	0	0	0	0
$208	$212	30.80	20.90	11.10	2.60	0	0	0	0	0	0	0
$212	$216	31.50	21.50	11.70	3.10	0	0	0	0	0	0	0
$216	$220	32.10	22.20	12.30	3.70	0	0	0	0	0	0	0
$220	$224	32.80	22.90	13.00	4.20	0	0	0	0	0	0	0
$224	$228	33.50	23.60	13.70	4.80	0	0	0	0	0	0	0
$228	$232	34.20	24.30	14.40	5.40	0	0	0	0	0	0	0
$232	$236	34.90	24.90	15.00	5.90	0	0	0	0	0	0	0
$236	$240	35.50	25.60	15.70	6.50	0	0	0	0	0	0	0
$240	$248	36.60	26.60	16.70	7.40	0	0	0	0	0	0	0
$248	$256	37.90	28.00	18.10	8.60	.30	0	0	0	0	0	0
$256	$264	39.30	29.40	19.50	9.80	1.40	0	0	0	0	0	0
$264	$272	40.60	30.70	20.80	11.00	2.50	0	0	0	0	0	0
$272	$280	42.00	32.10	22.20	12.30	3.60	0	0	0	0	0	0
$280	$288	43.40	33.40	23.50	13.60	4.80	0	0	0	0	0	0
$288	$296	44.70	34.80	24.90	15.00	5.90	0	0	0	0	0	0
$296	$304	46.10	36.20	26.30	16.30	7.10	0	0	0	0	0	0
$304	$312	47.40	37.50	27.60	17.70	8.30	0	0	0	0	0	0
$312	$320	48.80	38.90	29.00	19.10	9.50	1.10	0	0	0	0	0
$320	$328	50.20	40.20	30.30	20.40	10.70	2.20	0	0	0	0	0
$328	$336	51.50	41.60	31.70	21.80	11.90	3.30	0	0	0	0	0
$336	$344	52.90	43.00	33.10	23.10	13.20	4.40	0	0	0	0	0
$344	$352	54.20	44.30	34.40	24.50	14.60	5.60	0	0	0	0	0
$352	$360	55.60	45.70	35.80	25.90	15.90	6.70	0	0	0	0	0
$360	$368	57.00	47.00	37.10	27.20	17.30	7.90	0	0	0	0	0

If the payroll period with respect to an employee is monthly and he is not married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$368	$376	$58.50	$48.40	$38.50	$28.60	$18.70	$9.10	$.70	$0	$0	$0	$0
$376	$384	60.10	49.80	39.90	29.90	20.00	10.30	1.90	0	0	0	0
$384	$392	61.70	51.10	41.20	31.30	21.40	11.50	3.00	0	0	0	0
$392	$400	63.30	52.50	42.60	32.70	22.70	12.80	4.10	0	0	0	0
$400	$420	66.10	54.90	45.00	35.00	25.10	15.20	6.10	0	0	0	0
$420	$440	70.10	58.40	48.40	38.40	28.50	18.60	9.10	.70	0	0	0
$440	$460	74.10	62.40	51.80	41.80	31.90	22.00	12.10	3.50	0	0	0
$460	$480	78.10	66.40	55.20	45.20	35.30	25.40	15.50	6.30	0	0	0
$480	$500	82.10	70.40	58.80	48.60	38.70	28.80	18.90	9.30	.90	0	0
$500	$520	86.10	74.40	62.80	52.00	42.10	32.20	22.30	12.40	3.70	0	0
$520	$540	90.10	78.40	66.80	55.40	45.50	35.60	25.70	15.80	6.60	0	0
$540	$560	94.10	82.40	70.80	59.10	48.90	39.00	29.10	19.20	9.60	1.20	0
$560	$580	98.10	86.40	74.80	63.10	52.30	42.40	32.50	22.60	12.70	4.00	0
$580	$600	102.10	90.40	78.80	67.10	55.70	45.80	35.90	26.00	16.10	6.80	0
$600	$640	108.10	96.40	84.80	73.10	61.40	50.90	41.00	31.10	21.20	11.30	2.80
$640	$680	116.10	104.40	92.80	81.10	69.40	57.80	47.80	37.90	28.00	18.00	8.60
$680	$720	124.10	112.40	100.80	89.10	77.40	65.80	54.60	44.70	34.80	24.80	14.90
$720	$760	132.40	120.40	108.80	97.10	85.40	73.80	62.10	51.50	41.60	31.60	21.70
$760	$800	142.40	128.40	116.80	105.10	93.40	81.80	70.10	58.40	48.40	38.40	28.50
$800	$840	152.40	137.80	124.80	113.10	101.40	89.80	78.10	66.40	55.20	45.20	35.30
$840	$880	162.40	147.80	133.30	121.10	109.40	97.80	86.10	74.40	62.80	52.00	42.10
$880	$920	172.40	157.80	143.30	129.10	117.40	105.80	94.10	82.40	70.80	59.10	48.90
$920	$960	183.60	167.80	153.30	138.70	125.40	113.80	102.10	90.40	78.80	67.10	55.70
$960	$1,000	195.60	178.10	163.30	148.70	134.10	121.80	110.10	98.40	86.80	75.10	63.40
$1,000	$1,040	207.60	190.10	173.30	158.70	144.10	129.80	118.10	106.40	94.80	83.10	71.40
$1,040	$1,080	219.60	202.10	184.60	168.70	154.10	139.50	126.10	114.40	102.80	91.10	79.40
$1,080	$1,120	231.60	214.10	196.60	179.10	164.10	149.50	134.90	122.40	110.80	99.10	87.40
$1,120	$1,160	243.60	226.10	208.60	191.10	174.10	159.50	144.90	130.40	118.80	107.10	95.40
$1,160	$1,200	255.60	238.10	220.60	203.10	185.60	169.50	154.90	140.30	126.80	115.10	103.40
$1,200	$1,240	267.60	250.10	232.60	215.10	197.60	180.10	164.90	150.30	135.80	123.10	111.40
$1,240	$1,280	279.60	262.10	244.60	227.10	209.60	192.10	174.90	160.30	145.80	131.20	119.40
$1,280	$1,320	291.60	274.10	256.60	239.10	221.60	204.10	186.60	170.30	155.80	141.20	127.40
$1,320	$1,360	303.60	286.10	268.60	251.10	233.60	216.10	198.60	181.10	165.80	151.20	136.60
$1,360	$1,400	315.60	298.10	280.60	263.10	245.60	228.10	210.60	193.10	175.80	161.20	146.60
$1,400	$1,440	327.60	310.10	292.60	275.10	257.60	240.10	222.60	205.10	187.60	171.20	156.60
$1,440	$1,480	339.60	322.10	304.60	287.10	269.60	252.10	234.60	217.10	199.60	182.10	166.60
$1,480	$1,520	351.60	334.10	316.60	299.10	281.60	264.10	246.60	229.10	211.60	194.10	176.60
		30 percent of the excess over $1,520 plus—										
$1,520 and over		357.60	340.10	322.60	305.10	287.60	270.10	252.60	235.10	217.60	200.10	182.60

If the payroll period with respect to an employee is monthly and he is married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$16	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$16	$20	.20	0	0	0	0	0	0	0	0	0	0
$20	$24	.70	0	0	0	0	0	0	0	0	0	0
$24	$28	1.30	0	0	0	0	0	0	0	0	0	0
$28	$32	1.90	0	0	0	0	0	0	0	0	0	0
$32	$36	2.40	0	0	0	0	0	0	0	0	0	0
$36	$40	3.00	0	0	0	0	0	0	0	0	0	0
$40	$44	3.50	0	0	0	0	0	0	0	0	0	0
$44	$48	4.10	0	0	0	0	0	0	0	0	0	0
$48	$52	4.70	0	0	0	0	0	0	0	0	0	0
$52	$56	5.20	0	0	0	0	0	0	0	0	0	0
$56	$60	5.80	0	0	0	0	0	0	0	0	0	0
$60	$64	6.30	0	0	0	0	0	0	0	0	0	0
$64	$68	6.90	0	0	0	0	0	0	0	0	0	0
$68	$72	7.50	0	0	0	0	0	0	0	0	0	0
$72	$76	8.00	0	0	0	0	0	0	0	0	0	0
$76	$80	8.60	.40	0	0	0	0	0	0	0	0	0
$80	$84	9.10	1.00	0	0	0	0	0	0	0	0	0
$84	$88	9.70	1.50	0	0	0	0	0	0	0	0	0
$88	$92	10.30	2.10	0	0	0	0	0	0	0	0	0
$92	$96	10.80	2.70	0	0	0	0	0	0	0	0	0
$96	$100	11.40	3.20	0	0	0	0	0	0	0	0	0
$100	$104	12.00	3.80	0	0	0	0	0	0	0	0	0
$104	$108	12.60	4.30	0	0	0	0	0	0	0	0	0
$108	$112	13.20	4.90	0	0	0	0	0	0	0	0	0
$112	$116	13.80	5.50	0	0	0	0	0	0	0	0	0
$116	$120	14.40	6.00	0	0	0	0	0	0	0	0	0
$120	$124	15.00	6.60	0	0	0	0	0	0	0	0	0
$124	$128	15.60	7.10	0	0	0	0	0	0	0	0	0
$128	$132	16.20	7.70	0	0	0	0	0	0	0	0	0
$132	$136	16.80	8.30	.10	0	0	0	0	0	0	0	0
$136	$140	17.40	8.80	.70	0	0	0	0	0	0	0	0
$140	$144	18.00	9.40	1.20	0	0	0	0	0	0	0	0
$144	$148	18.60	9.90	1.80	0	0	0	0	0	0	0	0
$148	$152	19.20	10.50	2.30	0	0	0	0	0	0	0	0
$152	$156	19.80	11.10	2.90	0	0	0	0	0	0	0	0
$156	$160	20.40	11.60	3.50	0	0	0	0	0	0	0	0
$160	$164	21.00	12.20	4.00	0	0	0	0	0	0	0	0
$164	$168	21.60	12.80	4.60	0	0	0	0	0	0	0	0
$168	$172	22.20	13.40	5.10	0	0	0	0	0	0	0	0
$172	$176	22.80	14.00	5.70	0	0	0	0	0	0	0	0
$176	$180	23.40	14.60	6.30	0	0	0	0	0	0	0	0
$180	$184	24.00	15.20	6.80	0	0	0	0	0	0	0	0
$184	$188	24.60	15.80	7.40	0	0	0	0	0	0	0	0
$188	$192	25.20	16.40	7.90	0	0	0	0	0	0	0	0
$192	$196	25.80	17.00	8.50	.30	0	0	0	0	0	0	0
$196	$200	26.40	17.60	9.10	.90	0	0	0	0	0	0	0
$200	$204	27.00	18.20	9.60	1.40	0	0	0	0	0	0	0
$204	$208	27.60	18.80	10.20	2.00	0	0	0	0	0	0	0
$208	$212	28.20	19.40	10.70	2.60	0	0	0	0	0	0	0
$212	$216	28.80	20.00	11.30	3.10	0	0	0	0	0	0	0
$216	$220	29.40	20.60	11.90	3.70	0	0	0	0	0	0	0
$220	$224	30.00	21.20	12.50	4.20	0	0	0	0	0	0	0
$224	$228	30.60	21.80	13.10	4.80	0	0	0	0	0	0	0
$228	$232	31.20	22.40	13.70	5.40	0	0	0	0	0	0	0
$232	$236	31.80	23.00	14.30	5.90	0	0	0	0	0	0	0
$236	$240	32.40	23.60	14.90	6.50	0	0	0	0	0	0	0
$240	$248	33.30	24.50	15.80	7.30	0	0	0	0	0	0	0
$248	$256	34.50	25.70	17.00	8.40	.30	0	0	0	0	0	0
$256	$264	35.70	26.90	18.20	9.60	1.40	0	0	0	0	0	0
$264	$272	36.90	28.10	19.40	10.70	2.50	0	0	0	0	0	0
$272	$280	38.10	29.30	20.60	11.80	3.60	0	0	0	0	0	0
$280	$288	39.30	30.50	21.80	13.00	4.80	0	0	0	0	0	0
$288	$296	40.50	31.70	23.00	14.20	5.90	0	0	0	0	0	0
$296	$304	41.70	32.90	24.20	15.40	7.00	0	0	0	0	0	0
$304	$312	42.90	34.10	25.40	16.60	8.10	0	0	0	0	0	0
$312	$320	44.10	35.30	26.60	17.80	9.20	1.10	0	0	0	0	0
$320	$328	45.30	36.50	27.80	19.00	10.40	2.20	0	0	0	0	0
$328	$336	46.50	37.70	29.00	20.20	11.50	3.30	0	0	0	0	0
$336	$344	47.70	38.90	30.20	21.40	12.70	4.40	0	0	0	0	0
$344	$352	48.90	40.10	31.40	22.60	13.90	5.60	0	0	0	0	0
$352	$360	50.10	41.30	32.60	23.80	15.10	6.70	0	0	0	0	0
$360	$368	51.30	42.50	33.80	25.00	16.30	7.80	0	0	0	0	0
$368	$376	52.60	43.70	35.00	26.20	17.50	8.90	.70	0	0	0	0

If the payroll period with respect to an employee is monthly and he is married—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$376	$384	$53.90	$44.90	$36.20	$27.40	$18.70	$10.00	$1.90	$0	$0	$0	$0
$384	$392	55.30	46.10	37.40	28.60	19.90	11.20	3.00	0	0	0	0
$392	$400	56.70	47.30	38.60	29.80	21.10	12.30	4.10	0	0	0	0
$400	$420	59.00	49.40	40.70	31.90	23.20	14.40	6.10	0	0	0	0
$420	$440	62.40	52.50	43.70	34.90	26.20	17.40	8.90	.70	0	0	0
$440	$460	65.80	55.90	46.70	37.90	29.20	20.40	11.70	3.50	0	0	0
$460	$480	69.20	59.30	49.70	40.90	32.20	23.40	14.70	6.30	0	0	0
$480	$500	72.60	62.70	52.80	43.90	35.20	26.40	17.70	9.10	.90	0	0
$500	$520	76.00	66.10	56.20	46.90	38.20	29.40	20.70	11.90	3.70	0	0
$520	$540	79.40	69.50	59.60	49.90	41.20	32.40	23.70	14.90	6.50	0	0
$540	$560	82.80	72.90	63.00	53.10	44.20	35.40	26.70	17.90	9.30	1.20	0
$560	$580	86.20	76.30	66.40	56.50	47.20	38.40	29.70	20.90	12.20	4.00	0
$580	$600	89.60	79.70	69.80	59.90	50.20	41.40	32.70	23.90	15.20	6.80	0
$600	$640	94.70	84.80	74.90	65.00	55.10	45.90	37.20	28.40	19.70	11.00	2.80
$640	$680	101.50	91.60	81.70	71.80	61.90	52.00	43.20	34.40	25.70	16.90	8.40
$680	$720	108.30	98.40	88.50	78.60	68.70	58.80	49.20	40.40	31.70	22.90	14.20
$720	$760	115.30	105.20	95.30	85.40	75.50	65.60	55.60	46.40	37.70	28.90	20.20
$760	$800	123.30	112.00	102.10	92.20	82.30	72.40	62.40	52.50	43.70	34.90	26.20
$800	$840	131.30	119.70	108.90	99.00	89.10	79.20	69.20	59.30	49.70	40.90	32.20
$840	$880	139.30	127.70	116.00	105.80	95.90	86.00	76.00	66.10	56.20	46.90	38.20
$880	$920	147.30	135.70	124.00	112.60	102.70	92.80	82.80	72.90	63.00	53.10	44.20
$920	$960	155.30	143.70	132.00	120.30	109.50	99.60	89.60	79.70	69.80	59.90	50.20
$960	$1,000	163.30	151.70	140.00	128.30	116.70	106.40	96.40	86.50	76.60	66.70	56.80
$1,000	$1,040	171.30	159.70	148.00	136.30	124.70	113.20	103.20	93.30	83.40	73.50	63.60
$1,040	$1,080	179.30	167.70	156.00	144.30	132.70	121.00	110.00	100.10	90.20	80.30	70.40
$1,080	$1,120	187.30	175.70	164.00	152.30	140.70	129.00	117.30	106.90	97.00	87.10	77.20
$1,120	$1,160	195.30	183.70	172.00	160.30	148.70	137.00	125.30	113.70	103.80	93.90	84.00
$1,160	$1,200	203.30	191.70	180.00	168.30	156.70	145.00	133.30	121.70	110.60	100.70	90.80
$1,200	$1,240	211.30	199.70	188.00	176.30	164.70	153.00	141.30	129.70	118.00	107.50	97.60
$1,240	$1,280	219.30	207.70	196.00	184.30	172.70	161.00	149.30	137.70	126.00	114.30	104.40
$1,280	$1,320	227.30	215.70	204.00	192.30	180.70	169.00	157.30	145.70	134.00	122.30	111.20
$1,320	$1,360	235.30	223.70	212.00	200.30	188.70	177.00	165.30	153.70	142.00	130.30	118.70
$1,360	$1,400	243.30	231.70	220.00	208.30	196.70	185.00	173.30	161.70	150.00	138.30	126.70
$1,400	$1,440	251.30	239.70	228.00	216.30	204.70	193.00	181.30	169.70	158.00	146.30	134.70
$1,440	$1,480	259.30	247.70	236.00	224.30	212.70	201.00	189.30	177.70	166.00	154.30	142.70
$1,480	$1,520	268.60	255.70	244.00	232.30	220.70	209.00	197.30	185.70	174.00	162.30	150.70
$1,520	$1,560	278.60	264.00	252.00	240.30	228.70	217.00	205.30	193.70	182.00	170.30	158.70
$1,560	$1,600	288.60	274.00	260.00	248.30	236.70	225.00	213.30	201.70	190.00	178.30	166.70
$1,600	$1,640	298.60	284.00	269.40	256.30	244.70	233.00	221.30	209.70	198.00	186.30	174.70
$1,640	$1,680	308.60	294.00	279.40	264.80	252.70	241.00	229.30	217.70	206.00	194.30	182.70
$1,680	$1,720	318.60	304.00	289.40	274.80	260.70	249.00	237.30	225.70	214.00	202.30	190.70
$1,720	$1,760	328.60	314.00	299.40	284.80	270.30	257.00	245.30	233.70	222.00	210.30	198.70
$1,760	$1,800	338.60	324.00	309.40	294.80	280.30	265.70	253.30	241.70	230.00	218.30	206.70
$1,800	$1,840	348.60	334.00	319.40	304.80	290.30	275.70	261.30	249.70	238.00	226.30	214.70
$1,840	$1,880	359.90	344.00	329.40	314.80	300.30	285.70	271.10	257.70	246.00	234.30	222.70
$1,880	$1,920	371.90	354.40	339.40	324.80	310.30	295.70	281.10	266.50	254.00	242.30	230.70
$1,920	$1,960	383.90	366.40	349.40	334.80	320.30	305.70	291.10	276.50	262.00	250.30	238.70
$1,960	$2,000	395.90	378.40	360.90	344.80	330.30	315.70	301.10	286.50	271.90	258.30	246.70
$2,000	$2,040	407.90	390.40	372.90	355.40	340.30	325.70	311.10	296.50	281.90	267.30	254.70
$2,040	$2,080	419.90	402.40	384.90	367.40	350.30	335.70	321.10	306.50	291.90	277.30	262.80
$2,080	$2,120	431.90	414.40	396.90	379.40	361.90	345.70	331.10	316.50	301.90	287.30	272.80
$2,120	$2,160	443.90	426.40	408.90	391.40	373.90	356.40	341.10	326.50	311.90	297.30	282.80
$2,160	$2,200	455.90	438.40	420.90	403.40	385.90	368.40	351.10	336.50	321.90	307.30	292.80
$2,200	$2,240	467.90	450.40	432.90	415.40	397.90	380.40	362.90	346.50	331.90	317.30	302.80
$2,240	$2,280	479.90	462.40	444.90	427.40	409.90	392.40	374.90	357.40	341.90	327.30	312.80
$2,280	$2,320	491.90	474.40	456.90	439.40	421.90	404.40	386.90	369.40	351.90	337.30	322.80
$2,320	$2,360	503.90	486.40	468.90	451.40	433.90	416.40	398.90	381.40	363.90	347.30	332.80
$2,360	$2,400	515.90	498.40	480.90	463.40	445.90	428.40	410.90	393.40	375.90	358.40	342.80
$2,400	$2,440	527.90	510.40	492.90	475.40	457.90	440.40	422.90	405.40	387.90	370.40	352.90
		30 percent of the excess over $2,440 plus—										
$2,440 and over		533.90	516.40	498.90	481.40	463.90	446.40	428.90	411.40	393.90	376.40	358.90

If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period and he is not married—

And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least—	But less than—	The amount of income tax to be withheld shall be the following amount multiplied by the number of days in such periods—										
$0	$0.75	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$.75	$1.00	.05	0	0	0	0	0	0	0	0	0	0
$1.00	$1.25	.10	0	0	0	0	0	0	0	0	0	0
$1.25	$1.50	.10	0	0	0	0	0	0	0	0	0	0
$1.50	$1.75	.15	0	0	0	0	0	0	0	0	0	0
$1.75	$2.00	.20	0	0	0	0	0	0	0	0	0	0
$2.00	$2.25	.20	0	0	0	0	0	0	0	0	0	0
$2.25	$2.50	.25	0	0	0	0	0	0	0	0	0	0
$2.50	$2.75	.30	0	0	0	0	0	0	0	0	0	0
$2.75	$3.00	.35	.05	0	0	0	0	0	0	0	0	0
$3.00	$3.25	.35	.10	0	0	0	0	0	0	0	0	0
$3.25	$3.50	.40	.15	0	0	0	0	0	0	0	0	0
$3.50	$3.75	.45	.15	0	0	0	0	0	0	0	0	0
$3.75	$4.00	.50	.20	0	0	0	0	0	0	0	0	0
$4.00	$4.25	.55	.25	0	0	0	0	0	0	0	0	0
$4.25	$4.50	.60	.25	0	0	0	0	0	0	0	0	0
$4.50	$4.75	.60	.30	.05	0	0	0	0	0	0	0	0
$4.75	$5.00	.65	.35	.05	0	0	0	0	0	0	0	0
$5.00	$5.25	.70	.40	.10	0	0	0	0	0	0	0	0
$5.25	$5.50	.75	.45	.15	0	0	0	0	0	0	0	0
$5.50	$5.75	.80	.45	.15	0	0	0	0	0	0	0	0
$5.75	$6.00	.85	.50	.20	0	0	0	0	0	0	0	0
$6.00	$6.25	.90	.55	.25	0	0	0	0	0	0	0	0
$6.25	$6.50	.90	.60	.30	0	0	0	0	0	0	0	0
$6.50	$6.75	.95	.65	.30	.05	0	0	0	0	0	0	0
$6.75	$7.00	1.00	.70	.35	.10	0	0	0	0	0	0	0
$7.00	$7.25	1.05	.70	.40	.10	0	0	0	0	0	0	0
$7.25	$7.50	1.10	.75	.45	.15	0	0	0	0	0	0	0
$7.50	$7.75	1.15	.80	.50	.20	0	0	0	0	0	0	0
$7.75	$8.00	1.20	.85	.55	.20	0	0	0	0	0	0	0
$8.00	$8.25	1.20	.90	.55	.25	0	0	0	0	0	0	0
$8.25	$8.50	1.25	.95	.60	.30	0	0	0	0	0	0	0
$8.50	$8.75	1.30	1.00	.65	.35	.05	0	0	0	0	0	0
$8.75	$9.00	1.35	1.00	.70	.35	.10	0	0	0	0	0	0
$9.00	$9.25	1.40	1.05	.75	.40	.15	0	0	0	0	0	0
$9.25	$9.50	1.45	1.10	.80	.45	.15	0	0	0	0	0	0
$9.50	$9.75	1.45	1.15	.80	.50	.20	0	0	0	0	0	0
$9.75	$10.00	1.50	1.20	.85	.55	.25	0	0	0	0	0	0
$10.00	$10.50	1.60	1.25	.95	.60	.30	0	0	0	0	0	0
$10.50	$11.00	1.65	1.35	1.00	.70	.35	.10	0	0	0	0	0
$11.00	$11.50	1.75	1.40	1.10	.75	.45	.15	0	0	0	0	0
$11.50	$12.00	1.85	1.50	1.20	.85	.55	.25	0	0	0	0	0
$12.00	$12.50	1.95	1.60	1.25	.95	.60	.30	.05	0	0	0	0
$12.50	$13.00	2.05	1.70	1.35	1.05	.70	.40	.10	0	0	0	0
$13.00	$13.50	2.15	1.75	1.45	1.10	.80	.45	.15	0	0	0	0
$13.50	$14.00	2.25	1.85	1.50	1.20	.85	.55	.25	0	0	0	0
$14.00	$14.50	2.35	1.95	1.60	1.30	.95	.65	.30	.05	0	0	0
$14.50	$15.00	2.45	2.05	1.70	1.35	1.05	.70	.40	.10	0	0	0
$15.00	$15.50	2.55	2.15	1.80	1.45	1.15	.80	.45	.20	0	0	0
$15.50	$16.00	2.65	2.25	1.85	1.55	1.20	.90	.55	.25	0	0	0
$16.00	$16.50	2.75	2.35	1.95	1.60	1.30	.95	.65	.35	.05	0	0
$16.50	$17.00	2.85	2.45	2.05	1.70	1.40	1.05	.75	.40	.10	0	0
$17.00	$17.50	2.95	2.55	2.15	1.80	1.45	1.15	.80	.50	.20	0	0
$17.50	$18.00	3.05	2.65	2.25	1.90	1.55	1.25	.90	.55	.25	0	0
$18.00	$18.50	3.15	2.75	2.35	2.00	1.65	1.30	1.00	.65	.35	.05	0
$18.50	$19.00	3.25	2.85	2.45	2.10	1.70	1.40	1.05	.75	.40	.15	0
$19.00	$19.50	3.35	2.95	2.55	2.20	1.80	1.50	1.15	.85	.50	.20	0
$19.50	$20.00	3.45	3.05	2.65	2.30	1.90	1.55	1.25	.90	.60	.30	0
$20.00	$21.00	3.60	3.20	2.80	2.45	2.05	1.70	1.35	1.05	.70	.40	.10
$21.00	$22.00	3.80	3.40	3.00	2.65	2.25	1.85	1.55	1.20	.90	.55	.25
$22.00	$23.00	4.00	3.60	3.20	2.85	2.45	2.05	1.70	1.40	1.05	.75	.40
$23.00	$24.00	4.20	3.80	3.40	3.05	2.65	2.25	1.90	1.55	1.25	.90	.55
$24.00	$25.00	4.40	4.00	3.60	3.25	2.85	2.45	2.10	1.70	1.40	1.05	.75
$25.00	$26.00	4.65	4.20	3.80	3.45	3.05	2.65	2.30	1.90	1.55	1.25	.90
$26.00	$27.00	4.90	4.40	4.00	3.65	3.25	2.85	2.50	2.10	1.75	1.40	1.10
$27.00	$28.00	5.15	4.65	4.20	3.85	3.45	3.05	2.70	2.30	1.90	1.60	1.25
$28.00	$29.00	5.40	4.90	4.45	4.05	3.65	3.25	2.90	2.50	2.10	1.75	1.40
$29.00	$30.00	5.65	5.15	4.70	4.25	3.85	3.45	3.10	2.70	2.30	1.90	1.60
$30.00	$31.00	5.90	5.40	4.95	4.45	4.05	3.65	3.30	2.90	2.50	2.10	1.75
$31.00	$32.00	6.20	5.65	5.20	4.70	4.25	3.85	3.50	3.10	2.70	2.30	1.95
$32.00	$33.00	6.50	5.95	5.45	4.95	4.50	4.05	3.70	3.30	2.90	2.50	2.15
$33.00	$34.00	6.80	6.25	5.70	5.20	4.75	4.25	3.90	3.50	3.10	2.70	2.35

If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period and he is not married—

And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least—	But less than—	The amount of income tax to be withheld shall be the following amount multiplied by the number of days in such periods—										
$34.00	$35.00	$7.10	$6.55	$5.95	$5.45	$5.00	$4.50	$4.10	$3.70	$3.30	$2.90	$2.55
$35.00	$36.00	7.40	6.85	6.25	5.70	5.25	4.75	4.30	3.90	3.50	3.10	2.75
$36.00	$37.00	7.70	7.15	6.55	6.00	5.50	5.00	4.50	4.10	3.70	3.30	2.95
$37.00	$38.00	8.00	7.45	6.85	6.30	5.75	5.25	4.75	4.30	3.90	3.50	3.15
$38.00	$39.00	8.30	7.75	7.15	6.60	6.00	5.50	5.00	4.55	4.10	3.70	3.35
$39.00	$40.00	8.60	8.05	7.45	6.90	6.30	5.75	5.25	4.80	4.30	3.90	3.55
$40.00	$41.00	8.90	8.35	7.75	7.20	6.60	6.05	5.50	5.05	4.55	4.10	3.75
$41.00	$42.00	9.20	8.65	8.05	7.50	6.90	6.35	5.75	5.30	4.80	4.35	3.95
$42.00	$43.00	9.50	8.95	8.35	7.80	7.20	6.65	6.05	5.55	5.05	4.60	4.15
$43.00	$44.00	9.80	9.25	8.65	8.10	7.50	6.95	6.35	5.80	5.30	4.85	4.35
$44.00	$45.00	10.10	9.55	8.95	8.40	7.80	7.25	6.65	6.10	5.55	5.10	4.60
$45.00	$46.00	10.40	9.85	9.25	8.70	8.10	7.55	6.95	6.40	5.80	5.35	4.85
$46.00	$47.00	10.70	10.15	9.55	9.00	8.40	7.85	7.25	6.70	6.10	5.60	5.10
$47.00	$48.00	11.00	10.45	9.85	9.30	8.70	8.15	7.55	7.00	6.40	5.85	5.35
$48.00	$49.00	11.30	10.75	10.15	9.60	9.00	8.45	7.85	7.30	6.70	6.15	5.60
$49.00	$50.00	11.60	11.05	10.45	9.90	9.30	8.75	8.15	7.60	7.00	6.45	5.85
		30 percent of the excess over $50 plus—										
$50 and over		11.75	11.20	10.60	10.05	9.45	8.90	8.30	7.75	7.15	6.60	6.00

If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period and he is married—

And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least—	But less than—	The amount of income tax to be withheld shall be the following amount multiplied by the number of days in such periods—										
$0	$0.75	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$0.75	$1.00	.05	0	0	0	0	0	0	0	0	0	0
$1.00	$1.25	.10	0	0	0	0	0	0	0	0	0	0
$1.25	$1.50	.10	0	0	0	0	0	0	0	0	0	0
$1.50	$1.75	.15	0	0	0	0	0	0	0	0	0	0
$1.75	$2.00	.20	0	0	0	0	0	0	0	0	0	0
$2.00	$2.25	.20	0	0	0	0	0	0	0	0	0	0
$2.25	$2.50	.25	0	0	0	0	0	0	0	0	0	0
$2.50	$2.75	.30	0	0	0	0	0	0	0	0	0	0
$2.75	$3.00	.35	.05	0	0	0	0	0	0	0	0	0
$3.00	$3.25	.35	.10	0	0	0	0	0	0	0	0	0
$3.25	$3.50	.40	.15	0	0	0	0	0	0	0	0	0
$3.50	$3.75	.45	.15	0	0	0	0	0	0	0	0	0
$3.75	$4.00	.45	.20	0	0	0	0	0	0	0	0	0
$4.00	$4.25	.50	.25	0	0	0	0	0	0	0	0	0
$4.25	$4.50	.55	.25	0	0	0	0	0	0	0	0	0
$4.50	$4.75	.60	.30	.05	0	0	0	0	0	0	0	0
$4.75	$5.00	.60	.35	.05	0	0	0	0	0	0	0	0
$5.00	$5.25	.65	.35	.10	0	0	0	0	0	0	0	0
$5.25	$5.50	.70	.40	.15	0	0	0	0	0	0	0	0
$5.50	$5.75	.75	.45	.15	0	0	0	0	0	0	0	0
$5.75	$6.00	.75	.50	.20	0	0	0	0	0	0	0	0
$6.00	$6.25	.80	.50	.25	0	0	0	0	0	0	0	0
$6.25	$6.50	.85	.55	.30	0	0	0	0	0	0	0	0
$6.50	$6.75	.90	.60	.30	.05	0	0	0	0	0	0	0
$6.75	$7.00	.90	.65	.35	.10	0	0	0	0	0	0	0
$7.00	$7.25	.95	.65	.40	.10	0	0	0	0	0	0	0
$7.25	$7.50	1.00	.70	.40	.15	0	0	0	0	0	0	0
$7.50	$7.75	1.05	.75	.45	.20	0	0	0	0	0	0	0
$7.75	$8.00	1.05	.80	.50	.20	0	0	0	0	0	0	0
$8.00	$8.25	1.10	.80	.55	.25	0	0	0	0	0	0	0
$8.25	$8.50	1.15	.85	.55	.30	0	0	0	0	0	0	0

If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period and he is married—

And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least—	But less than—	The amount of income tax to be withheld shall be the following amount multiplied by the number of days in such periods—										
$8.50	$8.75	$1.20	$.90	$.60	$.35	$.05	$0	$0	$0	$0	$0	$0
$8.75	$9.00	1.20	.95	.65	.35	.10	0	0	0	0	0	0
$9.00	$9.25	1.25	.95	.70	.40	.15	0	0	0	0	0	0
$9.25	$9.50	1.30	1.00	.70	.45	.15	0	0	0	0	0	0
$9.50	$9.75	1.35	1.05	.75	.45	.20	0	0	0	0	0	0
$9.75	$10.00	1.35	1.10	.80	.50	.25	0	0	0	0	0	0
$10.00	$10.50	1.45	1.15	.85	.55	.30	0	0	0	0	0	0
$10.50	$11.00	1.50	1.20	.95	.65	.35	.10	0	0	0	0	0
$11.00	$11.50	1.60	1.30	1.00	.70	.45	.15	0	0	0	0	0
$11.50	$12.00	1.65	1.35	1.10	.80	.50	.25	0	0	0	0	0
$12.00	$12.50	1.75	1.45	1.15	.85	.60	.30	.05	0	0	0	0
$12.50	$13.00	1.80	1.50	1.25	.95	.65	.35	.10	0	0	0	0
$13.00	$13.50	1.90	1.60	1.30	1.00	.75	.45	.15	0	0	0	0
$13.50	$14.00	2.00	1.65	1.40	1.10	.80	.50	.25	0	0	0	0
$14.00	$14.50	2.05	1.75	1.45	1.15	.90	.60	.30	.05	0	0	0
$14.50	$15.00	2.15	1.85	1.55	1.25	.95	.65	.40	.10	0	0	0
$15.00	$15.50	2.25	1.90	1.60	1.30	1.05	.75	.45	.20	0	0	0
$15.50	$16.00	2.35	2.00	1.70	1.40	1.10	.80	.55	.25	0	0	0
$16.00	$16.50	2.40	2.10	1.75	1.45	1.20	.90	.60	.30	.05	0	0
$16.50	$17.00	2.50	2.15	1.85	1.55	1.25	.95	.70	.40	.10	0	0
$17.00	$17.50	2.60	2.25	1.95	1.60	1.35	1.05	.75	.45	.20	0	0
$17.50	$18.00	2.65	2.35	2.00	1.70	1.40	1.10	.85	.55	.25	0	0
$18.00	$18.50	2.75	2.45	2.10	1.75	1.50	1.20	.90	.60	.35	.05	0
$18.50	$19.00	2.85	2.50	2.20	1.85	1.55	1.25	1.00	.70	.40	.15	0
$19.00	$19.50	2.90	2.60	2.25	1.95	1.65	1.35	1.05	.75	.50	.20	0
$19.50	$20.00	3.00	2.70	2.35	2.05	1.70	1.40	1.15	.85	.55	.25	0
$20.00	$21.00	3.15	2.80	2.50	2.15	1.85	1.55	1.25	.95	.65	.40	.10
$21.00	$22.00	3.30	3.00	2.65	2.35	2.00	1.70	1.40	1.10	.80	.55	.25
$22.00	$23.00	3.45	3.15	2.80	2.50	2.15	1.85	1.55	1.25	.95	.70	.40
$23.00	$24.00	3.65	3.30	3.00	2.65	2.35	2.00	1.70	1.40	1.10	.85	.55
$24.00	$25.00	3.85	3.50	3.15	2.85	2.50	2.20	1.85	1.55	1.25	1.00	.70
$25.00	$26.00	4.05	3.65	3.35	3.00	2.70	2.35	2.05	1.70	1.40	1.15	.85
$26.00	$27.00	4.25	3.85	3.50	3.20	2.85	2.50	2.20	1.85	1.55	1.30	1.00
$27.00	$28.00	4.45	4.05	3.65	3.35	3.00	2.70	2.35	2.05	1.70	1.45	1.15
$28.00	$29.00	4.65	4.25	3.85	3.50	3.20	2.85	2.55	2.20	1.90	1.60	1.30
$29.00	$30.00	4.85	4.45	4.05	3.70	3.35	3.05	2.70	2.40	2.05	1.75	1.45
$30.00	$31.00	5.05	4.65	4.25	3.90	3.55	3.20	2.90	2.55	2.25	1.90	1.60
$31.00	$32.00	5.25	4.85	4.45	4.10	3.70	3.35	3.05	2.70	2.40	2.05	1.75
$32.00	$33.00	5.45	5.05	4.65	4.30	3.90	3.55	3.20	2.90	2.55	2.25	1.90
$33.00	$34.00	5.65	5.25	4.85	4.50	4.10	3.70	3.40	3.05	2.75	2.40	2.10
$34.00	$35.00	5.85	5.45	5.05	4.70	4.30	3.90	3.55	3.25	2.90	2.60	2.25
$35.00	$36.00	6.05	5.65	5.25	4.90	4.50	4.10	3.75	3.40	3.10	2.75	2.40
$36.00	$37.00	6.25	5.85	5.45	5.10	4.70	4.30	3.90	3.55	3.25	2.90	2.60
$37.00	$38.00	6.45	6.05	5.65	5.30	4.90	4.50	4.10	3.75	3.40	3.10	2.75
$38.00	$39.00	6.65	6.25	5.85	5.50	5.10	4.70	4.30	3.95	3.60	3.25	2.95
$39.00	$40.00	6.85	6.45	6.05	5.70	5.30	4.90	4.50	4.15	3.75	3.45	3.10
$40.00	$41.00	7.05	6.65	6.25	5.90	5.50	5.10	4.70	4.35	3.95	3.60	3.25
$41.00	$42.00	7.25	6.85	6.45	6.10	5.70	5.30	4.90	4.55	4.15	3.75	3.45
$42.00	$43.00	7.45	7.05	6.65	6.30	5.90	5.50	5.10	4.75	4.35	3.95	3.60
$43.00	$44.00	7.65	7.25	6.85	6.50	6.10	5.70	5.30	4.95	4.55	4.15	3.80
$44.00	$45.00	7.85	7.45	7.05	6.70	6.30	5.90	5.50	5.15	4.75	4.35	4.00
$45.00	$46.00	8.05	7.65	7.25	6.90	6.50	6.10	5.70	5.35	4.95	4.55	4.20
$46.00	$47.00	8.25	7.85	7.45	7.10	6.70	6.30	5.90	5.55	5.15	4.75	4.40
$47.00	$48.00	8.45	8.05	7.65	7.30	6.90	6.50	6.10	5.75	5.35	4.95	4.60
$48.00	$49.00	8.65	8.25	7.85	7.50	7.10	6.70	6.30	5.95	5.55	5.15	4.80
$49.00	$50.00	8.90	8.45	8.05	7.70	7.30	6.90	6.50	6.15	5.75	5.35	5.00
$50.00	$51.00	9.15	8.65	8.25	7.90	7.50	7.10	6.70	6.35	5.95	5.55	5.20
$51.00	$52.00	9.40	8.90	8.45	8.10	7.70	7.30	6.90	6.55	6.15	5.75	5.40
$52.00	$53.00	9.65	9.15	8.65	8.30	7.90	7.50	7.10	6.75	6.35	5.95	5.60
$53.00	$54.00	9.90	9.40	8.90	8.50	8.10	7.70	7.30	6.95	6.55	6.15	5.80
$54.00	$55.00	10.15	9.65	9.15	8.70	8.30	7.90	7.50	7.15	6.75	6.35	6.00
$55.00	$56.00	10.40	9.90	9.40	8.95	8.50	8.10	7.70	7.35	6.95	6.55	6.20
$56.00	$57.00	10.65	10.15	9.65	9.20	8.70	8.30	7.90	7.55	7.15	6.75	6.40
$57.00	$58.00	10.90	10.40	9.90	9.45	8.95	8.50	8.10	7.75	7.35	6.95	6.60
$58.00	$59.00	11.15	10.65	10.15	9.70	9.20	8.75	8.30	7.95	7.55	7.15	6.80
$59.00	$60.00	11.40	10.90	10.40	9.95	9.45	9.00	8.50	8.15	7.75	7.35	7.00
$60.00	$61.00	11.65	11.15	10.65	10.20	9.70	9.25	8.75	8.35	7.95	7.55	7.20
$61.00	$62.00	11.95	11.40	10.90	10.45	9.95	9.50	9.00	8.55	8.15	7.75	7.40
$62.00	$63.00	12.25	11.65	11.15	10.70	10.20	9.75	9.25	8.75	8.35	7.95	7.60
$63.00	$64.00	12.55	11.95	11.40	10.95	10.45	10.00	9.50	9.00	8.55	8.15	7.80
$64.00	$65.00	12.85	12.25	11.70	11.20	10.70	10.25	9.75	9.25	8.80	8.35	8.00

And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least—	But less than—	The amount of income tax to be withheld shall be the following amount multiplied by the number of days in such periods—										
$65.00	$66.00	13.15	12.55	12.00	11.45	10.95	10.50	10.00	9.50	9.05	8.55	8.20
$66.00	$67.00	13.45	12.85	12.30	11.70	11.20	10.75	10.25	9.75	9.30	8.80	8.40
$67.00	$68.00	13.75	13.15	12.60	12.00	11.45	11.00	10.50	10.00	9.55	9.05	8.60
$68.00	$69.00	14.05	13.45	12.90	12.30	11.75	11.25	10.75	10.25	9.80	9.30	8.85
$69.00	$70.00	14.35	13.75	13.20	12.60	12.05	11.50	11.00	10.50	10.05	9.55	9.10
$70.00	$71.00	14.65	14.05	13.50	12.90	12.35	11.75	11.25	10.75	10.30	9.80	9.35
$71.00	$72.00	14.95	14.35	13.80	13.20	12.65	12.05	11.50	11.00	10.55	10.05	9.60
$72.00	$73.00	15.25	14.65	14.10	13.50	12.95	12.35	11.80	11.25	10.80	10.30	9.85
$73.00	$74.00	15.55	14.95	14.40	13.80	13.25	12.65	12.10	11.50	11.05	10.55	10.10
$74.00	$75.00	15.85	15.25	14.70	14.10	13.55	12.95	12.40	11.80	11.30	10.80	10.35
$75.00	$76.00	16.15	15.55	15.00	14.40	13.85	13.25	12.70	12.10	11.55	11.05	10.60
$76.00	$77.00	16.45	15.85	15.30	14.70	14.15	13.55	13.00	12.40	11.85	11.30	10.85
$77.00	$78.00	16.75	16.15	15.60	15.00	14.45	13.85	13.30	12.70	12.15	11.55	11.10
$78.00	$79.00	17.05	16.45	15.90	15.30	14.75	14.15	13.60	13.00	12.45	11.85	11.35
$79.00	$80.00	17.35	16.75	16.20	15.60	15.05	14.45	13.90	13.30	12.75	12.15	11.60
		30 percent of the excess over $80 plus—										
$80 and over		17.50	16.90	16.35	15.75	15.20	14.60	14.05	13.45	12.90	12.30	11.75"

(d) DISCLOSURE OF MARITAL STATUS; DETERMINATION OF MARITAL STATUS; TREATMENT OF SURVIVING SPOUSE.—Section 3402 (relating to income tax collected at source) is amended by adding at the end thereof the following new subsection:

(l) DETERMINATION AND DISCLOSURE OF MARITAL STATUS.—

(1) DETERMINATION OF STATUS BY EMPLOYER.—For purposes of applying the tables in subsections (a) and (c) to a payment of wages, the employer shall treat the employee as a single person unless there is in effect with respect to such payment of wages a withholding exemption certificate furnished to the employer by the employee after the date of the enactment of this subsection indicating that the employee is married.

(2) DISCLOSURE OF STATUS BY EMPLOYEE.—An employee shall be entitled to furnish the employer with a withholding exemption certificate indicating he is married only if, on the day of such furnishing, he is married (determined with the application of the rules in paragraph (3)). An employee whose marital status changes from married to single shall, at such time as the Secretary or his delegate may by regulations prescribe, furnish the employer with a new withholding exemption certificate.

(3) DETERMINATION OF MARITAL STATUS.—For purposes of paragraph (2), an employee shall on any day be considered—

(A) as not married, if (i) he is legally separated from his spouse under a decree of divorce or separate maintenance, or (ii) either he or his spouse is, or on any preceding day within the calendar year was, a nonresident alien; or

(B) as married, if (i) his spouse (other than a spouse referred to in subparagraph (A)) died within the portion of his taxable year which precedes such day, or (ii) his spouse died during one of the two taxable years immediately preceding the current taxable year and, on the basis of facts existing at the beginning of such day, the employee reasonably expects, at the close of his taxable year, to be a surviving spouse (as defined in section 2(b)).

(e) WITHHOLDING ALLOWANCES FOR ITEMIZED DEDUCTIONS.—

(1) ALLOWANCE.—Section 3402(f)(1) relating to withholding exemptions) is amended—

(A) by striking out "and" at the end of subparagraph (D),

(B) by striking out the period at the end of subparagraph (E) and inserting in lieu thereof "; and", and

(C) by adding at the end thereof the following new subparagraph:

(F) any allowance to which he is entitled under subsection (m), but only if his spouse does not have in effect a withholding exemption certificate claiming such allowance.

(2) WITHHOLDING ALLOWANCES BASED ON ITEMIZED DEDUCTIONS.—Section 3402 (relating to income tax collected at source) is amended by adding at the end thereof the following new subsection:

(m) WITHHOLDING ALLOWANCES BASED ON ITEMIZED DEDUCTIONS.—

(1) GENERAL RULE.—An employee shall be entitled to withholding allowances under this subsection with respect to a payment of wages in a number equal to the number determined by dividing by $700 the excess of—

(A) his estimated itemized deductions, over

(B) an amount equal to the sum of 10 percent of the first $7,500 of his estimated wages and 17 percent of the remainder of his estimated wages.

For purposes of this subsection, fractional numbers shall not be taken into account.

(2) DEFINITIONS.—For purposes of this subsection—

(A) ESTIMATED ITEMIZED DEDUCTIONS.—The term "estimated itemized deductions" means the aggregate amount which he reasonably expects will be allowable as deductions under chapter 1 (other than the deductions referred to in sections 141 and 151 and other than the deductions required to be taken into account in determining adjusted gross income under section 62) for the estimation year. In no case shall such aggregate amount be greater than (i) the amount of such deductions shown on his return of tax under subtitle A for the taxable year preceding the estimation year, or (ii) in the case of an employee who did not show such deductions on his return for such preceding taxable year, an amount equal to the lesser of $1,000 or 10 percent of the wages shown on his return for such preceding taxable year.

(B) ESTIMATED WAGES.—The term "estimated wages" means the aggregate amount which he reasonably expects will constitute wages for the estimation year. In no case shall such aggregate amount be less than the amount of wages shown on his return for the taxable year preceding the estimation year.

(C) ESTIMATION YEAR.—In the case of an employee who files his return on the basis of a calendar year, the term "estimation year" means—

(i) with respect to payments of wages after April 30 and on or before December 31 of any calendar year, such calendar year, and

(ii) with respect to payments of wages on or after January 1 and before May 1 of any calendar year, the preceding calendar year (except that with respect to an exemption certificate furnished by an employee after he has filed his return for the preceding calendar year, such term means the current calendar year).

In the case of an employee who files his return on a basis other than the calendar year, his estimation year, and the amounts deducted and withheld to be governed by such estimation year, shall be determined under regulations prescribed by the Secretary or his delegate.

(3) SPECIAL RULES.—

(A) MARRIED INDIVIDUALS.—The number of withholding allowances to which a husband and wife are entitled under this subsection shall be

determined on the basis of their combined wages and deductions. This subparagraph shall not apply to a husband and wife who filed separate returns for the taxable year preceding the estimation year and who reasonably expect to file separate returns for the estimation year.

(B) ONLY ONE CERTIFICATE TO BE IN EFFECT.—In the case of any employee, withholding allowances under this subsection may not be claimed with more than one employer at any one time.

(C) TERMINATION OF EFFECTIVENESS.—In the case of an employee who files his return on the basis of a calendar year, that portion of a withholding exemption certificate which relates to allowances under this subsection shall not be effective with respect to payments of wages after the first April 30 following the close of the estimation year on which it is based.

(D) LIMITATION.—In the case of employees whose estimated wages are at levels at which the amounts deducted and withheld under this chapter generally are insufficient (taking into account a reasonable allowance for deductions and exemptions) to offset the liability for tax under chapter 1 with respect to the wages from which such amounts are deducted and withheld, the Secretary or his delegate may by regulation reduce the withholding allowances to which such employees would, but for this subparagraph, be entitled under this subsection.

(E) TREATMENT OF ALLOWANCES.—For purposes of this title, any withholding allowance under this subsection shall be treated as if it were denominated a withholding exemption.

(4) AUTHORITY TO PRESCRIBE TABLES.—The Secretary or his delegate may prescribe tables pursuant to which employees shall determine the number of withholding allowances to which they are entitled under this subsection (in lieu of making such determination under paragraphs (1) and (3)). Such tables shall be consistent with the provisions of paragraphs (1) and (3), except that such tables—

(A) shall provide for entitlement to withholding allowances based on reasonable wage and itemized deduction brackets, and

(B) may increase or decrease the number of withholding allowances to which employees in the various wage and itemized deduction brackets would, but for this subparagraph, be entitled to the end that, to the extent practicable, amounts deducted and withheld under this chapter (i) generally do not exceed the liability for tax under chapter 1 with respect to the wages from which such amounts are deducted and withheld, and (ii) generally are sufficient to offset such liability for tax.

(3) STATUS DETERMINATION DATE.—The last sentence of section 3402(f) (3) (B) is amended to read as follows: "For purposes of this subparagraph, the term 'status determination date' means January 1, May 1, July 1, and October 1 of each year."

(4) CIVIL PENALTY.—

(A) Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new section:

SEC. 6682. FALSE INFORMATION WITH RESPECT TO WITHHOLDING ALLOWANCES BASED ON ITEMIZED DEDUCTIONS.

(a) CIVIL PENALTY.—In addition to any criminal penalty provided by law, if any individual in claiming a withholding allowance under section 3402(f) (1) (F) states (1) as the amount of the wages (within the meaning of chapter 24) shown on his return for any taxable year an amount less than such wages actually shown, or (2) as the amount of the itemized deductions referred to in section 3402(m) shown on the return for any taxable year an amount greater than such deductions actually shown, he shall pay a penalty of $50 for such statement, unless (1) such statement did not result in a decrease in the amounts deducted and withheld under chapter 24, or (2) the taxes imposed with respect to the individual under subtitle A for the succeeding taxable year do not exceed the sum of (A) the credits against such taxes allowed by part IV of subchapter A of chapter 1, and (B) the payments of estimated tax which are considered payments on account of such taxes.

(b) DEFICIENCY PROCEDURES NOT TO APPLY.—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, and gift taxes) shall not apply in respect of the assessment or collection of any penalty imposed by subsection (a).

(B) The table of sections of such subchapter B is amended by adding at the end thereof the following:

Sec. 6682. False information with respect to withholding allowances based on itemized deductions.

(5) CRIMINAL PENALTY.—Section 7205 (relating to fraudulent withholding exemption certificate or failure to supply information) is amended—

(A) by striking out "section 3402(f)" and inserting in lieu thereof "section 3402", and

(B) by striking out "any penalty otherwise provided" and inserting in lieu thereof "any other penalty provided by law (except the penalty provided by section 6682)".

(6) EFFECTIVE DATE.—The amendments made by paragraphs (1) and (2) of this subsection shall apply only with respect to remuneration paid after December 31, 1966, but only with respect to withholding exemptions based on estimation years beginning after such date.

(f) TRANSITIONAL DETERMINATION STATUS DATE.—Notwithstanding section 3402(f)(3)(B) of the Internal Revenue Code of 1954, a withholding exemption certificate furnished the employer after the date of the enactment of this Act and before May 1, 1966, shall take effect with respect to the first payment of wages made on or after May 1, 1966, or the 10th day after the date on which such certificate is furnished to the employer, whichever is later, and at the election of the employer such certificate may be made effective with respect to any payment of wages made on or after the date on which such certificate is furnished.

(g) EFFECTIVE DATE.—The amendments made by this section (other than subsection (e)) shall apply only with respect to remuneration paid after April 30, 1966.

SEC. 102. ESTIMATED TAX IN CASE OF INDIVIDUALS.

(a) INCLUSION OF SELF-EMPLOYMENT TAX IN ESTIMATED TAX.—Section 6015(c) (relating to definition of estimated tax in the case of an individual) is amended to read as follows:

(c) ESTIMATED TAX.—For purposes of this title, in the case of an individual, the term "estimated tax" means—

(1) the amount which the individual estimates as the amount of the income tax imposed by chapter 1 for the taxable year, plus

(2) the amount which the individual estimates as the amount of the self-employment tax imposed by chapter 2 for the taxable year, minus

(3) the amount which the individual estimates as the sum of any credits against tax provided by part IV of subchapter A of chapter 1.

(b) ADDITION TO TAX FOR UNDERPAYMENT OF ESTIMATED TAX.—

(1) Section 6654(a) (relating to addition to the tax for underpayment of estimated tax by an individual) is amended by inserting after "chapter 1" the following: "and the tax under chapter 2".

(2) Section 6654(d) is amended to read as follows:

(d) EXCEPTION.—Notwithstanding the provisions of the preceding subsections, the addition to the tax with respect to any underpayment of any installment shall

not be imposed if the total amount of all payments of estimated tax made on or before the last date prescribed for the payment of such installment equals or exceeds the amount which would have been required to be paid on or before such date if the estimated tax were whichever of the following is the least—

(1) The tax shown on the return of the individual for the preceding taxable year, if a return showing a liability for tax was filed by the individual for the preceding taxable year and such preceding year was a taxable year of 12 months.

(2) An amount equal to 70 percent (66⅔ percent in the case of individuals referred to in section 6073(b), relating to income from farming or fishing) of the tax for the taxable year computed by placing on an annualized basis the taxable income for the months in the taxable year ending before the month in which the installment is required to be paid and by taking into account the adjusted self-employment income (if the net earnings from self-employment (as defined in section 1402(a)) for the taxable year equal or exceed $400). For purposes of this paragraph—

(A) The taxable income shall be placed on an annualized basis by—

(i) multiplying by 12 (or, in the case of a taxable year of less than 12 months, the number of months in the taxable year) the taxable income (computed without deduction of personal exemptions) for the months in the taxable year ending before the month in which the installment is required to be paid,

(ii) dividing the resulting amount by the number of months in the taxable year ending before the month in which such installment date falls, and

(iii) deducting from such amount the deductions for personal exemptions allowable for the taxable year (such personal exemptions being determined as of the last date prescribed for payment of the installment).

(B) The term "adjusted self-employment income" means—

(i) the net earnings from self-employment (as defined in section 1402(a)) for the months in the taxable year ending before the month in which the installment is required to be paid, but not more than

(ii) the excess of $6,600 over the amount determined by placing the wages (within the meaning of section 1402(b)) for the months in the taxable year ending before the month in which the installment is required to be paid on an annualized basis in a manner consistent with clauses (i) and (ii) of subparagraph (A).

(3) An amount equal to 90 percent of the tax computed, at the rates applicable to the taxable year, on the basis of the actual taxable income and the actual self-employment income for the months in the taxable year ending before the month in which the installment is required to be paid as if such months constituted the taxable year.

(4) An amount equal to the tax computed, at the rates applicable to the taxable year, on the basis of the taxpayer's status with respect to personal exemptions under section 151 for the taxable year, but otherwise on the basis of the facts shown on his return for, and the law applicable to, the preceding taxable year.

(3) Section 6654(f) (relating to definition of tax for purposes of subsections (b) and (d) of section 6654) is amended to read as follows:

(f) TAX COMPUTED AFTER APPLICATION OF CREDITS AGAINST TAX.—For purposes of subsections (b) and (d), the term "tax" means—

(1) the tax imposed by this chapter 1, plus

(2) the tax imposed by chapter 2, minus

(3) the credits against tax allowed by part IV of subchapter A of chapter 1, other than the credit against tax provided by section 31 (relating to tax withheld on wages).

(4) Section 6211(b)(1) (relating to definition of a deficiency) is amended by striking out "chapter 1" and inserting in lieu thereof "subtitle A".

(5) Section 7701(a) (relating to definitions) is amended by adding at the end thereof the following new paragraph:

(34) ESTIMATED INCOME TAX.—The term "estimated income tax" means—
(A) in the case of an individual, the estimated tax as defined in section 6015(c), or
(B) in the case of a corporation, the estimated tax as defined in section 6016(b).

(6) Section 1403(b) (cross references) is amended by adding at the end thereof the following new paragraph:

(3) For provisions relating to declarations of estimated tax on self-employment income, see section 6015.

(c) MINISTERS, MEMBERS OF RELIGIOUS ORDERS, AND CHRISTIAN SCIENCE PRACTITIONERS.—Section 1402(e)(3) (relating to effective date of waiver certificates) is amended by adding at the end thereof the following new subparagraph:

(E) For purposes of sections 6015 and 6654, a waiver certificate described in paragraph (1) shall be treated as taking effect on the first day of the first taxable year beginning after the date on which such certificate is filed.

(d) EFFECTIVE DATE.—The amendments made by subsections (a), (b), and (c) shall apply with respect to taxable years beginning after December 31, 1966.

SEC. 103. UNDERPAYMENT OF INSTALLMENTS OF ESTIMATED INCOME TAX IN CASE OF INDIVIDUALS.

(a) IN GENERAL.—Section 6654(b) (relating to amount of underpayment), and section 6654(d) (relating to exception) as amended by section 102(b)(2) of this Act, are amended by striking out "70 percent" each place it appears and inserting in lieu thereof "80 percent".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply with respect to taxable years beginning after December 31, 1966.

SEC. 104. INSTALLMENT PAYMENTS OF ESTIMATED INCOME TAX BY CORPORATIONS.

(a) IN GENERAL.—Subsection (a) of section 6154 (relating to installment payments of estimated income tax by corporations) is amended to read as follows:

(a) AMOUNT AND TIME FOR PAYMENT OF EACH INSTALLMENT.—The amount of estimated tax (as defined in section 6016(b)) with respect to which a declaration is required under section 6016 shall be paid as follows:
(1) TAXABLE YEARS BEGINNING IN 1966.—With respect to taxable years beginning after December 31, 1965, and before January 1, 1967, such estimated tax shall be paid in installments in accordance with the following table:

If the declaration is timely filed on or before the 15th day of the—	The following percentages of the estimated tax shall be paid on the 15th day of the—			
	4th month	6th month	9th month	12th month
4th month of the taxable year	12	12	25	25
6th month of the taxable year (but after the 15th day of the 4th month)	------	16	29	29
9th month of the taxable year (but after the 15th day of the 6th month)	------	------	37	37
12th month of the taxable year (but after the 15th day of the 9th month)	------	------	------	74

(2) TAXABLE YEARS BEGINNING AFTER 1966.—With respect to taxable years beginning after December 31, 1966, such estimated tax shall be paid in installments in accordance with the following table:

If the declaration is timely filed on or before the 15th day of the—	The following percentages of the estimated tax shall be paid on the 15th day of the—			
	4th month	6th month	9th month	12th month
4th month of the taxable year	25	25	25	25
6th month of the taxable year (but after the 15th day of the 4th month)	------	33⅓	33⅓	33⅓
9th month of the taxable year (but after the 15th day of the 6th month)	------	------	50	50
12th month of the taxable year (but after the 15th day of the 9th month)	------	------	------	100

(3) TIMELY FILING.—A declaration is timely filed for the purposes of paragraphs (1) and (2) if it is not required by section 6074(a) to be filed on a date (determined without regard to any extension of time for filing the declaration under section 6081) before the date it is actually filed.

(4) LATE FILING.—If the declaration is filed after the time prescribed in section 6074(a) (determined without regard to any extension of time for filing the declaration under section 6081), there shall be paid at the time of such filing all installments of estimated tax which would have been payable on or before such time if the declaration had been filed within the time prescribed in section 6074(a), and the remaining installments shall be paid at the times at which, and in the amounts in which, they would have been payable if the declaration had been so filed.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to taxable years beginning after December 31, 1965.

TITLE II—POSTPONEMENT OF CERTAIN EXCISE TAX RATE REDUCTIONS

SEC. 201. PASSENGER AUTOMOBILES.

(a) POSTPONEMENT OF RATE REDUCTIONS.—Subparagraph (A) of section 4061(a)(2) (relating to imposition of tax) is amended to read as follows:

> (A) Articles enumerated in subparagraph (B) are taxable at whichever of the following rates is applicable:
>
> 7 percent for the period beginning with the day after the date of the enactment of the Tax Adjustment Act of 1966, through March 31, 1968.

2 percent for the period April 1, 1968, through December 31, 1968.
1 percent for the period after December 31, 1968.

(b) CONFORMING AMENDMENT.—Section 6412(a)(1) (relating to floor stocks refunds on passenger automobiles, etc.) is amended by striking out "January 1, 1966, 1967, 1968, or 1969," and inserting in lieu thereof "January 1, 1966, April 1, 1968, or January 1, 1969,".

(c) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to articles sold after the date of the enactment of this Act.

SEC. 202. COMMUNICATION SERVICES.

(a) POSTPONEMENT OF RATE REDUCTIONS.—Section 4251 (relating to tax on communications) is amended—

(1) By striking out subsection (a)(2) and inserting in lieu thereof:

(2) The rate of tax referred to in paragraph (1) is as follows:

Amounts paid pursuant to bills first rendered—	Percent—
Before April 1, 1968	10
After March 31, 1968, and before January 1, 1969	1

(2) By striking out subsection (c) and inserting in lieu thereof:

(c) SPECIAL RULE.—For purposes of subsection (a), in the case of communications services rendered before February 1, 1968, for which a bill has not been rendered before April 1, 1968, a bill shall be treated as having been first rendered on March 31, 1968. For purposes of subsections (a) and (b), in the case of communications services rendered after January 31, 1968, and before November 1, 1968, for which a bill has not been rendered before January 1, 1969, a bill shall be treated as having been first rendered on December 31, 1968.

(b) NONPROFIT HOSPITALS.—Section 4253 (relating to exemptions from tax on communications) is amended by adding at the end thereof the following new subsection:

(h) NONPROFIT HOSPITALS.—No tax shall be imposed under section 4251 on any amount paid by a nonprofit hospital for services furnished to such organization. For purposes of this subsection, the term "nonprofit hospital" means a hospital referred to in section 503(b)(5) which is exempt from income tax under section 501(a).

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to amounts paid pursuant to bills first rendered on or after April 1, 1966, for services rendered on or after such date. In the case of amounts paid pursuant to bills rendered on or after such date for services which were rendered before such date and for which no previous bill was rendered, such amendments shall apply except with respect to such services as were rendered more than 2 months before such date. In the case of services rendered more than 2 months before such date, the provisions of subchapter B of chapter 33 of the Code in effect at the time such services were rendered, subject to the provision of section 701(b)(2) of the Excise Tax Reduction Act of 1965, shall apply to the amounts paid for such services.

TITLE III—MISCELLANEOUS PROVISIONS

SEC. 301. DISALLOWANCE OF DEDUCTION FOR CERTAIN INDIRECT CONTRIBUTIONS TO POLITICAL PARTIES.

(a) DISALLOWANCE.—Part IX of subchapter B of chapter 1 (relating to items not deductible) is amended by adding at the end thereof the following new section:

SEC. 276. CERTAIN INDIRECT CONTRIBUTIONS TO POLITICAL PARTIES.

(a) DISALLOWANCE OF DEDUCTION.—No deduction otherwise allowable under this chapter shall be allowed for any amount paid or incurred for—

(1) advertising in a convention program of a politcal party, or in any other publication if any part of the proceeds of such publication directly or indirectly inures (or is intended to inure) to or for the use of a political party or a political candidate,

(2) admission to any dinner or program, if any part of the proceeds of such dinner or program directly or indirectly inures (or is intended to inure) to or for the use of a political party or a political candidate, or

(3) admission to an inaugural ball, inaugural gala, inaugural parade, or inaugural concert, or to any similar event which is identified with a political party or a political candidate.

(b) DEFINITIONS.—For purposes of this section—

(1) POLITICAL PARTY.—The term "political party" means—

(A) a political party;

(B) a National, State, or local committee of a political party; or

(C) a committee, association, or organization, whether incorporated or not, which directly or indirectly accepts contributions (as defined in section 271(b)(2)) or make expenditures (as defined in section 271(b)(3)) for the purpose of influencing or attempting to influence the selection, nomination, or election of any individual to any Federal, State, or local elective public office, or the election of presidential and vice-presidential electors, whether or not such individual or electors are selected, nominated, or elected.

(2) PROCEEDS INURING TO OR FOR THE USE OF POLITICAL CANDIDATES.—Proceeds shall be treated as inuring to or for the use of a political candidate only if—

(A) such proceeds may be used directly or indirectly for the purpose of furthering his candidacy for selection, nomination, or election to any elective public office, and

(B) such proceeds are not received by such candidate in the ordinary course of a trade or business (other than the trade or business of holding elective public office).

(c) CROSS REFERENCE.—

For disallowace of certain entertainment, etc., expenses, see section 274.

(b) CLERICAL AMENDMENT.—The table of sections for such part IX is amended by adding at the end thereof the following new item:

Sec. 276. Certain indirect contributions to political parties.

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after December 31, 1965, but only with respect to amounts paid or incurred after the date of the enactment of this Act.

SEC. 302. BENEFITS AT AGE 72 FOR CERTAIN UNINSURED INDIVIDUALS.

(a) MONTHLY BENEFITS.—Title II of the Social Security Act is amended by adding at the end thereof the following new section:

BENEFITS AT AGE 72 FOR CERTAIN UNINSURED INDIVIDUALS

Eligibility

Sec. 228. (a) Every individual who—

(1) has attained the age of 72,

(2) (A) attained such age before 1968, or (B) has not less than 3 quarters of coverage, whenever acquired, for each calendar year elapsing after 1966—and before the year in which he attained such age,

(3) is a resident of the United States (as defined in subsection (e)), and is (A) a citizen of the United States or (B) an alien lawfully admitted for permanent residence who has resided in the United States (as defined in

section 210(i)) continuously during the 5 years immediately preceding the month in which he files application under this section, and

(4) has filed application for benefits under this section,

shall (subject to the limitations in this section) be entitled to a benefit under this section for each month beginning with the first month after September 1966 in which he becomes so entitled to such benefits and ending with the month preceding the month in which he dies. No application under this section which is filed by an individual more than 3 months before the first month in which he meets the requirements of paragraphs (1), (2), and (3) shall be accepted as an application for purposes of this section.

Benefit Amount

(b)(1) Except as provided in paragraph (2), the benefit amount to which an individual is entitled under this section for any month shall be $35.

(2) If both husband and wife are entitled (or upon application would be entitled) to benefits under this section for any month, the amount of the husband's benefit for such month shall be $35 and the amount of the wife's benefit for such month shall be $17.50.

Reduction for Governmental Pension System Benefits

(c)(1) The benefit amount of any individual under this section for any month shall be reduced (but not below zero) by the amount of any periodic benefit under a govermental pension system for which he is eligible for such month.

(2) In the case of a husband and wife only one of whom is entitled to benefits under this section for any month, the benefit amount, after any reduction under paragraph (1), shall be further reduced (but not below zero) by the excess (if any) of (A) the total amount of any periodic benefits under governmental pension systems for which the spouse who is not entitled to benefits under this section is eligible for such month, over (B) $17.50.

(3) In the case of a husband and wife both of whom are entitled to benefits under this section for any month—

(A) the benefit amount of the wife, after any reduction under paragraph (1), shall be further reduced (but not below zero) by the excess (if any) of (i) the total amount of any periodic benefits under governmental pension systems for which the husband is eligible for such month, over (ii) $35, and

(B) the benefit amount of the husband, after any reduction under paragraph (1), shall be further reduced (but not below zero) by the excess (if any) of (i) the total amount of any periodic benefits under governmental pension systems for which the wife is eligible for such month, over (ii) $17.50.

(4) For purposes of this subsection, in determining whether an individual is eligible for periodic benefits under a governmental pension system—

(A) such individual shall be deemed to have filed application for such benefits,

(B) to the extent that entitlement depends on an application by such individual's spouse, such spouse shall be deemed to have filed application, and

(C) to the extent that entitlement depends on such individual or his spouse having retired, such individual and his spouse shall be deemed to have retired before the month for which the determination of eligibility is being made.

(5) For purposes of this subsection, if any periodic benefit is payable on any basis other than a calendar month, the Secretary shall allocate the amount of such benefit to the appropriate calendar months.

(6) If, under the foregoing provisions of this section, the amount payable for any month would be less than $1, such amount shall be reduced to zero. In the case of a husband and wife both of whom are entitled to benefits under this section for the month, the preceding sentence shall be applied with respect to the aggregate amount so payable for such month.

(7) If any benefit amount computed under the foregoing provisions of this section is not a multiple of $0.10, it shall be raised to the next higher multiple of $0.10.

(8) Under regulations prescribed by the Secretary, benefit payments under this section to an individual (or aggregate benefit payments under this section in the case of a husband and wife) of less than $5 may be accumulated until they equal or exceed $5.

Suspension for Months in Which Cash Payments Are Made Under Public Assistance

(d) The benefit to which any individual is entitled under this section for any month shall not be paid for such month if—

(1) such individual receives aid or assistance in the form of money payments in such month under a State plan approved under title I, IV, X, XIV, or XVI, or

(2) such individual's husband or wife receives such aid or assistance in such month, and under the State plan the needs of such individual were taken into account in determining eligibility for (or amount of) such aid or assistance,

unless the State agency administering or supervising the administration of such plan notifies the Secretary, at such time and in such manner as may be prescribed in accordance with regulations of the Secretary, that such payments to such individual (or such individual's husband or wife) under such plan are being terminated with the payment or payments made in such month.

Suspension Where Individual Is Residing Outside the United States

(e) The benefit to which any individual is entitled under this section for any month shall not be paid if, during such month, such individual is not a resident of the United States. For purposes of this subsection the term "United States" means the 50 States and the District of Columbia.

Treatment as Monthly Insurance Benefits

(f) For purposes of subsections (t) and (u) of section 202, and of section 1840, a monthly benefit under this section shall be treated as a monthly insurance benefit payable under section 202.

Annual Reimbursement of Federal Old-Age and Survivors Insurance Trust Fund

(g) There are authorized to be appropriated to the Federal Old-Age and Survivors Insurance Trust Fund for the fiscal year ending June 30, 1969, and for each fiscal year thereafter, such sums as the Secretary of Health, Education, and Welfare deems necessary on account of—

(1) payments made under this section during the second preceding fiscal year and all fiscal years prior thereto to individuals who, as of the beginning of the calendar year in which falls the month for which payment was made, had less than 3 quarters of coverage.

(2) the additional administrative expenses resulting from the payments described in paragraph (1), and

(3) any loss in interest to such Trust Fund resulting from such payments and expenses.

in order to place such Trust Fund in the same position at the end of such fiscal year as it would have been in if such payments had not been made.

Definitions

(h) For purposes of this section—

(1) The term "quarter of coverage" includes a quarter of coverage as defined in section 5(1) of the Railroad Retirement Act of 1937.

(2) The term "governmental pension system" means the insurance system established by this title or any other system or fund established by the United States, a State, any political subdivision of a State, or any wholly owned instrumentality of any one or more of the foregoing which provides for payment of (A) pensions, (B) retirement or retired pay, or (C) annuities or similar amounts payable on account of personal services performed by any individual (not including any payment under any workmen's compensation law or any payment by the Veterans' Administration as compensation for service-connected disability or death).

(3) The term "periodic benefit" includes a benefit payable in a lump sum if it is a commutation of, or a substitute for, periodic payments.

(4) The determination of whether an individual is a husband or wife for any month shall be made under subsection (h) of section 216 without regard to subsections (b) and (f) of section 216.

(b) CERTAIN APPLICATIONS UNDER 1965 AMENDMENTS.—For purposes of paragraph (4) of section 228(a) of the Social Security Act (added by subsection (a) of this section), an application filed under section 103 of the Social Security Amendments of 1965 before July 1966 shall be regarded as an application under such section 228 and shall, for purposes of such paragraph and of the last sentence of such section 228(a), be deemed to have been filed in July 1966 unless the person by whom or on whose behalf such application was filed notifies the Secretary that he does not want such application so regarded.

SEC. 303. TEMPORARY DUTY-FREE ENTRY FOR GIFTS FROM MEMBERS OF ARMED FORCES IN COMBAT ZONES.

(a) GIFTS COSTING $50 OR LESS.—Subpart B of part 1 of the appendix to the Tariff Schedules of the United States (19 U.S.C. 1202) is amended by inserting after item 915.20 the following new item:

915.25	Articles constituting a bona fide gift from a member of the Armed Forces of the United States serving in a combat zone (within the meaning of section 112(c) of the Internal Revenue Code of 1954) to the extent such articles in any shipment do not exceed $50 in aggregate retail value in the country of shipment and with such limitations on the importation of alcoholic beverages and tobacco products as the Secretary of the Treasury may prescribe, if such articles were purchased in or through authorized agencies of the Armed Forces of the United States or in accordance with regulations prescribed by the Secretary of Defense	Free (see headnote 2 of this subpart)	Free (see headnote 2 of this subpart)	On or before 12/31/67

(b) CLERICAL AMENDMENT.—Headnote 2 for subpart B of part 1 of such appendix is amended by striking out "item 915.20" and inserting in lieu thereof "items 915.20 and 915.25".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to articles entered, or withdrawn from warehouse, for consumption after the date of the enactment of this Act.

Approved March 15, 1966, 8:15 p.m.

PUBLIC LAW 89-384
EIGHTY-NINTH CONGRESS, APRIL 8, 1966
H.R. 6319 [1]

An Act to amend the Internal Revenue Code of 1954 to provide for treatment of the recovery of losses arising from expropriation, intervention, or confiscation of properties by governments of foreign countries, and to amend title XVIII of the Social Security Act to extend the initial enrollment period for supplementary medical insurance benefits.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.

SECTION 1. RECOVERIES OF FOREIGN EXPROPRIATION LOSSES.

(a) Subchapter Q of chapter 1 of the Internal Revenue Code of 1954 (relating to readjustment of tax between years) is amended by adding at the end thereof the following new part:

PART VII—RECOVERIES OF FOREIGN EXPROPRIATION LOSSES

Sec. 1351. Treatment of recoveries of foreign expropriation losses.

Sec. 1351. Treatment of Recoveries of Foreign Expropriation Losses.

(a) ELECTION.—

(1) IN GENERAL.—This section shall apply only to a recovery, by a domestic corporation subject to the tax imposed by section 11 or 802, of a foreign expropriation loss sustained by such corporation and only if such corporation was subject to the tax imposed by section 11 or 802, as the case may be, for the year of the loss and elects to have the provisions of this section apply with respect to such loss.

(2) TIME, MANNER, AND SCOPE.—An election under paragraph (1) shall be made at such time and in such manner as the Secretary or his delegate may prescribe by regulations. An election made with respect to any foreign expropriation loss shall apply to all recoveries in respect of such loss.

(b) DEFINITION OF FOREIGN EXPROPRIATION LOSS.—For purposes of this section, the term "foreign expropriation loss" means any loss sustained by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing. For purposes of the preceding sentence, a debt which becomes worthless shall, to the extent of any deduction allowed under section 166(a), be treated as a loss.

(c) AMOUNT OF RECOVERY.—

(1) GENERAL RULE.—The amount of any recovery of a foreign expropriation loss is the amount of money and the fair market value of other property received in respect of such loss, determined as of the date of receipt.

(2) SPECIAL RULE FOR LIFE INSURANCE COMPANIES.—The amount of any recovery of a foreign expropriation loss includes, in the case of a life insurance company, the amount of decrease of any item taken into account under section 810(c), to the extent such decrease is attributable to the release, by reason of such loss, of its liabilities with respect to such item.

(d) ADJUSTMENT FOR PRIOR TAX BENEFITS.—

(1) IN GENERAL.—That part of the amount of a recovery of a foreign expropriation loss to which this section applies which, when added to the aggregate of the amounts of previous recoveries with respect to such loss, does not exceed the allowable deductions in prior taxable years on account of such loss shall be excluded from gross income for the taxable year of the recovery for purposes of computing the tax under this subtitle; but there shall be added to, and assessed and collected as a part of, the tax under this subtitle for such taxable year an amount equal to the total increase in the tax under this subtitle for all taxable years which would result by decreasing, in an amount equal to such part of the recovery so excluded, the deduc-

[1] This publication of the law is restricted to excerpts involving internal revenue matters; Senate Report No. 1091, page 521, this Bulletin; House Report No. 1125 is not published herein.

tions allowable in the prior taxable years on account of such loss. For purposes of this paragraph, if the loss to which the recovery relates was taken into account as a loss from the sale or exchange of a capital asset, the amount of the loss shall be treated as an allowable deduction even though there were no gains against which to allow such loss.

(2) COMPUTATION.—The increase in the tax for each taxable year referred to in paragraph (1) shall be computed in accordance with regulations prescribed by the Secretary or his delegate. Such regulations shall give effect to previous recoveries of any kind (including recoveries described in section 111, relating to recovery of bad debts, etc.) with respect to any prior taxable year, but shall otherwise treat the tax previously determined for any taxable year in accordance with the principles set forth in section 1314(a) (relating to correction of errors). Subject to the provisions of paragraph (3), all credits allowable against the tax for any taxable year, and all carryovers and carrybacks affected by so decreasing the allowable deductions, shall be taken into account in computing the increase in the tax.

(3) FOREIGN TAXES.—For purposes of this subsection—

(A) any choice made under subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year may be changed,

(B) subject to the provisions of section 904(b), an election to have the limitation provided by section 904(a)(2) apply may be made, and

(C) notwithstanding section 904(b)(1), an election previously made to have the limitation provided by section 904(a)(2) apply may be revoked with respect to any taxable year and succeeding taxable years.

(4) SUBSTITUTION OF CURRENT NORMAL TAX AND SURTAX RATES.—For purposes of this subsection, the normal tax rate provided by section 11(b) and the surtax rate provided by section 11(c) which are in effect for the taxable year of the recovery shall be treated as having been in effect for all prior taxable years.

(e) GAIN ON RECOVERY.—That part of the amount of a recovery of a foreign expropriation loss to which this section applies which is not excluded from gross income under subsection (d)(1) shall be considered for the taxable year of the recovery as gain on the involuntary conversion of property as a result of its destruction or seizure and shall be recognized or not recognized as provided in section 1033.

(f) BASIS OF RECOVERED PROPERTY.—The basis of property (other than money) received as a recovery of a foreign expropriation loss to which this section applies shall be an amount equal to its fair market value on the date of receipt, reduced by such part of the gain under subsection (e) which is not recognized as provided in section 1033.

(g) RESTORATION OF VALUE OF INVESTMENTS.—For purposes of this section, if the value of any interest in, or with respect to, property (including any interest represented by a security, as defined in section 165(g)(2))—

(1) which became worthless by reason of the expropriation, intervention, seizure, or similar taking of such property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing, and

(2) which was taken into account as a loss from the sale or exchange of a capital asset or with respect to which a deduction for a loss was allowed under section 165 or a deduction for a bad debt was allowed under section 166,

is restored in whole or in part by reason of any recovery of money or other property in respect of the property which became worthless, the value so restored shall be treated as property received as a recovery in respect of such loss or such bad debt.

(h) SPECIAL RULE FOR EVIDENCES OF INDEBTEDNESS.—Bonds or other evidences of indebtedness received as a recovery of a foreign expropriation loss to which this section applies shall not be considered to have any original issue discount within the meaning of section 1232(a)(2).

(i) ADJUSTMENTS FOR SUCCEEDING YEARS.—For purposes of this subtitle, proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, in—

(1) the credit under section 33 (relating to foreign tax credit),

(2) the credit under section 38 (relating to investment credit),

(3) the net operating loss deduction under section 172, or the operations loss deduction under section 812,

(4) the capital loss carryover under section 1212(a), and
(5) such other items as may be specified by such regulations,
for the taxable year of a recovery of a foreign expropriation loss to which this section applies, and for succeeding taxable years, to take into account items changed in making the computations under subsection (d) for taxable years prior to the taxable year of such recovery.

(b)(1) Part II of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to items specifically included in gross income) is amended by adding at the end thereof the following new section:

SEC. 80. RESTORATION OF VALUE OF CERTAIN SECURITIES.

(a) GENERAL RULE.—In the case of a domestic corporation subject to the tax imposed by section 11 or 802, if the value of any security (as defined in section 165(g)(2))—

(1) which became worthless by reason of the expropriation, intervention, seizure, or similar taking by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing of property to which such security was related, and

(2) which was taken into account as a loss from the sale or exchange of a capital asset or with respect to which a deduction for a loss was allowed under section 165.

is restored in whole or in part during any taxable year by reason of any recovery of money or other property in respect of the property to which such security was related, the value so restored (to the extent that, when added to the value so restored during prior taxable years, it does not exceed the amount of the loss described in paragraph (2)) shall, except as provided in subsection (b), be included in gross income for the taxable year in which such restoration occurs.

(b) REDUCTION FOR FAILURE TO RECEIVE TAX BENEFIT.—The amount otherwise includible in gross income under subsection (a) in respect of any security shall be reduced by an amount equal to the amount (if any) of the loss described in subsection (a)(2) which did not result in a reduction of the taxpayer's tax under this subtitle for any taxable year, determined under regulations prescribed by the Secretary or his delegate.

(c) CHARACTER OF INCOME.—For purposes of this subtitle—

(1) Except as provided in paragraph (2), the amount included in gross income under this section shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

(2) If the loss described in subsection (a)(2) was taken into account as a loss from the sale or exchange of a capital asset, the amount included in gross income under this section shall be treated as long-term capital gain.

(d) TREATMENT UNDER FOREIGN EXPROPRIATION LOSS RECOVERY PROVISION.—This section shall not apply to any recovery of a foreign expropriation loss to which section 1351 applies.

(2) The table of sections for such part II is amended by adding at the end thereof the following:

Sec. 80. Restoration of value of certain securities.

(3) The amendments made by this subsection shall apply to taxable years beginning after December 31, 1965, but only with respect to losses described in section 80(a)(2) of the Internal Revenue Code of 1954 (as added by paragraph (1) of this subsection) which were sustained after December 31, 1958.

(c)(1) Section 46(a)(3) of the Internal Revenue Code of 1954 (relating to liability for tax for purposes of the investment credit) is amended by inserting after "personal holding company tax)" the following: ", and any additional tax imposed for the taxable year by section 1351(d)(1) (relating to recoveries of foreign expropriation losses),".

(2) Section 901(a) of such Code (relating to foreign tax credit) is amended by inserting after "section 1333 (relating to war loss recov-

eries)" in the last sentence thereof "or under section 1351 (relating to recoveries of foreign expropriation losses)".

(d) Subchapter B of chapter 62 of the Internal Revenue Code of 1954 (relating to time and place for paying tax) is amended by adding at the end thereof the following new section:

SEC. 6167. EXTENSION OF TIME FOR PAYMENT OF TAX ATTRIBUTABLE TO RECOVERY OF FOREIGN EXPROPRIATION LOSSES.

(a) EXTENSION ALLOWED BY ELECTION.—If—

(1) a corporation has a recovery of a foreign expropriation loss to which section 1351 applies, and

(2) the portion of the recovery received in money is less than 25 percent of the amount of such recovery (as defined in section 1351(c)) and is not greater than the tax attributable to such recovery.

the tax attributable to such recovery shall, at the election of the taxpayer, be payable in 10 equal installments on the 15th day of the third month of each of the taxable years following the taxable year of the recovery. Such election shall be made at such time and in such manner as the Secretary or his delegate may prescribe by regulations. If an election is made under this subsection, the provisions of this subtitle shall apply as though the Secretary or his delegate were extending the time for payment of such tax.

(b) EXTENSION PERMITTED BY SECRETARY.—If a corporation has a recovery of a foreign expropriation loss to which section 1351 applies and if an election is not made under subsection (a), the Secretary or his delegate may, upon finding that the payment of the tax attributable to such recovery at the time otherwise provided in this subtitle would result in undue hardship, extend the time for payment of such tax for a reasonable period or periods not in excess of 9 years from the date on which such tax is otherwise payable.

(c) ACCELERATION OF PAYMENTS.—If—

(1) an election is made under subsection (a),

(2) during any taxable year before the tax attributable to such recovery is paid in full—

(A) any property (other than money) received on such recovery is sold or exchanged, or

(B) any property (other than money) received on any sale or exchange described in subparagraph (A) is sold or exchanged, and

(3) the amount of money received on such sale or exchange (reduced by the amount of the tax imposed under chapter 1 with respect to such sale or exchange), when added to the amount of money—

(A) received on such recovery, and

(B) received on previous sales or exchanges described in subparagraphs (A) and (B) of paragraph (2) (as so reduced),

exceeds the amount of money which may be received under subsection (a)(2), an amount of the tax attributable to such recovery equal to such excess shall be payable on the 15th day of the third month of the taxable year following the taxable year in which such sale or exchange occurs. The amount of such tax so paid shall be treated, for purposes of this section, as a payment of the first unpaid installment or installments (or portion thereof) which become payable under subsection (a) following such taxable year.

(d) PRORATION OF DEFICIENCY TO INSTALLMENTS.—If an election is made under subsection (a), and a deficiency attributable to the recovery of a foreign expropriation loss has been assessed, the deficiency shall be prorated to such installments. The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be collected at the same time as, and as part of, such installment. The part of the deficiency so prorated to any installment the date for payment of which has arrived shall be paid upon notice and demand from the Secretary or his delegate. This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(e) TIME FOR PAYMENT OF INTEREST.—If the time for payment for any amount of tax has been extended under this section, interest payable under section 6601 on any unpaid portion of such amount shall be paid annually at the same time as, and as part of, each installment payment of the tax. Interest, on that part of a deficiency prorated under this section to any installment the date for payment of which has not arrived, for the period before the date fixed for the last

installment preceding the assessment of the deficiency, shall be paid upon notice and demand from the Secretary or his delegate. In applying section 6601(j) (relating to the application of the 4-percent rate of interest in the case of recoveries of foreign expropriation losses to which this section applies) in the case of a deficiency, the entire amount which is prorated to installments under this section shall be treated as an amount of tax the payment of which is extended under this section.

(f) TAX ATTRIBUTABLE TO RECOVERY OF FOREIGN EXPROPRIATION LOSS.—For purposes of this section, the tax attributable to a recovery of a foreign expropriation loss is the sum of—

(1) the additional tax imposed by section 1351(d)(1) on such recovery, and

(2) the amount by which the tax imposed under subtitlte A is increased by reason of the gain on such recovery which under section 1351(e) is considered as gain on the involuntary conversion of property.

(g) FAILURE TO PAY INSTALLMENT.—If any installment under this section is not paid on or before the date fixed for its payment by this section (including any extension of time for the payment of such installment), the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary or his delegate.

(h) CROSS-REFERENCES.—

(1) INTEREST.—For provisions requiring the payment of interest at the rate of 4 percent per annum for the period of an extension, see section 6601(j).

(2) SECURITY.—For authority of the Secretary or his delegate to require security in the case of an extension under this section, see section 6165.

(3) PERIOD OF LIMITATION.—For extension of the period of limitation in the case of an extension under this section, see section 6503(f).

(e) Section 6503 of the Internal Revenue Code of 1954 (relating to suspension of running of period of limitation) is amended by redesignating subsection (f) as (g), and by inserting after subsection (e) the following new subsection:

(f) EXTENSIONS OF TIME FOR PAYMENT OF TAX ATTRIBUTABLE TO RECOVERIES OF FOREIGN EXPROPRIATION LOSSES.—The running of the period of limitations for collection of the tax attributable to a recovery of a foreign expropriation loss (within the meaning of section 6167(f)) shall be suspended for the period of any extension of time for payment under subsection (a) or (b) of section 6167.

(f) Section 6601 of the Internal Revenue Code of 1954 (relating to interest on underpayments) is amended by redesignating subsection (j) as (k), and by inserting after subsection (i) the following new subsection:

(j) EXTENSIONS OF TIME FOR PAYMENT OF TAX ATTRIBUTABLE TO RECOVERIES OF FOREIGN EXPROPRIATION LOSSES.—If the time for payment of an amount of the tax attributable to a recovery of a foreign expropriation loss (within the meaning of section 6167(f)) is extended as provided in subsection (a) or (b) of section 6167, interest shall be paid at the rate of 4 percent, in lieu of 6 percent as provided in subsection (a).

(g)(1) The table of parts for subchapter Q of chapter 1 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following:

Part VII. Recoveries of foreign expropriation losses.

(2) The table of sections for subchapter B of chapter 62 of such Code is amended by adding at the end thereof the following:

Sec. 6167. Extension of time for payment of tax attributable to recovery of foreign expropriation losses.

SEC. 2. EFFECTIVE DATE.

The amendments made by section 1 (except subsection (b)) shall apply with respect to amounts received after December 31, 1964, in

respect of foreign expropriation losses (as defined in section 1351(b) of the Internal Revenue Code of 1954 added by section 1(a)) sustained after December 31, 1958.

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Approved April 8, 1966, 12:15 p.m.

PUBLIC LAW 89-389
EIGHTY-NINTH CONGRESS, APRIL 14, 1966
H.R. 9883 [1]

An Act to amend subchapter S of chapter 1 of the Internal Revenue Code of 1954, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a)(1) section 1375 of the Internal Revenue Code of 1954 (relating to special rules applicable to distributions of electing small business corporations) is amended by adding at the end thereof the following new subsection:

(f) DISTRIBUTIONS WITHIN 2½-MONTH PERIOD AFTER CLOSE OF TAXABLE YEAR.—

(1) DISTRIBUTIONS CONSIDERED AS DISTRIBUTIONS OF UNDISTRIBUTED TAXABLE INCOME.—Any distribution of money made by a corporation after the close of a taxable year with respect to which it was an electing small business corporation and on or before the 15th day of the third month following the close of such taxable year to a person who was a shareholder of such corporation at the close of such taxable year shall be treated as a distribution of the corporation's undistributed taxable income for such year, to the extent such distribution (when added to the sum of all prior distributions of money made to such person by such corporation following the close of such year) does not exceed such person's share of the corporation's undistributed taxable income for such year. Any distribution so treated shall, for purposes of this chapter, be considered a distribution which is not a dividend, and the earnings and profits of the corporation shall not be reduced by reason of such distribution.

(2) SHARE OF UNDISTRIBUTED TAXABLE INCOME.—For purposes of paragraph (1), a person's share of a corporation's undistributed taxable income for a taxable year is the amount required to be included in his gross income under section 1373(b) as a shareholder of such corporation for his taxable year in which or with which the taxable year of the corporation ends.

(3) ELECTION UNDER SUBSECTION (e).—Paragraph (1) shall not apply to any distribution with respect to which an election under subsection (e) applies.

(2) Subsection (e) of section 1375 of the Internal Revenue Code of 1954 is repealed effective with respect to distributions made after the close of any taxable year of the corporation beginning after the date of the enactment of this Act.

(b) Section 1375(d)(2)(B)(ii) of such Code is amended by striking out "under paragraph (1)" and inserting in lieu thereof "under subsection (f) or paragraph (1) of this subsection".

(c) Except as provided by subsection (d), the amendments made by subsections (a)(1) and (b) shall apply only with respect to distributions made after the date of the enactment of this Act.

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[1] Senate Report No. 1007, page 543, this Bulletin; since House Report No. 1238 is substantially the same as the Senate Report, it is not published herein.

(d) (1) The amendments made by subsections (a) (1) and (b) shall also apply with respect to distributions of money (other than distributions with respect to which an election under section 1375(e) of the Internal Revenue Code of 1954 applies) made by a corporation on or before the date of the enactment of this Act and on or after the date of the first distribution of money during the taxable year designated by the corporation if—

(A) such corporation elects to have such amendments apply to all such distributions made by it, and

(B) except as otherwise provided by this subsection, all persons (or their personal representatives) who were shareholders of such corporation at any time on or after the date of such first distribution and before the date on which the corporation files the election with the Secretary of the Treasury or his delegate consent to such election and to the application of this subsection.

(2) An election by a corporation under this subsection, and the consent thereto of the persons who are or were shareholders of such corporation, shall be made in such manner and within such time as the Secretary of the Treasury or his delegate prescribes by regulations, but the period for making such election shall not expire before one year after the date on which the regulations prescribed under this subsection are published in the Federal Register.

(3) In applying paragraphs (1) and (2), the consent of a person (or his personal representative) shall not be required if, under regulations prescribed under this subsection, it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the liability of such person for Federal income tax for any taxable year cannot be affected by the election of the corporation of which he is or was a shareholder.

(4) In applying this subsection, the reference in section 1375(f) of the Internal Revenue Code of 1954 (as added by subsection (a) (1)) to the 15th day of the third month following the close of the taxable year shall be treated as referring to the 15th day of the fourth month following the close of the taxable year.

(5) The statutory period for the assessment of any deficiency for any taxable year against the corporation filing the election or any person consenting thereto, to the extent such deficiency is attributable to an election under this subsection, shall not expire before the last day of the 2-year period beginning on the date on which the regulations prescribed under this subsection are published in the Federal Register; and such deficiency may be assessed at any time before the expiration of such 2-year period, notwithstanding any law or rule of law which would otherwise prevent such assessment.

(6) If—

(A) credit or refund of the amount of any overpayment for any taxable year attributable to an election under this subsection is not prevented, on the date of the enactment of this Act, by the operation of any law or rule of law, and

(B) credit or refund of the amount of such overpayment is prevented, by the operation of any law or rule of law (other than chapter 74 of the Internal Revenue Code of 1954, relating to closing agreements and compromises), at any time on or before the expiration of the 2-year period beginning on the date on

which the regulations prescribed under this subsection are published in the Federal Register,

credit or refund of such overpayment may, nevertheless, be allowed or made, to the extent such overpayment is attributable to such election, if claim therefor is filed before the expiration of such 2-year period.

(7) If—

(A) (i) one or more consecutive distributions of money made by the corporation after the close of a taxable year and on or before the 15th day of the fourth month following the close of the taxable year were substantially the same in amount as the undistributed taxable income of such corporation for such year, or

(ii) it is established to the satisfaction of the Secretary of the Treasury or his delegate that one or more distributions of money made by the corporation during the period described in clause (i) were intended to be distributions of the undistributed taxable income of such corporation for the taxable year preceding such period, and

(B) credit or refund of the amount of any overpayment for the taxable year in which such distribution or distributions were received is prevented on the date of the enactment of this Act, by the operation of any law or rule of law (other than chapter 74 of the Internal Revenue Code of 1954, relating to closing agreements and compromises),

credit or refund of such overpayment may, nevertheless, be allowed or made, to the extent such overpayment is attributable to an election under this subsection, if claim therefor is filed before the expiration of the 2-year period beginning on the date on which the regulations prescribed under this subsection are published in the Federal Register.

(8) No interest on any deficiency attributable to an election under this subsection shall be assessed or collected for any period before the expiration of the 2-year period beginning on the date on which the regulations prescribed under this subsection are published in the Federal Register. No interest on any overpayment attributable to an election under this subsection shall be allowed or paid for any period before the expiration of such 2-year period.

SEC. 2. (a) Subchapter S of chapter 1 of the Internal Revenue Code of 1954 (relating to election by certain small business corporations as to taxable status) is amended by adding at the end thereof the following new section:

SEC. 1378. TAX IMPOSED ON CERTAIN CAPITAL GAINS.

(a) GENERAL RULE.—If for a taxable year of an electing small business corporation—

(1) the excess of the net long-term capital gain over the net short-term capital loss of such corporation exceeds $25,000, and exceeds 50 percent of its taxable income for such year, and

(2) the taxable income of such corporation for such year exceeds $25,000, there is hereby imposed a tax (computed under subsection (b)) on the income of such corporation.

(b) AMOUNT OF TAX.—The tax imposed by subsection (a) shall be the lower of—

(1) an amount equal to 25 percent of the amount by which the excess of the net long-term capital gain over the net short-term capital loss of the corporation for the taxable year exceeds $25,000, or

(2) an amount equal to the tax which would be imposed by section 11 on the taxable income (computed as provided in section 1373(d)) of the corporation for the taxable year if the corporation was not an electing small business corporation.

No credit shall be allowable under part IV of subchapter A of this chapter (other than under section 39) against the tax imposed by subsection (a).

(c) EXCEPTIONS.—

(1) IN GENERAL.—Subsection (a) shall not apply to an electing small business corporation for any taxable year if the election under section 1372(a) which is in effect with respect to such corporation for such taxable year has been in effect for the 3 immediately preceding taxable years.

(2) NEW CORPORATIONS.—Subsection (a) shall not apply to an electing small business corporation if—

(A) it has been in existence for less than 4 taxable years, and

(B) an election under section 1372(a) has been in effect with respect to such corporation for each of its taxable years.

(3) PROPERTY WITH SUBSTITUTED BASIS.—If—

(A) but for paragraph (1) or (2), subsection (a) would apply for the taxable year,

(B) any long-term capital gain is attributable to property acquired by the electing small business corporation during the period beginning 3 years before the first day of the taxable year and ending on the last day of the taxable year, and

(C) the basis of such property is determined in whole or in part by reference to the basis of any property in the hands of another corporation which was not an electing small business corporation throughout all of the period described in subparagraph (B) before the transfer by such other corporation and during which such other corporation was in existence,

then subsection (a) shall apply for the taxable year, but the amount of the tax determined under subsection (b) shall not exceed 25 percent of the excess of the net long-term capital gain over the net short-term capital loss attributable to property acquired as provided in subparagraph (B) and having a basis described in subparagraph (C).

(b)(1) The table of sections for subchapter S of chapter 1 of such Code is amended by adding at the end thereof the following new item:

Sec. 1378. Tax imposed on certain capital gains.

(2) Section 1372(b)(1) of such Code (relating to effect of election by small business corporation) is amended by inserting "(other than the tax imposed by section 1378)" after "this chapter".

(3) Section 1373(c) of such Code (relating to definition of undistributed taxable income) is amended by inserting "the sum of (1) the tax imposed by section 1378(a) and (2)" after "minus".

(4) Section 1375(a) of such Code (relating to treatment of capital gains in the hands of shareholders) is amended by adding at the end thereof the following new paragraph:

(3) REDUCTION FOR TAX IMPOSED BY SECTION 1378.—For purposes of paragraphs (1) and (2), the excess of an electing small business corporation's net long-term capital gain over its net short-term capital loss for a taxable year shall be reduced by an amount equal to the amount of the tax imposed by section 1378(a) on the income of such corporation for such year.

(5) Section 46(a)(3) of such Code (relating to liability for tax for purposes of the credit for investment in certain depreciable property) is amended by striking out "or by section 541 (relating to personal holding company tax)" and inserting in lieu thereof ", section 541 (relating to personal holding company tax), or section 1378 (relating to tax on certain capital gains of subchapter S corporations)".

(c) The amendments made by this section shall apply with respect to taxable years of electing small business corporations beginning

after the date of the enactment of this Act, but such amendments shall not apply with respect to sales or exchanges occurring before February 24, 1966.

SEC. 3. (a) Section 1372(e)(5) of the Internal Revenue Code of 1954 (relating to termination of election by small business corporations) is amended to read as follows:

> (5) PASSIVE INVESTMENT INCOME.—
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> (A) Except as provided in subparagraph (B), an election under subsection (a) made by a small business corporation shall terminate if, for any taxable year of the corporation for which the election is in effect, such corporation has gross receipts more than 20 percent of which is passive investment income. Such termination shall be effective for the taxable year of the corporation in which it has gross receipts of such amount, and for all succeeding taxable years of the corporation.
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> (B) Subparagraph (A) shall not apply with respect to a taxable year in which a small business corporation has gross receipts more than 20 percent of which is passive investment income, if—
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> (i) such taxable year is the first taxable year in which the corporation commenced the active conduct of any trade or business or the next succeeding taxable year; and
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> (ii) the amount of passive investment income for such taxable year is less than $3,000.
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> (C) For purposes of this paragraph, the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (gross receipts from such sales or exchanges being taken into account for purposes of this paragraph only to the extent of gains therefrom).

(b) The amendment made by subsection (a) shall apply to taxable years of electing small business corporations ending after the date of the enactment of this Act. Such amendment shall also apply with respect to taxable years beginning after December 31, 1962, and ending on or before such date of enactment, if (at such time and in such manner as the Secretary of the Treasury or his delegate prescribes by regulations)—

(1) the corporation elects to have such amendment so apply, and

(2) all persons (or their personal representatives) who were shareholders of such corporation at any time during any taxable year beginning after December 31, 1962, and ending on or before the date of the enactment of this Act consent to such election and to the application of the amendment made by subsection (a).

SEC. 4. (a) Section 1361 of the Internal Revenue Code of 1954 (relating to unincorporated business enterprises electing to be taxed as domestic corporations) is amended—

(1) by adding at the end of subsection (a) the following new sentence: "No election (other than an election referred to in subsection (f)) may be made under this subsection after the date of the enactment of this sentence.";

(2) by striking out in subsection (c) ", except as provided in subsection (m),";

(3) by striking out "subsection (f)" in subsection (e) and inserting in lieu thereof "subsections (f) and (n)";

(4) by striking out subsection (m); and

(5) by adding at the end of such section the following new subsection:

(n) REVOCATION AND TERMINATION OF ELECTIONS.—

(1) REVOCATION.—An election under subsection (a) with respect to an unincorporated business enterprise may be revoked after the date of the enactment of this subsection by the proprietor of such enterprise or by all the partners owning an interest in such enterprise on the date on which the revocation is made. Such enterprise shall not be considered a domestic corporation for any period on or after the effective date of such revocation. A revocation under this paragraph shall be made in such manner as the Secretary or his delegate may prescribe by regulations.

(2) TERMINATION.—If a revocation under paragraph (1) of an election under subsection (a) with respect to any unincorporated business enterprise is not effective on or before December 31, 1968, such election shall terminate on January 1, 1969, and such enterprise shall not be considered a domestic corporation for any period on or after January 1, 1969.

(b) Effective on January 1, 1969—

(1) subchapter R of chapter 1 of such Code (relating to election of certain partnerships and proprietorships as to taxable status) is repealed;

(2) the table of subchapters for chapter 1 of such Code is amended by striking out the item relating to subchapter R; and

(3) section 1504(b) of such Code (relating to definition of includible corporation) is amended by striking out paragraph (7).

(c) The amendments made by subsections (a) (2) and (4) shall apply with respect to transactions occurring after the date of the enactment of this Act.

Approved April 14, 1966.

SUBPART C.—COMMITTEE REPORTS

[H.R. 327] [1]

ORGANIZATIONS PROVIDING FUNDS FOR TAX EXEMPT SAVINGS INSTITUTIONS

[Senate Report No. 945, Eighty-ninth Congress, Second Session, Calendar No. 919]

[JANUARY 19 (legislative day, January 18, 1966)]

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following report to accompany H.R. 327.

The Committee on Finance to which was referred the bill (H.R. 327) to amend section 501(c) of the Internal Revenue Code of 1954 to exempt from taxation certain nonprofit corporations and associations operated to provide reserve funds for domestic building and loan associations, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. SUMMARY OF BILL

This bill exempts from income taxation mutual, nonprofit organizations organized before September 1, 1957, and operated to provide reserves for building and loan associations, cooperative banks, and mutual savings banks, if at least 85 percent of their income is attributable to providing such reserve funds and to investments. The bill extends this tax-exempt status to organizations which are similar in essential respects to those already exempt. Present provisions, however, exempt such organizations only if they provide both reserves for, and insurance of shares and deposits of, member associations.

The bill also provides that net income derived by such organizations (both that of the organizations exempted by this bill and that of the similar organizations already exempt) which is not related to the provision of reserves or insurance will be taxed as unrelated business income. This latter provision confines the privilege of tax exemption to income derived from the specific services upon which that exemption is based.

The provisions described above are to be effective for taxable years beginning after the date of enactment of this bill.

The Treasury Department has indicated that it has no objections to this bill.

II. GENERAL STATEMENT

Present law exempts from tax certain corporations or associations which provide reserve funds for, and insurance of shares or deposits in, domestic building and loan associations, cooperative banks, and mutual savings banks. To be exempt, the organization must be nonprofit, be organized and operated for mutual purposes, have no capital stock, and have been organized before September 1, 1957.

Prior to September 1, 1951, organizations of this type were exempt from tax under the general exemption provisions then applicable to mutual savings banks, savings associations, and building and loan associations. While the

[1] Public Law 89-352, page 375, this Bulletin.

Revenue Act of 1951 imposed the corporate income tax on certain undistributed profits of formerly tax-exempt organizations, provision was made in what is now section 501(c)(14) for continuing the exemption of nonprofit, mutual-deposit guarantee organizations without capital stock organized for the benefit of a group of mutual savings banks or building and loan associations which were organized before September 1, 1951. The law was amended in 1959 to change the required date of organization from September 1, 1951, to September 1, 1957. At that time, it was stated that the law, as amended, would apply to at least four such organizations.

It has come to light that at least one organization, the New York State Savings & Loan Bank, similar in nearly all essential respects to those now exempt is not included within the scope of section 501(c)(14). While the organization is a nonprofit, mutual organization and provides reserve funds for savings and loan associations, it does not insure accounts of its members.

Following the enactment of what is now section 501(c)(14), this organization initially was ruled tax exempt by the Internal Revenue Service. The organization was subsequently notified, however, that its tax-exempt status would be terminated because it was not providing insurance of shares and deposits for its members. Disposition of the matter was delayed for a time while the organization endeavored to obtain an amendment to the banking laws of New York, the State in which it is chartered, but the exemption finally was revoked for 1962 and subsequent years. The law previously authorized the administration of a fund for the insurance of savings accounts only if 100 or more savings and loan associations in the State were included. Recently the State law has been amended to eliminate this requirement, but the organization has not, as yet, found it advisable to establish such an insurance program because so few of its member banks have need for such insurance. Moreover, the law only authorizes the organization to act as a trustee for such an insurance and it is not clear that this would qualify the organization for the present exemption.

Your committee, like the Committee on Ways and Means of the House, has concluded that an organization which meets all the other requirements of section 501(c)(14) should not be precluded from tax-exempt status under Federal income tax law merely because it does not provide insurance of the shares and deposits of its members in addition to reserve funds. As the situation described above illustrates, such an organization may be prevented from providing such services, either by the restrictions imposed by the laws of the State in which it is chartered, or by the lack of need for them.

This bill therefore amends present law with respect to section 501(c)(14) to add a new subparagraph to the existing provision. The new subparagraph provides that certain nonprofit corporations or associations organized before September 1, 1957, and operated for mutual purposes to provide reserve funds for domestic building and loan associations, cooperative banks, or mutual savings banks may be exempt from the tax even if they do not provide insurance of shares and deposits of member associations. The exemption is only available, however, if 85 percent or more of the income of such an organization is attributable to providing reserve funds and to investments. The provision does not apply to organizations which qualify for tax exemption under existing law.

With respect to all organizations described above, including both those previously tax exempt and those newly exempt under the terms of this bill, your committee agrees with the Committee on Ways and Means that only income connected with the provision of reserve funds for, and insurance of shares and deposits in, domestic building and loan associations, cooperative banks, and mutual savings banks should be tax exempt. Therefore the bill taxes as unrelated business income the net income derived by such an organization from activities not substantially related to the purpose or function which constitutes the basis for its exemption. Under this provision, the income derived by such an organization from the provision of data processing services, for example, would be subject to tax as unrelated business income of a tax-exempt organization.

The provisions of the bill will apply to taxable years ending after the date of enactment. They are expected to have a negligible effect on revenue.

[H.R. 8445] [1]

RETIRED PAY OF JUDGES OF TAX COURT

[Senate Report No. 947, Eighty-ninth Congress, Second Session, Calendar No. 921]

[JANUARY 19 (legislative day, January 18), 1966]

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following report to accompany H.R. 8445.

The Committee on Finance, to which was referred the bill (H.R. 8445) to amend the Internal Revenue Code of 1939 and the Internal Revenue Code of 1954 to change the method of computing the retired pay of judges of the Tax Court of the United States, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

PURPOSE

The purpose of H.R. 8445 is to eliminate an inequity in the provisions of existing law which prescribe the formula for computing retired pay for judges of the Tax Court of the United States. Under present law the retired pay of a judge of the Tax Court, unlike the retired pay of judges of other Federal courts, is based on the salary payable to him as judge "at the time he ceases to be a judge" rather than on the salary of the office, the normal basis utilized in computing retired pay for judges of the U.S. district courts and of the U.S. Court of Claims.

H.R. 8445 would eliminate this disparate treatment in the law by providing for the calculation of retired pay of Tax Court judges in a manner similar to that presently provided for judges of the other Federal tribunals.

GENERAL STATEMENT

Present law

Under present law a judge of the Tax Court of the United States may retire after 24 years of service and thereafter receive retired pay equal to his salary. He may also retire after 18 years of service and receive retired pay based on the ratio that the number of years actually served bears to 24 years; e.g., if he has served for 18 years he will receive eighteen twenty-fourths of his salary. A judge of the Tax Court must retire after having attained age 70 and having served for 10 years or more, and if he has not served for 18 years, his retirement pay will be one-half of his salary. In all of the above cases, however, section 1106(d) of the Internal Revenue Code of 1939 and section 7447(d) of the Internal Revenue Code of 1954 require that the retired pay be calculated on the basis of the salary payable to him as judge "at the time he ceases to be a judge."

Reason for bill

Judges of the U.S. district courts and the Court of Claims may retire after 15 years of service upon attaining the age of 65 and after 10 years upon attaining the age of 70. Moreover, their retired pay is based on the full amount of the salary of the office, which extends to them the benefit of increases in the salary of the office which occur after their retirement.

Your committee agrees with the Ways and Means Committee of the House, that the method prescribed by existing law for computing the retired pay of judges of the Tax Court, when considered with the stringent statutory limitations imposed on them after retirement, has been inequitable in operation. All retired Tax Court judges, unless precluded by illness or disability, are subject to recall to active duty by the chief judge for a period of 90 days each year and may be recalled for longer periods with their consent. Any retired judge of the Tax Court who should fail to perform the judicial duties required of him on recall would forfeit entirely his retired pay for the year in which such failure occurs. In addition, in order to insure the availability of retired judges for recall, the retired judges of the Tax Court are prohibited from accepting any other Federal office or employment or from engaging in the practice of law or accounting in the field of Federal taxation. If they do so they would forever lose their rights to retirement pay.

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[1] Public Law 89-354, page 376, this Bulletin.

The longer terms of service required of judges of the Tax Court and the more stringent obligations imposed on them by law to perform judicial service on recall during retirement requires that the method of calculation of their retirement payments be brought more closely in line with that of the judges of the Federal district courts and of the Court of Claims.

Change proposed by H.R. 8445

Your committee's bill would provide that the retired pay of judges of the Tax Court be based on the salary of the office. This would bring the salary basis for retirement purposes of Tax Court judges in line with that of judges of the U.S. district courts and of the U.S. Court of Claims. It would mean that Tax Court judges, like these other judges, would receive the benefit of increases in the salary of the office which occur after their retirement.

The amendments provided in the bill would be effective with respect to retired pay accruing on or after the first day of the first calendar month which begins after the date of enactment.

[H.R. 10185] [1]

CERTAIN DEFICIENCIES UNDER ESTATE TAX PROVISIONS OF INTERNAL REVENUE CODE OF 1939

[Senate Report No. 956, Eighty-ninth Congress, Second Session, Calendar No. 928]

[FEBRUARY 9 (legislative day, January 26), 1966]

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following report to accompany H.R. 10185.

The Committee on Finance, to which was referred the bill (H.R. 10185) amending certain estate tax provisions of the Internal Revenue Code of 1939, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

I. SUMMARY OF BILL

H.R. 10185 amends the Internal Revenue Code of 1939 to provide that if any part of a deficiency with respect to estate tax liability is due to fraud with intent to evade tax, the penalty to be imposed is 50 percent of the total amount of the deficiency, rather than 50 percent of the total tax liability. This conforms the rule under the Internal Revenue Code of 1939 to the rule now applicable in the case of estate tax deficiencies under the 1954 code.

The Treasury Department has indicated that it does not object to this bill.

II. REASONS FOR THE BILL

The attention of your committee has been called to the recent case of *Commissioner of Internal Revenue* v. *Estate of H. S. Leyman* ((Mar. 29, 1965) 344 F. 2d 763), in which a circuit court of appeals, reversing a decision of the Tax Court, held that under the Internal Revenue Code of 1939 the penalty, in the case of a fraudulent estate tax return, is 50 percent of the entire estate tax. The Tax Court had held that the penalty was the same as under the Internal Revenue Code of 1954—50 percent of the deficiency (the underpayment) in the estate tax.

In the *Leyman* case, the decedent died on May 24, 1954. If he had died on or after August 17, 1954, the Internal Revenue Code of 1954 would have been applicable to his estate and it would have been clear that the penalty, in the case of a false or fraudulent return, is 50 percent of the deficiency and not 50 percent of the tax. The decedent's son was the executor of the estate, and he filed an estate tax return which showed a tax due in an amount slightly in excess of $2,056,000, and that tax was paid in full. Thereafter, the Commissioner of Internal Revenue asserted a large deficiency in the estate tax and claimed that part of the deficiency was due to fraud. The Tax Court held that there was a deficiency in the estate tax of $1,240,242, most of which was attributable to a change in the valuation of an unlisted stock owned by the decedent and no fraud was involved on this issue. However, the Tax Court also held that part of the deficiency was

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[1] Public Law 89–359, page 376, this Bulletin.

attributable to fraud; that the executor had fraudulently omitted from the estate tax return the sum of $613,000 in cash owned by the decedent at the time of his death. Since part of the deficiency was attributable to fraud, the Tax Court added a penalty of $620,121 (50 percent of the deficiency of $1,240,242).

The Commissioner contended that the fraud penalty should include, in addition to the $620,121, 50 percent of the $2,056,000 in tax paid when the original estate tax return was filed. The U.S. Court of Appeals for the Sixth Circuit agreed with the Commissioner and held that under the 1939 code the penalty for a fraudulent estate tax return was 50 percent of the entire tax and not just 50 percent of the underpayment.

In its decision the court of appeals stated that it was presented with a case of first impression for which it could find "no guiding casebook authority." Although the issue had not been previously litigated, it can be noted that the decision is contrary to the understanding your committee had of the 1939 code provision at the time of the enactment of the Internal Revenue Code of 1954. At that time the 1939 code provided a fraud penalty, in the case of excise taxes, of 50 percent of the entire tax. Your committee then believed that the fraud penalty should be limited in all cases to only 50 percent of the deficiency or underpayment, which was clearly the rule under the 1939 code in the case of the income and gift taxes and also, so your committee thought, in the case of the estate tax.

In reporting the bill which became the Internal Revenue Code of 1954 and which provided that the fraud penalty in all cases should be only 50 percent of the deficiency or underpayment, your committee reported to the Senate language identical to that which had been reported to the House:

> Existing law imposes a 50-percent addition in the case of fraud applicable to all taxes, but in the case of taxes other than income, estate, and gift, that addition is based on the total amount of tax imposed. (S. Rept. 1622, p. 591, 83d Cong.)

Your committee, like the Committee on Ways and Means of the House, believes that the type of decision reached in the *Leyman* case produces a harsh result which cannot be justified, particularly in view of the fact that the burden of the penalty may fall in part on innocent beneficiaries of an estate who had nothing at all to do with the filing of the false estate tax return.

III. GENERAL EXPLANATION

The bill amends the Internal Revenue Code of 1939, to provide that if any part of a deficiency in the estate tax is due to fraud with intent to evade tax, then 50 percent of the total amount of the deficiency (in addition to the deficiency) is to be assessed and collected—in lieu of 50 percent of the entire tax.

The amendment is applicable with respect to any estate of a decedent subject to the estate tax provisions of the Internal Revenue Code of 1939, but the bill does not open up the statute of limitations if a refund is barred by the statute of limitations. Your committee is informed that there are only a few cases in which the Service has collected a fraud penalty based upon 50 percent of the entire tax. In those cases (if refunds are not barred by the statute of limitations or by any other law or rule of law, such as res adjudicata) the bill provides that no interest is to be paid or allowed on any refund resulting from the bill.

[H.R. 10625][1]

TAX TREATMENT OF CERTAIN AMOUNTS PAID TO CERTAIN MEMBERS AND FORMER MEMBERS OF UNIFORMED SERVICES AND TO THEIR SURVIVORS

[House of Representatives Report No. 1118, Eighty-ninth Congress, First Session]

[OCTOBER 5, 1965]

Mr. MILLS, from the Committee on Ways and Means, submitted the following report to accompany H.R. 10625.

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[1] Public Law 89–365, page 377, this Bulletin.

The Committee on Ways and Means, to whom was referred the bill (H.R. 10625) to amend the Internal Revenue Code of 1954 with respect to the tax treatment of certain amounts paid to servicemen and survivors, having considered the same, report favorably thereon with amendments and recommended that the bill as amended do pass.

The amendments are as follows:

Strike out all after the enacting clause and insert in lieu thereof the following: That (a)(1) part III of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to items specifically excluded from gross income) is amended by redesignating section 122 as section 123, and by inserting after section 121 the following new section:

"SEC. 122. CERTAIN REDUCED UNIFORMED SERVICES RETIREMENT PAY.

"(a) GENERAL RULE.—In the case of a member or former member of the uniformed services of the United States who has made an election under chapter 73 of title 10 of the United States Code to receive a reduced amount of retired or retainer pay, gross income does not include the amount of any reduction after December 31, 1965, in his retired or retainer pay by reason of such election.

"(b) SPECIAL RULE.—

"(1) AMOUNT EXCLUDED FROM GROSS INCOME.—In the case of any individual referred to in subsection (a), all amounts received after December 31, 1965, as retired or retainer pay shall be excluded from gross income until there has been so excluded an amount equal to the consideration for the contract. The preceding sentence shall apply only to the extent that the amounts received would, but for such sentence, be includible in gross income.

"(2) CONSIDERATION FOR THE CONTRACT.—For purposes of paragraph (1) and section 72(o), the term 'consideration for the contract' means, in respect of any individual, the sum of—

"(A) the total amount of the reductions before January 1, 1966, in his retired or retainer pay by reason of an election under chapter 73 of title 10 of the United States Code, and

"(B) any amounts deposited at any time by him pursuant to section 1438 of such title 10."

(2) The table of sections for such part III is amended by striking out the item relating to section 122 and inserting in lieu thereof the following:

"Sec. 122. Certain reduced uniformed services retirement pay.
"Sec. 123. Cross references to other Act."

(b) Section 72 of such Code (relating to tax treatment of annuities) is amended by redesignating subsection (o) as subsection (p), and by inserting after subsection (n) the following new subsection:

"(o) ANNUITIES UNDER RETIRED SERVICEMAN'S FAMILY PROTECTION PLAN.—Subsections (b) and (d) shall not apply in the case of amounts received after December 31, 1965, as an annuity under chapter 73 of title 10 of the United States Code, but all such amounts shall be excluded from gross income until there has been so excluded (under section 122(b)(1) or this section, including amounts excluded before January 1, 1966) an amount equal to the consideration for the contract (as defined by section 122(b)(2)), plus any amount treated pursuant to section 101(b)(2)(D) as additional consideration paid by the employee. Thereafter all amounts so received shall be included in gross income."

(c) Section 101(b)(2)(D) of such Code (relating to special rules for employees' death benefits) is amended by adding at the end thereof the following new sentence: "Paragraph (1) shall not apply in the case of an annuity under chapter 73 of title 10 of the United States Code if the individual who made the election under such chapter died after attaining retirement age."

(d) The amendments made by subsections (a) and (b) shall apply with respect to taxable years ending after December 31, 1965. The amendment made by subsection (c) shall apply with respect to individuals making an election under chapter 73 of title 10 of the United States Code who die after December 31, 1965.

SEC. 2. (a) Section 2039(c) of the Internal Revenue Code of 1954 (relating to exclusion from gross estate of annuities under certain trusts and plans) is amended—

(1) by striking out "or" at the end of paragraph (2), by striking out the period at the end of paragraph (3) and inserting in lieu thereof "; or", and by adding at the end thereof the following new paragraph:

"(4) chapter 73 of title 10 of the United States Code.";

(2) by striking out "or under a contract described in paragraph (3)" in the second sentence and inserting in lieu thereof ", under a contract described in paragraph (3), or under chapter 73 of title 10 of the United States Code"; and

(3) by inserting at the end thereof the following new sentence: "For purposes of this subsection, amounts payable under chapter 73 of title 10 of the United States Code are attributable to payments or contributions made by the decedent only to the extent of amounts deposited by him pursuant to section 1438 of such title 10."

(b)(1) Section 2517(a) of such Code (relating to gift tax treatment of certain annuities under qualified plans) is amended by striking out "or" at the end of paragraph (2), by striking out the period at the end of paragraph (3) and inserting in lieu thereof "; or", and by adding at the end thereof the following new paragraph:

"(4) chapter 73 of title 10 of the United States Code."

(2) The first sentence of section 2517(b) of such Code (relating to transfers attributable to employee contributions) is amended by inserting "(other than paragraph (4))" after "referred to in subsection (a)".

(c) The amendments made by subsection (a) shall apply with respect to decedents dying after December 31, 1965. The amendments made by subsection (b) shall apply with respect to calendar years after 1965.

Amend the title so as to read:

A bill relating to the tax treatment of certain amounts paid to certain members and former members of the uniformed services and to their survivors.

I. SUMMARY

This bill makes a series of amendments to the Internal Revenue Code designed to provide essentially the same tax treatment under the retired serviceman's family protection plan where provision is made for annuities for surviving spouses or certain child beneficiaries as already is provided in the case of the civil service retirement program and other qualified pension plans. Thus where reduced retirement pay is accepted by servicemen (or former servicemen) in order to provide annuities for their survivors, the amount of the reduction will no longer be taxed to the retired servicemen and such reductions which have been included in retired servicemen's retirement income in the past may be offset against otherwise taxable retirement pay in the future. The exclusion of up to $5,000 paid to a survivor of a decedent which is available where an employer makes the payment to a beneficiary on account of the death of an employee also is to be available to survivors of deceased servicemen who retired because of disability and died before attaining normal retirement age. In addition the estate and gift tax exclusions available under present law for the value of survivor annuities in the case of civil service annuities and those under other qualified pension plans are also to be made available in the case of annuities provided for survivors under the retired serviceman's family protection plan.

The income tax amendments generally apply to taxable years ending after December 31, 1965, or in the case of the death benefit exclusion to those who die after that date. The estate tax amendment applies to decedents dying after December 31, 1965, and the gift tax amendments to gifts made after the calendar year 1965.

The bill as amended has been reported unanimously by your committee and its passage is favored by both the Treasury Department and the Defense Department.

II. REASONS FOR THE BILL

Under present law, a member of the armed or other uniformed services may elect to receive a reduced amount of retired or retainer pay during his lifetime in order to provide an annuity for his surviving spouse or certain child beneficiaries. Provision is made for this under the retired serviceman's family protection plan (10 U.S.C. 1431 et seq.).

Under present law, generally, when an individual receives a pension or annuity which has been wholly provided by his employer, he is taxed on the payments

when received as ordinary income.[2] In addition, under present law, when an individual elects to receive a reduced pension in order to provide an annuity for his survivor, in lieu of a single pension, unless he is covered by a qualified pension or annuity plan, he generally is treated as if he still received the single pension, and is taxed on the full amount he would have received had he not elected to receive the lesser amount. This treatment prevails for such a nonqualified pension and annuity because the retiree had the option to receive the greater amount. By electing to receive the reduced amount, he is considered, in effect, to have constructively received each larger pension payment and to have exchanged part of each of these payments for the annuity for his survivor. In this case, therefore, upon the death of the retiree, his survivor is treated as having an investment in the annuity she then receives in an amount equal to the reduction in the retiree's pension on which he paid tax up to the time of his death. This amount is treated as the survivor's "consideration" for the annuity and she is permitted to recover it tax free over her life expectancy.

In the case of qualified pension plans, a different treatment is provided for elections of these survivor annuities. Instead of treating an election to take such an annuity to be an exchange of a portion of single pension for the survivor annuity (and, therefore, taxable to the extent of the exchange), the survivor annuity is treated as a mere continuation of the initial pension. It follows from this treatment that upon the death of the retiree, the survivor is treated as having no "consideration" for the survivor annuity by reason of the election and, therefore, she has no tax-free recovery (on this account) over her life expectancy. As a result, in the case of qualified pensions and annuities where the employee made no contributions, the entire amount of the payments actually received by the retiree and his survivor are subject to tax as received. However, the retiree is not taxed on any additional amount over and above the amount actually received (that is, the reduction in his single pension because of the election of the survivor feature).

Among the requirements to obtain qualified status and, therefore, to be eligible for this treatment of survivor annuities are requirements that the plan be nondiscriminatory and that it be funded. The retired serviceman's family protection plan meets the nondiscriminatory tests but is not a qualified plan under present law because it is not funded. In this respect it differs from the civil service retirement program (5 U.S.C. 2251 et seq.), which has been classified as a funded plan and, therefore, does qualify for the survivor annuity tax treatment outlined here.

In addition to the generally more favorable income tax treatment received by qualified pension or annuity plans with respect to the survivor feature, these qualified plans also receive other tax advantages under present law. In the case of the estate tax, for example, the value of annuities to be received under qualified plans (to the extent not contributed by the employee) passing to a survivor are excluded from the gross estate and, therefore, not subject to estate tax. In the case of nonqualified plans, generally this value is included in the estate tax base.

In addition, in the case of qualified pensions and annuities (to the extent not contributed by the employee), the exercise (or failure to exercise) by an employee of an election to take a survivor annuity in place of part of a single pension is not considered a taxable gift by the retiree. The contrary is generally true in the case of nonqualified plans.

A third advantage in having a qualified pension plan is that in the case of these plans an exclusion of up to $5,000 is available to the survivor where the retiree dies before retirement age. This is an exclusion for income tax purposes.

Your committee believes that members (or former members) of the uniformed services should be treated essentially the same as retirees under the civil service program and under other qualified pension or annuity plans. Your committee has concluded that there is no substantial grounds for distinguishing the tax treatment of the plan for the uniformed services from these other plans. Although qualified plans are required to be funded in order to give assurance that the money intended for payment of the retirement benefits is actually available to pay the benefits when needed, the obligation of the United States to pay bene-

[2] In the case of contributory pensions or annuities, a portion of the pension or annuity payments determined on the basis of the total of the contributions is free of tax. This entire amount, called the investment in the contract, may be returned in the first 3 years or over the life expectancy of the annuitant.

fits under the retired serviceman's family protection plan is, in the opinion of your committee, a sufficient guarantee that these amounts will be paid when due. As a result, your committee has concluded that these uniformed services retirees should be treated in the same manner as pensioners under qualified plans. In doing this, however, your committee does not intend to extend any advantages to the uniformed services personnel not available to civil service retirees. Thus, although survivor annuities are considered under this provision to be a continuation of the initial single pension for purposes of reducing the taxable portion to the retiree, it is not intended that any benefit the retiree receives on account of disability be carried over and applied in the case of the survivor. Such an exclusion is not available at present for the survivors of uniformed services retirees or in the case of civil service retirees, and it is not intended by this action that any such benefit be extended.

III. GENERAL EXPLANATION

Income tax treatment of election of annuity for survivor

The bill first deals with the income tax treatment of the uniformed services personnel who elect to take a reduced amount of retirement pay in order to obtain an annuity for their surviving spouse or other beneficiary.

The bill provides as a general rule (new sec. 122(a) of the code) that members, or former members, of the uniformed services of the United States who make or have made an election under the retired serviceman's family protection plan (ch. 73, title 10, U.S.C.) to receive a reduced amount of retirement pay (or retainer pay) are to exclude from their gross income for tax purposes any reduction in their retirement pay (or retainer pay) resulting from this election. This rule applies to reductions in retirement pay after December 31, 1965.

Thus, where a serviceman who was eligible to receive retirement pay of $500 a month elects to receive, perhaps, $400 a month instead in order to obtain for his wife an annuity of $200 a month upon his death, he will (insofar as retirement pay received in the future is concerned) report $400 a month for tax purposes during his lifetime, rather than the $500 required by present law. Upon his death his wife generally will report the full $200 a month she receives as income, instead of some lesser amount determined by treating as "consideration" the additional amounts ($100 a month for the period up to the husband's death) on which tax was paid under present law (but not under the bill) by her husband and spreading this exclusion over the period of her life expectancy. This new rule applies for any reduced amount received after December 31, 1965.

The bill also provides a special rule (sec. 122(b) of the code), designed in part as a transitional rule, to provide for those cases where a retired serviceman has already included in his income subject to tax more retirement pay than he has actually received. In such cases his retirement income is excluded from tax in 1966 and subsequent years until the amount so excluded equals this excess amount previously included in gross income. In other words, to continue the case presented above, assume that prior to January 1, 1966, the serviceman had already been retired for a period of 5 years and reported for tax purposes in this 60-month period an aggregate of $30,000 of income ($500×60), whereas he actually received only $24,000 ($400×60) in this period. In this case, he would be treated as having $6,000 as his "consideration for the contract." This consideration for the contract is then excluded under the bill from all retirement pay received after December 31, 1965, until the amount so excluded equals the "consideration for the contract." Thereafter, all retirement pay is included in gross income.

This special rule will also cover cases where a serviceman after retirement elects to receive veterans' benefits in lieu of some or all of his retirement pay. In such cases he may be required to pay to the U.S. Treasury an amount equal to the reduction in his retired pay resulting from electing the survivor's annuity. These deposits are made pursuant to section 1438 of title 10 of the United States Code and are treated as "consideration for the contract." Under the bill these amounts are recoverable in full on a tax-free basis from retirement pay before any of this pay is includible in gross income.

Another amendment (adding sec. 72(o) to the code) provides for the case where all of the consideration for the contract has not been offset against his retirement income at the time of the death of the retiree. Thus this amendment provides for the exclusion from gross income of all the payments received by the survivor until the amount so excluded equals any remaining "consideration for

the contract" not previously excluded from gross income by the retiree (under sec. 122(b)) or previously excluded from gross income (prior to 1966) by the survivor under section 72(b). Amounts received thereafter by the survivor are, of course, included in her income subject to tax. For both the retiree and his survivor this provision, together with the provision described above, provides for the full recovery of the consideration for the contract from the retirement pay (or from the survivor's annuity to the extent necessary) without regard to the life expectancy of the retiree or his survivor and without regard to whether or not this full amount may be recovered in the first 3 years of the survivor's annuity.

The application of new section 72(o) may be illustrated by the following example: Assume that a serviceman who was eligible to receive retired pay of $500 a month elected to receive reduced retired pay of $400 a month in order to provide an annuity for his wife of $200 a month upon his death, and that the serviceman received payments of $400 for 40 months before January 1, 1966. Assume further that no part of his retired pay is excludable from gross income by reason of disability or otherwise and that after attaining retirement age he dies on March 1, 1966, after receiving his retired pay of $400 for the months of January and February 1966. Under section 72(o) the widow will exclude the monthly payments she receives until she has excluded $3,200, since the consideration for the contract was $4,000 (40 times $100) and her husband was permitted to exclude under section 122(b) the two payments of $400 he received in January and February 1966, leaving $3,200 to be recovered tax free by his widow.

If the serviceman had died on July 1, 1965, after having received monthly payments of $400 for 34 months, the consideration for the contract would have been $3,400. Under section 72(o) the widow would be entitled to recover tax free the $3,400 less the amount she was entitled to exclude under section 72(b) of existing law with respect to the six monthly payments of $200 she received in the last 6 months of 1965 after her husband's death. Assume that by reason of the exclusion ratio under section 72(b) she was entitled to exclude $1,000 of the $1,200 she received in 1965, then beginning with the January 1966 payment she would be entitled to exclude the entire amount of 12 payments ($2,400) and thereafter she would include in gross income the entire amount of each monthly payment.

In determining whether there has been a recovery of the "consideration for the contract" by the retiree under section 122(b), there is not to be taken into account amounts which may be excluded from gross income under sections 104 (a)(4) and 105(d) of the code. These exclusions granted the retiree because of disability or sickness do not carry over to the surviving spouse since these exclusions are personally related to the retiree alone.

In cases where an individual whose name is removed from the temporary disability list receives a refund of an amount deducted from his retired pay, which was withheld while he was on the disability list to provide the survivor annuity (10 U.S.C. 1439), it is intended that, for taxable years beginning after December 31, 1965, he will be able to exclude from gross income that portion of the refunded amount which he would have been able to exclude if he had received the total amount of his retirement pay during the period he was on the temporary disability retired list.

Income tax exclusion for survivor, $5,000

The final income tax amendment made by the bill adds a new sentence to a provision in the code, relating to employee death benefits (sec. 101(b)(2)(D)).

Under present law, where the serviceman dies before retirement age but after having elected upon retirement for disability an annuity for his surviving spouse or certain other beneficiaries, the exclusion of up to $5,000 paid by an employer by reason of the death of the employee is not available because the annuity for the survivor is consdered as having been purchased by the "employee" rather than provided by the "employer." Because of the change made by this bill in the treatment of annuities for survivors in the case of servicemen, the annuity for the survivor no longer is considered as being purchased by the "employee." Therefore, the annuity of the survivor under this bill is treated as having been paid by the employer by reason of the death of the employee and in certain cases is eligible for the $5,000 income tax exclusion for the survivor.

The new sentence added to the employee death benefit provision (sec. 101(b)(2)(D)) by this bill provides that the death benefit exclusion is not to be

available in the case of an annuity paid under the retired serviceman's family protection plan if the individual who made the election under the plan died after attaining retirement age. Thus the exclusion in practice will be available only where the serviceman retired before normal retirement age because of disability and dies before attaining such age.

As in the case of other annuities the survivor's annuity provided under this bill for purposes of the $5,000 exclusion is to be valued on the date the former serviceman died (see first sentence of sec. 101(b)(2)(D)). Also, any amount excluded under the death benefit provision is, for the purposes of determining how much of the annuity is to be taxed, to be treated as additional consideration for the contract. (This is provided both by the second sentence of sec. 101(b)(2)(D) and also by the amendment adding sec. 72(o).)

The treatment described above will accord survivors under the retired serviceman's family protection plan the same treatment as survivors under the civil service retirement program (5 U.S.C. 2251 et seq.).

Income tax effective dates

The provision relating to employee death benefits applies with respect to individuals making the election with respect to an annuity for a survivor under chapter 73 of title 10 of the United States Code who die after December 31, 1965. The other income tax amendments apply with respect to taxable years ending after December 31, 1965.

Estate tax exclusion

The bill amends the estate tax provisions of the code (sec. 2039(c)(4)) to exclude from the gross estate on which the Federal death tax is levied the value of an annuity paid under the retired serviceman's family protection plan. This exclusion, however, does not apply to the extent any of the value of the annuity for the survivor is attributable to deposits (made pursuant to sec. 1438 of title 10) made by the deceased serviceman. This is the same treatment as provided under present law in the case of the civil service retirement program and other qualified pension plans.

Gift tax exclusion

The bill also amends the gift tax provisions (sec. 2517(a)(4)) to provide that the exercise, or nonexercise, by an employee of an election to provide an annuity for a survivor in lieu of a single pension is not to be considered a taxable transfer for gift tax purposes if made under the retired serviceman's family protection plan. This is the same treatment already available in the case of the civil service retirement program and other qualified pension plans.

Estate and gift tax effective dates

The estate tax amendment referred to above applies with respect to decedents dying after December 31, 1965, and the gift tax amendment applies with respect to calendar years after 1965.

[H.R. 12752] [1]

TAX ADJUSTMENT ACT OF 1966

[House of Representatives Report No. 1285, Eighty-ninth Congress, Second Session]

[February 15, 1966]

MR. MILLS, from the Committee on Ways and Means, submitted the following report to accompany H.R. 12752.

The Committee on Ways and Means, to whom was referred the bill (R.H. 12752) to provide for graduated withholding of income tax from wages, to require declarations of estimated tax with respect to selfemployment income, to accelerate current payments of estimated income tax by corporations, to postpone certain excise tax rate reductions, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. SUMMARY

H.R. 12752, the tax adjustment bill of 1966, is designed to contribute revenues to aid in financing the increased costs of government associated with operations in Vietnam. It is designed to help finance these costs in a manner which will avoid the creation of serious inflationary pressures.

The provisions of the bill, which are based upon recommendations made by the President with certain important modifications, are grouped under two headings. Most important from a revenue standpoint are the provisions which affect the procedures for collecting tax, but which do not affect tax liabilities. They include graduated withholding on wage income, tightening up the filing requirements for declarations, the acceleration of corporate estimated tax payments, and quarterly payments of estimated self-employment social security tax. The remaining provisions superimpose a 2-year moratorium on rate reductions scheduled under existing law for the excise taxes on passenger automobiles and telephone service. When this moratorium ends, these tax rates will immediately fall to the levels which would otherwise have been applicable under present law at that time, and will thereafter continue to be reduced as scheduled under existing law.

Revenue effect.—It is anticipated that these provisions will increase administrative budget revenues in the fiscal year 1966 by $1.2 billion and the revenues in the fiscal year 1967 by $4.8 billion relative to the levels that would be achieved under existing law. The temporary effects of the change in the timing of tax payments will be responsible for $1.1 billion of the added administrative budget revenues in the fiscal year 1966 and $3.6 billion of the increase in revenues in the fiscal year 1967. The quarterly payment of estimated self-employment tax will increase trust fund receipts, which are reflected in the consolidated cash budget but not in the administrative budget, by $200 million in the fiscal year 1967. The moratorium on excise tax reduction will retain $60 million in revenue which would otherwise be foregone in the fiscal year 1966 and $1.2 billion in revenue which would otherwise be foregone in the fiscal year 1967.

The provisions.—(1) *Graduated withholding.*—For wages paid after April 30, 1966, the bill replaces the present withholding tax rate with a series of six graduated rates ranging from 14 to 30 percent which are grouped in a system that takes account of the minimum standar deduction or deductions of 10 percent of wages and of the taxpayer's marital status as well as the statutory tax rates which apply to the first $12,000 of taxable income for single persons and $24,000 of taxable income for married persons.

[1] Public Law 89-368, page 379, this Bulletin.

Included in the bill is a provision, not a part of the President's recommendations, which is designed to reduce overwithholding. This provision, beginning in 1967, will permit taxpayers whose itemized deductions as a percentage of their wages are in excess of certain limits to claim withholding allowances. These allowances will have the effect of additional withholding exemptions. Withholding allowances will be based on the excess of estimated itemized deductions (which cannot exceed the deductions itemized in the previous year) over a prescribed amount of estimated wage income (which cannot be less than the wage income received in the previous year). The prescribed amount is a composite of 12 percent of the first $7,500 of estimated wages plus 17 percent of estimated wages in excess of $7,500. Beginning in 1967, withholding allowances may be claimed with respect to each full $700 of these excess itemized deductions. The Internal Revenue Service is authorized, and expected, to compile a table which will help taxpayers to determine the number of withholding allowances they may claim.

(2) *Quarterly payments of estimated self-employment tax.*—Effective for taxable years beginning after December 31, 1966, self-employed persons will be required to file declarations with respect to the total of their estimated income tax and self-employment tax and to make quarterly payments based on this declaration. The rules which now apply with regard to the requirement for filing a declaration of estimated income tax and the rules which govern the assessment of penalties for the underpayment of estimated tax will henceforth apply to the combined amount of estimated income tax and estimated self-employment tax.

(3) *Underpayment of estimated tax by individuals.*—Under existing law, a penalty may be incurerd by a taxpayer when the total of the amounts withheld from his wages and the amounts paid through quarterly payments of estimated tax are equal to less than 70 percent of the tax shown on his return. Effective for taxable years beginning after December 31, 1966, the present 70 percent provision is raised to 80 percent.

(4) *Acceleration of corporation income tax payments.*—The schedule bringing corporation payments of estimated income tax liabilities above $100,000 to a current basis will be accelerated so that the current payments basis will be reached in 1967 instead of 1970 as scheduled under present law. Calendar year corporations will pay 12 percent of their estimated tax liabilities in April and June 1966, instead of the presently scheduled 9 percent. In 1967 and in following years, they will pay 25 percent of estimated tax liabilities on each payment date.

(5) *Excise tax on passenger automobiles.*—The excise tax rate on passenger automobiles effective on the day after enactment of the bill will revert to 7 percent (the rate before January 1, 1966) from 6 percent, and there will be a moratorium until March 31, 1968, on further tax rate reductions scheduled under present law. At the expiration of the moratorium, the excise tax on passenger automobiles will fall to 2 percent, as presently scheduled for 1968, and then to 1 percent as presently scheduled for 1969. A tax of 1 percent will be imposed on dealer stocks of automobiles held on the day following the date of enactment. It will be collected from the dealers by the manufacturers.

(6) *Excise tax on telephone service.*—The excise tax rate on telephone service will revert to 10 percent (the rate before January 1, 1966), from 3 percent, on general and toll telephone and teletypewriter exchange services. It will be in effect until March 31, 1968, when it will decline to 1 percent and will be repealed on January 1, 1969, as scheduled under present law. Nonprofit hospitals will be exempt from the tax on telephone services. These provisions will be effective with respect to bills rendered on or after the first day of the month which begins 15 days after the effective date of this bill.

II. REVENUE EFFECTS

As indicated in table 1, your committee's bill is expected to increase fiscal year 1966 administrative budget receipts by $1,155 million and fiscal year 1967 receipts by $4,830 million. This latter figure is slightly above that recommended by the President. In addition, consolidated cash budget receipts will be further increased by $200 million in the fiscal year 1967. This increase differs from the recommendation of the President only in that the $200 million under his recommendation was spread over the fiscal years 1966 and 1967.

TABLE 1.—*Estimated revenue increase under H.R. 12752 for the fiscal years 1966 and 1967*

[In millions of dollars]

	Fiscal year 1966	Fiscal year 1967
Excises:		
Communication		785
Automobiles	60	420
Total excises	60	1,205
Corporate speed-up	1,000	3,200
Graduated withholding	95	275
Increase in declaration requirement under individual income tax from 70 to 80 percent		150
Total, administrative budget	1,155	4,830
Self-employment tax, social security, quarterly payments (goes into a trust fund)		200
Total, cash budget	1,155	5,030

The largest single source of additonal revenue provided by your committee's bill is attributable to advancing the payment dates for corporate tax. This is expected to increase revenues in the fiscal year 1966 by $1 billion and revenues in fiscal year 1967 by $3.2 billion. The excise reduction moratorium with respect to the taxes on automobiles and communications represents the second major revenue source under the bill. It is estimated that this will raise revenues by $60 million in the fiscal year 1966 and by $1.205 million in the fiscal year 1967. The provisions with respect to graduated withholding and the increase in the declaration requirement under the individual income tax from 70 to 80 percent of actual tax libility are expected to increase revenues by $425 million in the fiscal year 1967. The provision with respect to graduated withholding is expected to increase revenues in the fiscal year 1966 by $95 million.

TABLE 2.—*Revenue effect of provisions of H.R. 12752 relating to graduated withholding and declarations of estimated tax*

[In millions of dollars]

Provisions	Effective date	Full year effect	Change in receipts		
			Fiscal year 1966	Fiscal year 1967	Fiscal year 1968
6-rate graduated withholding	May 1, 1966	+1,240	+95	+400	
Extra withholding allowance for excess deductions [1]	Apr. 1, 1967	−770		−125	−190
Increase requirement for estimated tax from 70 to 80 percent	Apr. 15, 1967	+300		+150	
Total for individuals		+770	+95	+425	−190

[1] Assumes ⅔ utilization by eligible taxpayers.

Table 2 shows the revenue impact of the graduated withholding system and the declaration requirement change approved by your committee. Only the six-rate graduated withholding system has an impact in the fiscal year 1966. As previously indicated, this is expected to increase revenues in that year by $95 million. In the fiscal year 1967 a six-rate graduated withholding system with no allowances for excess itemized deductions would increase revenues by $400 million. If two-thirds of those eligible decrease overwithholding due to itemized deductions under the provision approved by your committee, this gain will be reduced by $125 million in the fiscal year 1967, resulting in a net gain from

graduated withholding of $275 million in the fiscal year 1967. However, your committee's action in raising the declaration requirement from 70 to 80 percent effective for the fiscal year 1967 is expected to increase revenues by $150 million. As a result these actions, taken together, give rise to an estimated revenue gain of $425 million for the fiscal year 1967, or slightly more than that recommended by the President. In the fiscal year 1968 the decrease in overwithholding attributable to allowances for itemized deductions will result in a loss of $190 million. This fiscal year 1968 loss of $190 million is a loss over and above any which would be incurred under the President's recommendations. However, there is a gain of $65 million in that year arising from extending the excise tax rates for passenger cars and communication services until April 1, 1968, which also would not be realized under the President's recommendations.

III. REASONS FOR THE BILL

1. Fiscal and economic impact

The tax adjustment bill of 1966 will help provide the additional revenues which your committee is advised will be required by the conflict in Vietnam. This bill is designed to help finance the additional expenditures required for this purpose without generating serious inflationary pressures in the domestic economy. The additional revenues will be derived from two general types of provisions. The first consists of improvements in tax collection procedures which, without affecting tax liabilities, involve a temporary increase in the amount of revenues by making payments more current. The remaining provisions restore rates in effect on December 31, 1965, and impose a 2-year moratorium on presently scheduled reductions in the excise taxes on passenger automobiles and telephone service.

Were it not for special Vietnam costs, administration testimony before your committee has informed us, the increase in Federal revenue attributable to the growth of the economy—growth largely in response to the tax reductions enacted in recent years—would be sufficient not only to meet the regular requirements of Federal operations but also to provide a surplus. The President's budget message indicates that special Vietnam expenses will account for an estimated $10.5 billion of administrative budget expenditures for the fiscal year 1967. These expenses account for $5.8 billion of the $6.4 billion increase in expenditures in the fiscal year 1967 over those for the fiscal year 1966. It is estimated that revenues would increase by $7.5 billion between the 2 fiscal years if no change were made in existing tax laws, an amount that would be sufficient to produce a substantial budget surplus were it not for the extraordinary defense requirements. It will be recalled that when the House was considering what became the Revenue Act of 1964 [P.L. 88–272, C.B. 1964–1 (Part 2), 6]—which provided a reduction of $11.5 billion, the largest reduction ever provided—the then Secretary of the Treasury Douglas Dillon indicated that despite this reduction, it might be possible to balance the budget in the fiscal year 1967. It should be noted that this objective of a balanced budget in the fiscal year 1967 would be obtained were it not for the extraordinary defense expenditures arising from the conflict in Vietnam. Thus, were it not for the special Vietnam expenses of $10.5 billion, there would be no need at this time for the 2-year excise tax reduction moratorium or for an advancement of the corporate tax payments at a more rapid rate then originally planned.

As a result of these extraordinary defense requirements, this bill provides additional temporary revenues designed to improve the budgetary outlook for both the fiscal years 1966 and 1967 as indicated in table 3.

Its provisions will increase revenues over present law yields in the current fiscal year by an estimated $1.2 billion on an administrative budget basis and by $4.8 billion in the following fiscal year. As a result, the deficit in the administration's budget expected for fiscal 1966 will be reduced from $7.6 to $6.4 billion, and will fall sharply to $1.8 billion in fiscal 1967. Viewed from the basis of the consolidated cash budget, the results of the bill will be even more significant. The anticipated consolidated cash budget deficit for the fiscal year 1966 is expected to be $6.9 billion. In the fiscal year 1967, this deficit will be eliminated and a small surplus achieved as a consequence of the $5 billion that will be added to cash receipts by this bill in that year. Moreover, the bill will increase fiscal 1966 cash receipts by $1.2 billion.

TABLE 3.—*Comparison of administrative budget receipts and expenditures with and without H.R. 12752, fiscal years 1966 and 1967*

[In billions of dollars]

	Fiscal year 1966	Fiscal year 1967	Change fiscal year 1967 over fiscal year 1966
Expenditures	106.4	112.8	+6.4
Receipts without bill	98.8	106.2	+7.3
Deficit without bill	7.6	6.7	−0.9
Increase in receipts under bill	+1.2	+4.8	+3.7
Total receipts (including those under this bill)	100.0	111.0	+11.0
Deficit after taking account of revenues under this bill	6.4	1.8	−4.6

NOTE. Figures are based on President's budget message, and therefore totals include estimated effects of proposed legislation other than H.R. 12752. Figures are rounded and will not necessarily add to totals.

The modifications in collection procedures enacted in this bill—that is, graduated withholding, tighter declaration requirements quarterly self-employment tax payments, and faster corporate income tax payments—will have a signficant effect on revenues even though they will not increase tax liabilities. These changes in timing will result in the collection of some revenues in fiscal 1966 and fiscal 1967 which would otherwise not be collected until the following years. Once the transition to the new collection procedures is completed, however, tax payments by individuals and corporations during each fiscal year will (apart from the effect of growth in the economy) be no greater than under present law.

It is expected that the increased tax collections that result from this bill will have a moderating influence on the expenditures of individuals and business firms. This influence will tend to offset the expansionary effects of increased defense expenditures. Such a policy is appropriate in view of the near capacity levels of output and employment at which the economy is now operating. In the absence of the moderating influence of increased tax collections, the total of private demand and Government requirements would threaten to exceed the present capacity of the Nation's productive resources, and in that manner constitute a threat to price stability.

The Nation has enjoyed 5 years of uninterrupted economic expansion, the longest period of peacetime expansion in U.S. business cycle annals. In 1961, at the start of the expansion, civilian labor force unemployment reached 7 percent and 22 percent of manufacturing capacity remained idle. The Revenue Acts of 1962 [P.L. 87–834, C.B. 1962–3, 111] and 1964 [P.L. 88–272, C.B. 1964–1 (Part 2), 6] and the Excise Tax Reduction Act of 1965 [P.L. 89–44, C.B. 1965–2, 568] were in large part directed at the removal of restraints to growth in the private sector of the economy arising from tax rates that were too high. Largely as a result of these measures, the rate of unemployment fell to 4 percent of the labor force in January 1966, and the capacity utilization index in manufacturing rose to 91 percent in the fourth quarter of 1965.

Today the gap between potential and actual output has thus been greatly narrowed. This is suggested by the recent behavior of the consumer and wholesale prices indexes. After 4 years of virtual stability, the index of wholesale prices increased 2 percent from 1964 to 1965. The percentage increases in the consumer price index from 1960 to 1964 averaged 1.2 percent a year. In 1965 the percentage increase was 1.7 percent and would have been 1.9 or 2 percent but for the effect of excise tax reductions enacted in the Excise Tax Reduction Act of 1965.

Evidence of the approach to the full use of our capacity is also indicated in statistics on capacity utilization rates in various industries. In December 1965, several important industries were operating at or above their preferred operating rates and the overall utilization index was only 1 point below the average preferred operating rate.

As pointed out to your committee by the Secretary of the Treasury, the various provisions of the bill will have a restraining influence on demands on available

capacity. Following the enactment of this bill, the amounts withheld from individual wages will increase by $1.24 billion at annual rates under the six-rate graduated withholding system. While these increased collections of $1.24 billion will be reflected in reduced amounts of tax due when final returns are filed in the spring of 1967 and, to a limited extent, in increased tax refunds, they will tend to reduce consumer purchases during the remaining portion of 1966 and during the early months of 1967.

The fiscal effect of more accurate withholding will be reinforced by the requirement that taxpayers pay at least 80 percent of their liability for the year through withholding, payments of estimated tax, or both, to avoid penalties for underpayments of estimated tax. This, too, will tend to lessen consumer spending during this period of extraordinary military expenditures. Presently only 70 percent of the final liability need be paid to avoid the application of penalties. (As under present law, however, penalties will not be imposed where payments equal the prior year's tax or are based on the prior year's income, or certain other conditions are met).

The postponement of some corporate investment expenditures, as will occur as a result of the acceleration of corporate tax payments for the larger corporations will be favorable to continued economic stability. Current levels of corporate investment in new plant and equipment are high. Outlays for business fixed investment rose by 11.5 percent in 1964 and by 15.4 percent in 1965 as compared with an average annual rate of increase of 7.5 percent in 1962 and 1963. Present announced plans indicate that investment will again increase at a rapid rate in the the first half of 1966. Mild restraint, therefore, may well promote better balance between the rate of growth of output and investment in expanded capacity. It will also support our effort to reduce the deficit in our balance of payments to manageable levels. A source of strength in the balance-of-payments outlook in recent years has been the comparative stability in the prices of U.S. goods as compared to rising prices of the goods of other nations.

2. Correlating withholding with tax liabilities

Apart from their beneficial budgetary and economic effects, improved collection techniques will mean important benefits to taxpayers. Under graduated withholding, amounts withheld will more nearly approximate final liabilities. In particular, fewer taxpayers will have substantial amounts of tax to pay when they file their final return for the year. Last year for many taxpayers the fact that such bills remained to be paid in the spring of 1965 caused a measure of financial hardship and considerable resentment which tended to blunt the very substantial benefits provided by the Revenue Act of 1964. Unless graduated withholding is enacted, this experience is likely to be repeated in future years. Thus, this is a desirable improvement in collection procedures wholly apart from the temporary revenue increase.

Your committee's bill incorporates a special withholding allowance which provides relief for those taxpayers who itemize deductions and would otherwise find that withholding resulted in substantial unwanted overpayment of tax. This feature will also promote more accurate withholding as is shown subsequently in table 4 in this report.

3. Change in corporate payments merely an advance in timing

The proposal regarding corporate tax payments accomplishes by 1967 what would otherwise be accomplished by 1970. The Revenue Act of 1964 provided that corporations were to estimate and pay currently that portion of their tax liability expected to exceed $100,000, but the transition to current payment was scheduled over a period which was to end in 1970. This bill simply achieves that transition by 1967. Instead of paying 9 percent of their estimated liabilities in excess of $100,000 in April and June of 1966, calendar-year corporations will be required to pay 12 percent. In the final two quarters of 1966, these corporations will pay the same percentage, 25 percent, of these estimated liabilities as they are required to pay under present law. In 1967, these corporations will be required to pay in each quarter amounts equal to 25 percent of their estimated liabilities in excess of $100,000. Under existing law, they would pay installments of 14 percent of this estimated liability in April and June 1967 and installments of 25 percent in September and December 1967. Tables 9 and 10, presented subsequently in this report, show the schedules of payments under present law and under the bill.

4. Self-employment social security tax placed on current basis.

This bill makes provision, for the first time, for the declaration and quarterly payment of estimated social security tax liabilities with respect to self-employment income. This bill places self-employed persons on the same current payment basis for social security tax purposes as they are on now for income tax purposes, and does so with a minimum degree of added complication. The declaration and estimated taxpayment system now in effect is simply broadened to include estimated self-employment social security tax.

5. Two-year moratorium for auto and telephone excise reductions

The excise tax rate reductions scheduled under present law for 1966 and later years in the case of telephone service and passenger automobiles are not rescinded by this bill. They are merely postponed for 2 years. This bill makes explicit provision for reduction on April 1, 1968, of these rates to the levels which would prevail under existing law, emphasizing the fact that the moratorium on rate reduction, while necessary in view of current budgetary and economic conditions, is not intended to cancel the eventual reductions of the 1965 act. Thus, the bill as reported by your committee in this respect differs to a significant degree from the proposals of the administration: the administration would have postponed the auto and telephone excise tax reductions for 2 years—not only the reductions occurring in the next 2 years, but also the reductions occurring after that time. Your committee's bill, on the other hand, merely provides a moratorium for the reductions which would under present law occur in the next 2 years. Under the bill, the rates will fall at the end of the 2-year period to the level they would have been at under present law at that time, and subsequent reductions under present law are not further postponed.

The excises on telephone service and passenger automobiles are selected for a number of reasons in addition to the fact that they yield substantial revenues. They are currently in effect, so that a moratorium on rate reduction is a much simpler matter administratively for business firms and the Government (since the payment and collection machinery is still in effect) than the reinstitution of excises previously repealed. The fact that these excises were not repealed outright by the Excise Tax Reduction Act of 1965 but were scheduled for gradual reduction also is indicative of the order of priorities in excise tax reduction established by the Congress in 1965. Moreover, the burden of these taxes is widely dispersed over the population, and, therefore, a disproportionate burden will not be imposed on a narrow segment of the population as a result of the moratorium.

IV. GENERAL EXPLANATION

1. Graduated withholding. (Sec. 101 of the bill and sec. 3402 of the code.)

(*a*) *Present law.*—Under present law, employers withhold Federal income tax from wages and salaries at the rate of 14 percent after recognizing the withholding exemptions claimed by an employee for himself, his wife and any dependents. The 14-percent rate is equivalent to the average of the four tax rates which apply to the initial $2,000 of taxable income ($4,000 for married couples), reduced to reflect the 10-percent standard deduction. To further reflect the standard deduction, the value of exemptions is increased from $600 to $667 for withholding purposes.

Employees claim withholding exemptions by filing withholding exemption certificates with their employers. These certificates remain in force until superseded by the submission of later ones. The number of exemptions claimed may be less than, but cannot exceed, the number of allowable exemptions. If the employer agrees, the employee may arrange to have extra amounts withheld from his wages.

The present 14-percent withholding rate went into effect on March 5, 1964, implementing the rate reductions enacted in the Revenue Act of 1964. It superseded the withholding rate of 18 percent which had been in effect since 1954. The latter was equivalent to the 20-percent tax rate on the first $2,000 of taxable income ($4,000 for married couples) reduced to reflect the 10-percent standard deduction.

(*b*) *General explanation of graduated rates.*—Under the present withholding system, taxpayers, including those who derive all their income from wages subject to withholding, often find that the amount of tax withheld from their

wages differs substantially from their income tax liability for the year. As a result, if the present system were continued, an estimated 12.5 million tax returns would show a tax liability for the year 1966 significantly in excess of the amount of tax withheld. At the same time, an estimated 39.8 million taxpayers, 20 million of them with incomes of $5,000 or less, would have tax liabilities significantly less than the amounts withheld from them. Those taxpayers who are underwithheld, in the sense that withholding falls short of their tax liability, must make payments when they file their final return for the year. When such payments are unexpected, as they were for many taxpayers in 1965, they can cause resentment and, at times, financial hardship. While taxpayers who are overwithheld receive a tax refund when they file their final returns, for some, particularly those whose refund is large relative to their income, it can be a hardship to wait for such a refund.

In the past the single-rate withholding structure resulted both in substantial underwithholding and overwithholding. However, the problem has become worse. With respect to underwithholding, the steady rise in individual and family incomes has lifted many taxpayers into income brackets where the present withholding rate falls substantially short of their effective rate of tax. Moreover, important structural provisions enacted in the Revenue Act of 1964 are not reflected in the present system.

Formerly, the first taxable income bracket covered the initial $2,000 of taxable income for single persons and the initial $4,000 of taxable income for married couples. In 1964 this range of taxable income was divided into four smaller brackets. To preserve the relationship between the withholding rate and taxable income that existed in the past, adopt a withholding rate that reflected the average of the first four statutory rates rather than the lowest such tax rate. The Revenue Act of 1964 also introduced the minimum standard deduction. This provision permits taxpayers with incomes which are low in relation to the size of their family to deduct an amount which exceeds 10 percent of their adjusted gross income even though they do not itemize deductions The present withholding system, however, still takes into account only the 10-percent standard deduction.

As a result of the structural changes enacted in 1964, the present 14-percent withholding rate overwithholds on persons whose taxable income is less than $2,000 if single or $4,000 if married. This is true even though such persons claim only the standard or minimum standard deduction, derive all their income from wages subject to withholding, are steadily employed during the year, and experience no increase in exemptions during the year.

At the same time, persons with incomes above these limits are likely to experience underwithholding, since they are subject to income tax rates well in excess of 14 percent. Thus, of the 63.1 million tax returns expected to be filed in 1966 upon which wages and salaries will be noted and with respect to which no declaration payments will be made, on only 10.8 million returns would tax withheld come within $10 of the actual liability under the present withholding system. Of the remaining 52.3 million returns, 39.8 million would show overwithholding and 12.5 million, underwithholding.

The withholding system proposed in your committee's bill will insure that for most wage earners amounts withheld will more closely approximate the final tax liability. The proposed system reflects fully the graduated rates in the income tax rate scale for taxable incomes up to $12,000 for single persons and $24,000 for married couples. Even for returns with higher taxable incomes which show wage income, graduated withholding will be far more accurate than the existing system. Moreover, these returns number only an estimated 600,000.

The proposed system also reflects the minimum standard deduction. This fact, taken in conjunction with the graduated rates and the withholding allowances, will reduce the amount of overwithholding from those with low and middle incomes, as is shown in table 4. It is estimated, for example, that on returns listing income of $5,000 or less, the total amount of overwithholding will decline by $580 million. This will be sufficient to reduce the number of returns in this group on which overwithholding exceeds $10 from 20.0 to 12.9 million and to increase the number of returns on which withheld tax comes to within $10 of the final liability from 8.4 to 15.4 million. On returns with incomes of $5,000 but less than $10,000, overwithholding will be reduced by $375 million, largely as a result of the provision for withholding allowances described below.

Your committee's bill includes a special relief provision which persons with substantial itemized deductions may elect and which further improves the

accuracy of the withholding system. This feature, which was not included in the President's recommendations, permits taxpayers to claim withholding allowances with their employer, which will have the same effect as withholding exemptions, when their estimated itemized deductions exceed a specified amount of their estimated wage and salary income.

The special relief provision is included in recognition of the fact that taxpayers with substantial itemized deductions are likely to be overwithheld under both the existing withholding rate and the proposed rate. Overwithholding occurs because most of those who itemize have deductions which, in total, exceed the allowance for deductions which is built into both the existing withholding system and the system provided in this bill. In both cases, the allowance for deductions, apart from the allowance for the minimum standard deduction, is equal to 10 percent of wage and salary income. In 1962, for example, itemized deductions were equal on the average to 19.6 percent of the adjusted gross incomes listed on the 26.5 million returns upon which the standard deduction was not employed. Under 14 percent withholding, the resulting overwithholding arising from the use of these itemized deductions is estimated to account for 44 percent of the overwithholding at 1966 income levels.

Under the graduated withholding rates, the importance of itemized deductions as a cause of overwithholding would increase substantially in the absence of the special relief provision. It is estimated that the amount of overwithholding due to itemized deductions would increase to $3.7 billion at 1966 income levels and would comprise 59 percent of the expected amount of overwithholding. Moreover, if voluntary adjustments are disregarded as a source of overwithholding, the percentage of overwithholding attributable to itemized deductions would approximate 70 percent.

The special provision is not intended for the use of all taxpayers with wage income who itemize their deductions, but is designed for the relief of those persons for whom overwithholding might otherwise become a burden. Therefore, when estimated wages are $7,500 or less, withholding allowances are based on the amount of itemized deductions estimated to exceed 12 percent of wage and salary income and, when estimated wage income exceeds $7,500, they are based on the total of $900 (12 percent of $7,500) plus 17 percent of wage and salary income in excess of $7,500. Withholding allowances are not based on the excess of estimated itemized deductions over 10 percent of estimated wage and salary income in recognition of the fact that many taxpayers receive some income that is not subject to withholding and that the average amount of such income is greater at high-income levels than at low-income levels. The method of computing withholding allowances minimizes the possibility that a taxpayer who receives dividends interest or other nonwage sources of income will inadvertently overcompensate for his itemized deductions and have a bill due at the end of the year which he would not otherwise have incurred. It also reduces the effect of overestimates of deductions, or underestimates of income, leading to underwithholding.

Table 4 indicates the effect of the graduated withholding provision of the bill and contrasts that effect with the present system and the 6-rate system recommended by the President.

Explanation of provisions.—(*a*) *Graduated withholding generally.*—Your committee's bill substitutes six graduated rates for the present withholding rate and incorporates features designed to reflect the minimum standard deduction. Moreover, it permits employees who would otherwise be overwithheld to make adjustments if their itemized deductions exceed specified amounts.

The graduated rates, which range from 14 percent to 30 percent, are included in two separate rate schedules, one for single persons and heads of households, and the other, with wider brackets to take account of statutory income splitting, for married persons and surviving spouses.

The minimum standard deduction is taken into account by raising the value of the exemption to $700 for withholding purposes and by establishing an initial band of wage income after exemptions, equal to $200 on an annual basis, from which no tax will be withheld. This is consistent with the provisions regarding the minimum standard deduction, which provide a deduction equal to a basic $200 amount for a single person, a head-of-household, or a married couple, and an additional $100 amount for each exemption claimed. The rate schedule reflects an allowance for deductions of approximately 10 percent of wage and salary income at wage levels where the minimum standard deduction is not used.

TABLE 4.—*Effect of graduated withholding provisions of H.R. 12752* [1]

	Present 14 percent withholding	Change resulting from—			Graduated withholding
		6-rate system	Extra $700 allowance [2]	Combined total	
All returns:					
A. Number of returns (millions):					
1. Overwithholding	39.8	−6.3	−0.7	−7.0	32.8
2. Underwithholding	12.5	−3.5	+0.6	−2.9	9.6
3. Breakeven [3]	10.8	+9.8	+0.1	+9.9	20.7
4. Total	63.1				63.1
B. Amount (millions of dollars):					
1. Overwithholding	6,130	+50	−700	−650	5,480
2. Underwithholding	2,700	−1,190	+70	−1,120	1,580
3. Total withholding	36,440	+1,240	−770	+470	36,910
Under $5,000 adjusted gross income:					
A. Number of returns (millions):					
1. Overwithholding	20.0	−7.0	−0.1	−7.1	12.9
2. Underwithholding	3.0	[4]	+0.1	+0.1	3.1
3. Breakeven [3]	8.4	+7.0	[4]	+7.0	15.4
4. Total	31.4				31.4
B. Amount (millions of dollars):					
1. Overwithholding	2,130	−500	−80	−580	1,550
2. Underwithholding	340	[4]	[4]	[4]	340
3. Total withholding	5,720	−500	−80	−580	5,140
$5,000 to $10,000 adjusted gross income:					
A. Number of returns (millions):					
1. Overwithholding	15.0	−1.4	−0.4	−1.8	13.2
2. Underwithholding	5.7	−1.2	+0.3	−0.9	4.8
3. Breakeven [3]	2.0	+2.6	+0.1	+2.7	4.7
4. Total	22.7				22.7
B. Amount (millions of dollars):					
1. Overwithholding	3,000	−20	−355	−375	2,625
2. Underwithholding	760	−250	+25	−225	535
3. Total withholding	17,140	+230	−380	−150	16,990
$10,000 and over adjusted gross income:					
A. Number of returns (millions):					
1. Overwithholding	4.8	+2.1	−0.2	+1.9	6.7
2. Underwithholding	3.8	−2.3	+0.2	−2.1	1.7
3. Breakeven [3]	0.4	+0.2	[4]	+0.2	0.6
4. Total	9.0				9.0
B. Amount (millions of dollars):					
1. Overwithholding	1,000	+570	−265	+305	1,305
2. Underwithholding	1,600	−940	+45	−895	705
3. Total withholding	13,570	+1,510	−310	+1,200	14,780

[1] Based on taxable and nontaxable returns with no declaration payments.
[2] Assumes ¾ utilization by eligible persons.
[3] Breakeven defined as within $10 of the tax liability.
[4] Negligible.

NOTE.—Based on calendar year 1966 levels of income. The terms "overwithholding" and "underwithholding" in this table means the difference between actual tax liabilities (based on all types of income, deductions, etc.) and the amount of tax withheld from wages and salaries.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

The withholding rate schedules for single persons and married persons as applied to an annual basis are as follows:

SINGLE PERSON

If the amount of wages reduced by $700 times the number of exemptions is:	*The amount of income tax to be withheld is:*
Not over $200	0.
Over $200 but not over $700	14% of wages in excess of $200.
Over $700 but not over $1,200	$70 plus 15% of wages in excess of $700.
Over $1,200 but not over $4,400	$145 plus 17% of wages in excess of $1,200.
Over $4,400 but not over $8,800	$689 plus 20% of wages in excess of $4,400.
Over $8,800 but not over $11,000	$1,569 plus 25% of wages in excess of $8,800.
Over $11,00	$2,119 plus 30% of wages in excess of $11,000.

MARRIED PERSON

If the amount of wages reduced by $700 times the number of exemptions is:	*The amount of income tax to be withheld is:*
Not over $200	0.
Over $200 but not over $1,200	14% of wages in excess of $200.
Over $1,200 but not over $4,400	$140 plus 15% of wages in excess of $1,200.
Over $4,400 but not over $8,800	$620 plus 17% of wages in excess of $4,400.
Over $8,800 but not over $17,700	$1,368 plus 20% of wages in excess of $8,800.
Over $17,700 but not over $22,000	$3,148 plus 25% of wages in excess of $17,700.
Over $22,000	$4,223 plus 30% of wages in excess of $22,000.

As under present law, employers will be permitted to compute withholding by means of either wage-bracket tables or by means of a percentage method. Wage-bracket tables for the various payroll periods now recognized, as set forth in the bill, will be distributed by the Internal Revenue Service. Instructions for applying the percentage method will also be supplied.

With regard to any irregular supplemental wage payment, such as a bonus, employers will be permitted either to compute withholding by treating the payment as if it were part of the current or preceding regular wage payment or by applying a flat percentage rate to the supplemental wage payment without making any allowance for exemptions. It is expected that the regulations will provide for a flat rate of around 20 percent.

For the purpose of graduated withholding, married persons will be required to file new withholding exemption certificates with their employers if they wish to have the tax withheld from them based on the rates applicable to married couples. A person who is married to a nonresident alien, or a person legally separated from his spouse under a decree of divorce or separate maintenance, will be considered single for withholding purposes. A "surviving spouse"—i.e., a person whose spouse died during one of the two immediately preceding taxable years—and also a person whose spouse died during the taxable year, will be considered married for withholding purposes unless the deceased spouse was either a nonresident alien or was legally separated from the taxpayer under a decree of divorce or separate maintenance at the time of his death.

Employers are required to compute withholding on the basis of the rates applicable to single persons if an employee fails to submit a new withholding exemption certificate.

(*b*) *Withholding allowances for persons with substantial itemized deductions.*—Your committee's bill establishes a procedure whereby taxpayers with relatively large itemized deductions may claim withholding allowances in addition to the regular withholding exemptions. Each of these allowances will have the same effect on withholding from wages and salaries as a claimed exemption; that is, it will exempt $700 from withholding on an annual basis.

Taxpayers who wish to utilize this procedure will be required to estimate their wage and salary income and the amount of their itemized deductions. The amount of estimated wage and salary income for this purpose, however, may not be less than the amount shown on the return for the previous year, while the estimated amount of itemized deductions may not exceed the amount of such deductions claimed on the tax return filed for the previous year.

For those with estimated wage or salary incomes of $7,500 or less, the number of withholding allowances will be based on the amount by which estimated itemized deductions exceed 12 percent of estimated wage and salary income. For those with higher estimated wages, the allowances will be based on the excess over the total of $900 (12 percent of $7,500) plus 17 percent of estimated wage and salary income in excess of $7,500. One allowance may be claimed with respect to each full $700 of such excess. For example, if his estimated wage income for the year is $7,000, a taxpayer with $2,000 in estimated itemized deductions will be permitted to claim one withholding allowance based on the fact that his estimated itemized deductions exceed 12 percent of his estimated wages by more than $700 but by less than $1,400.

Claims for withholding allowances will be filed by employees with their employers on withholding exemption certificates or similar forms. The employer will then withhold tax on the basis of the total of the claimed exemptions and withholding allowances. For a calendar year taxpayer, claims for withholding allowances will remain in effect during the period in the calendar year which

remains after the claim is filed and, unless a claim for the next year is filed, for the first 4 months of that year. Withholding allowances must be claimed anew each year. After May 1 of each year, employers will be required to disregard withholding allowances claimed on withholding exemption certificates filed in a prior calendar year. The fact that withholding allowances must be disregarded when a new claim is not filed will not affect the number of exemptions for dependents, etc., to be taken into account. The employer will continue to compute withholding on the basis of the number of these exemptions shown on the last withholding exemption certificate filed by the employee.

The Secretary of the Treasury or his delegate is authorized to design ready reference tables which will simplify the determination of the number of withholding allowances to which an employee is entitled and it is the committee's understanding that this will be done. When promulgated, such tables will be supplied to employers for the guidance of their employees. The Secretary of the Treasury or his delegate is further authorized to take into account in these tables (or in other ways), the fact that, at high-income levels, the withholding rates established by this bill are sufficiently below the tax rates so as to offset the need for additional withholding allowances.

To facilitate the above procedure, the bill increases the number of dates on which employers will be required to recognize changes in the number of exemptions and withholding allowances claimed by employees. In addition to the existing January 1 and July 1 status determination dates upon which such changes must now be recognized, the bill adds the further dates of May 1 and October 1. As under existing law, employers will be permitted to give effect to amended withholding exemption certificates prior to the given dates if they wish to do so.

The bill also provides that for married couples the computation as to whether they are entitled to withholding allowances must be made on a joint basis unless they filed separate returns for the prior year and expect to file separate returns for the current year. Married couples may divide the exemptions and withholding allowances to which they are jointly entitled if both receive wages subject to withholding. Furthermore, the bill requires that employees who work simultaneously for two or more employers may claim withholding allowances with only one of these employers.

The bill also provides a civil penalty of $50 to be imposed when a taxpayer lists wage and salary income of less than the amount received in the previous year or if he lists itemized deductions in excess of the amount claimed in the previous year. The civil penalty does not apply, however, if the misstatement does not result in reduced withholding or the tax liability does not exceed the amount withheld plus the payments of estimated tax.

Present law (sec. 7205) already provides that where an individual who is required to supply information to his employer under the withholding tax provision willfully supplies false or fraudulent information or willfully fails to supply information he is to be fined not more than $500 or imprisoned for not more than 1 year, or both. This presently applies to withholding tax exemptions and, under the bill, is extended to withholding allowances since for purposes of the internal revenue laws these allowances are treated as withholding exemptions. It should be noted, however, that this criminal penalty applies only in the case of "willful violations," and in practice it is applied only where the omission or failure results in a substantial amount of underwithholding.

(*c*) *Effective date.*—Withholding under the new graduated rates is to apply with respect to remuneration paid after April 30, 1966. The special relief procedures for persons with substantial itemized deductions will apply in years beginning after December 31, 1966. It was thought that this latter provision should not apply before 1967 because time was needed to acquaint taxpayers with the basic 6-rate graduated withholding system. Moreover, since the graduated system is not in effect for the first 4 months of 1966, and any overwithholding attributable to these rates is not expected to be serious in 1966.

(*d*) *Revenue effect.*—It is estimated that the proposals relating to graduated withholding will increase the amount of tax withheld by $1,240 million at annual rates during the calendar year 1966. When the procedures for claiming withholding allowances become effective, this amount will be reduced, if two-thirds of those eligible avail themselves of the procedure, to $470 million. As a result of the increase in amounts withheld, there will be a temporary increase in Federal tax collections of $95 million in budget receipts in the fiscal year 1966 and an increase of $275 million in budget receipts for the fiscal year 1967. A decrease

in revenue of $190 million is expected in the fiscal year 1968 because the impact of the withholding allowance system is not fully effective until that time.

(*e*) *Effect of graduated withholding at different income levels.*—Table 5 compares the average amount of overwithholding and underwithholding under present law and under the graduated withholding system for all returns, for those with adjusted gross income under $5,000, for those with income between $5,000 and $10,000, and for those with such income over $10,000. As is indicated in this table, your committee's bill makes a substantial reduction in underwithholding, decreasing this in the average case from $151 to $79. In addition, the bill, although primarily concerned with underwithholding, also substantially decreases overwithholding as well. This is attributable both to the provision for the minimum standard deduction in the lower brackets and also to the provision for a withholding allowance for those with substantial overwithholding. It should be noted that in the average case overwithholding under your committee's action is decreased in all three of the major income categories as well as on an overall basis.

TABLE 5.—*Comparison of average amounts of underwithholding and overwithholding under present law and under the tax adjustment bill of 1966*

	Present 14 percent withholding			Graduated withholding including withholding allowances		
	Returns [1]	Amount	Average	Returns [1]	Amount	Average
All returns:	*Millions*	*Millions*		*Millions*	*Millions*	
Overwithholding	45.2	$6,130	$136	43.2	$5,480	$127
Underwithholding	17.9	2,700	151	19.9	1,580	79
Under $5,000 adjusted gross income:						
Overwithholding	24.2	2,130	88	20.6	1,550	75
Underwithholding	7.2	340	47	10.8	340	31
$5,000 to $10,000 adjusted gross income:						
Overwithholding	16.0	3,000	188	15.6	2,625	168
Underwithholding	6.7	760	113	7.1	535	75
$10,000 and over adjusted gross income:						
Overwithholding	5.0	1,000	200	7.0	1,305	186
Underwithholding	4.0	1,600	400	2.0	705	353

[1] Returns from the $10 tolerance breakeven class have been assigned equally to overwithholding and underwithholding.

Tables 6–A through 6–G show the tax liability for single persons, married couples with no dependents, and married couples with two dependents for various wage income levels. This tax liability is shown for varying assumed levels of standard (or minimum standard) or itemized deductions. The assumptions shown are for a 10-percent deduction, a 15-percent deduction, a 20-percent deduction, a 22½-percent deduction, a 25-percent deduction, a 27½-percent deduction, and a 30-percent deduction. With the tax liability in each of these cases, there is shown the amount withheld at the 14-percent flat rate of existing law and also under the graduated withholding provided by your committee's bill. The special withholding allowance provided by your committee's bill for those with substantial itemized deductions begins to decrease overwithholding above the 15-percent level.[2] Thus the impact of this allowance is shown only on tables 6–C through 6–G. For these tables the effect of this allowance is taken into account in the amount of withholding under the graduated withholding system. However, the impact of graduated withholding with and without this allowance is shown in the columns relating to overwithholding or underwithholding. These tables show both the change in withholding from present law and the overwithholding or underwithholding under present law and under the graduated withholding system without regard to these allowances and with regard to these allowances.

[2] Although itemized deductions are taken into account on the first $7,500 of income where they exceed 12 percent, this nevertheless does not result in the availability of a special withholding allowance below the 15-percent level because this allowance is available only when there is a full $700 above the 12 percent.

TABLE 6–A.—*Tax liability and withholding under present 14 percent and graduated withholding (6-rate) for selected taxpayers (assumes 10 percent deductions or minimum standard deduction)*

Wage income	Tax liability	Amount of withholding		Change in withholding	Overwithholding (+) or underwithholding (−)	
		Present 14 percent	Graduated withholding		Present 14 percent	Graduated withholding
SINGLE INDIVIDUAL						
$1,000	$16	$47	$14	−$33	+$31	−$2
$2,000	163	187	162	−25	+24	−1
$3,000	329	327	332	+5	−2	+3
$5,000	671	607	672	+65	−64	+1
$7,500	1,168	957	1,169	+212	−211	+1
$10,000	1,742	1,307	1,694	+387	−435	−48
$12,500	2,398	1,657	2,359	+702	−741	−39
$15,000	3,154	2,007	3,109	+1,102	−1,147	−45
$20,000	4,918	2,707	4,609	+1,902	−2,211	−309
$25,000	6,982	3,407	6,109	+2,702	−3,575	−873
$35,000	11,627	4,807	9,109	+4,302	−6,820	−2,518
MARRIED COUPLE, NO DEPENDENTS						
$2,000	$58	$93	$56	−$37	+$35	−$2
$3,000	204	233	200	−33	+29	−4
$5,000	501	513	500	−13	+12	−1
$7,500	914	863	909	+46	−51	−5
$10,000	1,342	1,213	1,334	+121	−129	−8
$12,500	1,831	1,563	1,828	+265	−268	−3
$15,000	2,335	1,913	2,328	+415	−422	−7
$20,000	3,484	2,613	3,373	+760	−871	−111
$25,000	4,796	3,313	4,703	+1,390	−1,483	−93
$35,000	7,997	4,713	7,703	+2,990	−3,284	−294
MARRIED COUPLE, 2 DEPENDENTS						
$3,000	$4	$46	0	−$46	+$42	−$4
$5,000	290	326	$290	−36	+36	0
$7,500	686	676	671	−5	−10	+5
$10,000	1,114	1,026	1,096	+70	−88	−18
$12,500	1,567	1,376	1,548	+172	−191	−19
$15,000	2,062	1,726	2,048	+322	−336	−14
$20,000	3,160	2,426	3,048	+622	−734	−112
$25,000	4,412	3,126	4,283	+1,157	−1,286	−364
$35,000	7,529	4,526	7,283	+2,757	−3,003	−246

TABLE 6–B.—*Tax liability and withholding under present 14 percent and graduated withholding (6-rate) for selected taxpayers (assumes 15 percent deductions or minimum standard deduction)*

Wage income	Tax liability	Amount of withholding		Change in withholding	Overwithholding (+) or underwithholding (−)	
		Present 14 percent	Graduated withholding		Present 14 percent	Graduated withholding
SINGLE INDIVIDUAL						
$1,000	$16	$47	$14	−$33	+$31	−$2
$2,000	161	187	162	−25	+26	+1
$3,000	302	327	332	+5	+25	+30
$5,000	624	607	672	+65	−17	+48
$7,500	1,080	957	1,169	+212	−123	+89
$10,000	1,605	1,307	1,694	+387	−298	+89
$12,500	2,198	1,657	2,359	+702	−541	+161
$15,000	2,884	2,007	3,109	+1,102	−877	+225
$20,000	4,498	2,707	4,609	+1,902	−1,791	+111
$25,000	6,382	3,407	6,109	+2,702	−2,975	−273
$35,000	10,700	4,807	9,109	+4,302	−5,893	−1,591
MARRIED COUPLE, NO DEPENDENTS						
$2,000	$58	$93	$56	+$37	+$35	−$2
$3,000	192	233	200	−33	+41	+8
$5,000	458	513	500	−13	+55	+42
$7,500	843	863	909	+46	+20	+66
$10,000	1,247	1,213	1,334	+121	−34	+87
$12,500	1,694	1,563	1,828	+265	−131	+134
$15,000	2,161	1,913	2,328	+415	−248	+167
$20,000	3,210	2,613	3,373	+760	−597	+163
$25,000	4,396	3,313	4,703	+1,390	−1,083	+307
$35,000	7,314	4,713	7,703	+2,990	−2,601	+389
MARRIED COUPLE, 2 DEPENDENTS						
$3,000	$4	$46	0	−$46	+$42	−$4
$5,000	268	326	$290	−36	+58	+22
$7,500	616	676	671	−5	+60	+55
$10,000	1,019	1,026	1,096	+70	+7	+77
$12,500	1,430	1,376	1,548	+172	−54	+118
$15,000	1,897	1,726	2,048	+322	−171	+151
$20,000	2,910	2,426	3,048	+622	−484	+138
$25,000	4,058	3,126	4,283	+1,157	−932	+225
$35,000	6,866	4,526	7,283	+2,757	−2,340	+417

TABLE 6–C.—*Tax liabilities and withholding under present 14 percent and graduated withholding (6-rate) for selected taxpayers (assumes 20 percent deductions or minimum standard deduction)*

Wage income	Tax liability	Amount of withholding		Change in withholding	Overwithholding (+) or underwithholding (−)		
		Present 14 percent	Graduated withholding with allowance		Present 14 percent	Graduated withholding	
						Without allowance	With allowance
SINGLE INDIVIDUAL							
$1,000	$16	$47	$14	−$33	+$31	−$2	−$2
$2,000	145	187	162	−25	+42	+17	+17
$3,000	276	327	332	+5	+51	+56	+56
$5,000	576	607	672	+65	+31	+96	+96
$7,500	998	957	1,169	+212	−41	+171	+171
$10,000	1,480	1,307	1,694	+387	−173	+214	+214
$12,500	2,022	1,657	2,149	+492	−365	+337	+127
$15,000	2,638	2,007	2,899	+892	−631	+471	+261
$20,000	4,096	2,707	4,399	+1,692	−1,389	+513	+303
$25,000	5,800	3,407	5,899	+2,492	−2,393	+309	+99
$35,000	9,772	4,807	9,109	+4,302	−4,965	−663	[1] −663
MARRIED COUPLE, NO DEPENDENTS							
$2,000	$56	$93	$56	−$37	+$37	0	0
$3,000	170	233	200	−33	+63	+$30	+$30
$5,000	418	513	500	−13	+95	+82	+82
$7,500	772	863	909	+46	+91	+137	+137
$10,000	1,152	1,213	1,334	+121	+61	+182	+182
$12,500	1,556	1,563	1,688	+125	+7	+272	+132
$15,000	1,996	1,913	2,188	+275	−83	+332	+192
$20,000	2,960	2,613	3,198	+585	−347	+413	+238
$25,000	4,044	3,313	4,493	+1,180	−731	+659	+449
$35,000	6,668	4,713	7,283	+2,570	−1,955	+1,035	+615
MARRIED COUPLE, 2 DEPENDENTS							
$3,000	0	$46	0	−$46	+$46	0	0
$5,000	$230	326	$290	−36	+96	+$60	+$60
$7,500	552	676	671	−5	+124	+119	+119
$10,000	924	1,026	1,096	+70	+102	+172	+172
$12,500	1,304	1,376	1,408	+32	+72	+244	+104
$15,000	1,732	1,726	1,908	+182	−6	+316	+176
$20,000	2,660	2,426	2,908	+482	−234	+388	+248
$25,000	3,708	3,126	4,098	+972	−582	+575	+390
$35,000	6,236	4,526	6,863	+2,337	−1,710	+1,047	+627

[1] Allowance does not increase underwithholding because of limitation provided by the bill.

TABLE 6–D.—*Tax liabilities and withholding under present 14 percent and graduated withholding (6-rate) for selected taxpayers (assumes 22½ percent deductions or minimum standard deduction)*

Wage income	Tax liability	Amount of withholding		Change in withholding	Overwithholding (+) or underwithholding (−)		
		Present 14 percent	Graduated withholding with allowance		Present 14 percent	Graduated withholding	
						Without allowance	With allowance
SINGLE INDIVIDUAL							
$1,000	$16	$47	$14	−$33	+$31	−$2	−$2
$2,000	138	187	162	−25	+49	+24	+24
$3,000	263	327	332	+5	+64	+69	+69
$5,000	552	607	672	+65	+55	+120	+120
$7,500	957	957	1,029	+72	0	+212	+72
$10,000	1,418	1,307	1,529	+222	−111	+276	+111
$12,500	1,935	1,657	2,149	+492	−278	+424	+214
$15,000	2,518	2,007	2,899	+892	−511	+591	+381
$20,000	3,901	2,707	4,189	+1,482	−1,194	+708	+288
$25,000	5,519	3,407	5,689	+2,282	−2,112	+590	+170
$35,000	9,308	4,807	9,109	+4,302	−4,501	−199	[1] −199
MARRIED COUPLE, NO DEPENDENTS							
$2,000	$49	$93	$56	−$37	+$44	+$7	+$7
$3,000	159	233	200	−33	+74	+41	+41
$5,000	398	513	500	−13	+115	+102	+102
$7,500	736	863	790	−73	+127	+173	+54
$10,000	1,104	1,213	1,215	+2	+109	+230	+111
$12,500	1,487	1,563	1,688	+125	+76	+341	+201
$15,000	1,914	1,913	2,188	+275	−1	+414	+274
$20,000	2,835	2,613	3,048	+435	−222	+538	+213
$25,000	3,869	3,313	4,283	+970	−556	+834	+414
$35,000	6,353	4,713	7,073	+2,360	−1,640	+1,350	+720
MARRIED COUPLE, 2 DEPENDENTS							
$3,000	0	$46	0	−$46	+$46	0	0
$5,000	$211	326	$290	−36	+115	+$79	+$79
$7,500	520	676	560	−116	+156	+151	+40
$10,000	876	1,026	977	−49	+150	+220	+101
$12,500	1,245	1,376	1,408	+32	+131	+303	+163
$15,000	1,650	1,726	1,908	+182	+76	+398	+258
$20,000	2,535	2,426	2,768	+342	−109	+513	+233
$25,000	3,533	3,126	3,923	+797	−407	+750	+390
$35,000	5,921	4,526	6,653	+2,127	−1,395	+1,362	+732

[1] Allowance does not increase underwithholding because of limitation provided by the bill.

TABLE 6–E.—*Tax liabilities and withholding under present 14 percent and graduated withholding (6-rate) for selected taxpayers (assumes 25 percent deductions or minimum standard deduction)*

Wage income	Tax liability	Amount of withholding		Change in withholding	Overwithholding (+) or underwithholding (−)		
		Present 14 percent	Graduated withholding with allowance		Present 14 percent	Graduated withholding	
						Without allowance	With allowance
SINGLE INDIVIDUAL							
$1,000	$16	$47	$14	−$33	+$31	−$2	−$2
$2,000	130	187	162	−25	+57	+32	+32
$3,000	250	327	332	+5	+77	+82	+82
$5,000	528	607	672	+65	+79	+144	+144
$7,500	916	957	1,029	+72	+41	+253	+113
$10,000	1,355	1,307	1,529	+222	−48	+339	+174
$12,500	1,847	1,657	2,149	+492	−190	+512	+302
$15,000	2,398	2,007	2,689	+682	−391	+711	+291
$20,000	3,706	2,707	4,189	+1,482	−999	+903	+485
$25,000	5,238	3,407	5,479	+2,072	−1,831	+871	+241
$35,000	8,855	4,807	8,899	+4,092	−4,048	+254	[1] +44
MARRIED COUPLE, NO DEPENDENTS							
$2,000	$42	$93	$56	−$37	+$51	+$14	+$14
$3,000	148	233	200	−33	+85	+52	+52
$5,000	378	513	500	−13	+135	+122	+122
$7,500	701	863	790	−73	+162	+208	+89
$10,000	1,057	1,213	1,215	+2	+156	+277	+158
$12,500	1,418	1,563	1,688	+125	+145	+410	+270
$15,000	1,831	1,913	2,048	+135	+82	+497	+217
$20,000	2,710	2,613	3,048	+435	−97	+663	+338
$25,000	3,694	3,313	4,098	+785	−381	+1,009	+404
$35,000	6,038	4,713	6,863	+2,150	−1,325	+1,665	+825
MARRIED COUPLE, 2 DEPENDENTS							
$3,000	0	$46	0	−$46	−$46	0	0
$5,000	$192	326	$290	−36	+134	+$98	+$98
$7,500	488	676	560	−116	+188	+183	+72
$10,000	829	1,026	977	−49	+197	+267	+148
$12,500	1,185	1,376	1,408	+32	+191	+363	+223
$15,000	1,567	1,726	1,768	+42	+159	+481	+201
$20,000	2,410	2,426	2,768	+342	+16	+638	+358
$25,000	3,358	3,126	3,748	+622	−232	+925	+390
$35,000	5,612	4,526	6,443	+1,917	−1,086	+1,671	+831

[1] Allowance does not result in underwithholding because of limitation provided by the bill.

TABLE 6–F.—*Tax liabilities and withholding under present 14 percent and graduated withholding (6-rate) for selected taxpayers (assumes 27½ percent deductions or minimum standard deduction)*

Wage income	Tax liability	Amount of withholding		Change in withholding	Overwithholding (+) or underwithholding (−)		
		Present 14 percent	Graduated withholding with allowance		Present 14 percent	Graduated withholding	
						Without allowance	With allowance
SINGLE INDIVIDUAL							
$1,000	$16	$47	$14	−$33	+$31	−$2	−$2
$2,000	122	187	162	−25	+65	+40	+40
$3,000	238	327	332	+5	+89	+94	+94
$5,000	505	607	553	−54	+102	+167	+48
$7,500	874	957	1,029	+72	+83	+295	+155
$10,000	1,292	1,307	1,389	+82	+15	+402	+97
$12,500	1,760	1,657	1,969	+312	−103	+599	+209
$15,000	2,278	2,007	2,689	+682	−271	+831	+411
$20,000	3,514	2,707	3,979	+1,272	−807	+1,095	+465
$25,000	4,970	3,407	5,269	+1,862	−1,563	+1,139	+299
$35,000	8,418	4,807	8,479	+3,252	−3,611	+691	[1] +61
MARRIED COUPLE, NO DEPENDENTS							
$2,000	$35	$93	$56	−$37	+$58	+$21	+$21
$3,000	136	233	200	−33	+97	+64	+64
$5,000	358	513	395	−118	+155	+142	+37
$7,500	665	863	790	−73	+198	+244	+125
$10,000	1,010	1,213	1,096	−117	+203	+324	+86
$12,500	1,354	1,563	1,548	−15	+209	+474	+194
$15,000	1,748	1,913	2,048	+135	+165	+580	+300
$20,000	2,585	2,613	2,908	+295	+28	+788	+323
$25,000	3,519	3,313	3,923	+610	−206	+1,184	+404
$35,000	5,723	4,713	6,653	+1,940	−1,010	+1,980	+930
MARRIED COUPLE, 2 DEPENDENTS							
$3,000	0	$46	0	−$46	+$46	0	0
$5,000	$174	326	$185	−141	+152	+$116	+$11
$7,500	456	676	560	−116	+220	+215	+104
$10,000	782	1,026	858	−168	+244	+314	+76
$12,500	1,126	1,376	1,283	−93	+250	+422	+157
$15,000	1,484	1,726	1,768	+42	+242	+564	+284
$20,000	2,285	2,426	2,628	+202	+141	+763	+343
$25,000	3,191	3,126	3,573	+447	−65	+1,092	+382
$35,000	5,332	4,526	6,233	+1,707	−806	+1,951	+901

[1] Allowance does not result in underwithholding because of limitation provided by the bill.

TABLE 6–G.—*Tax liabilities and withholding under present 14 percent and graduated withholding (6-rate) for selected taxpayers (assumes 30 percent deductions or minimum standard deduction)*

Wage income	Tax liability	Amount of withholding		Change in withholding	Overwithholding (+) or underwithholding (–)		
		Present 14 percent	Graduated withholding with allowance		Present 14 percent	Graduated withholding	
						Without allowance	With allowance
SINGLE INDIVIDUAL							
$1,000	$14	$47	$14	−$33	+$33	0	0
$2,000	115	187	162	−25	+72	+$47	+$47
$3,000	225	327	332	+5	+102	+107	+107
$5,000	481	607	553	−54	+126	+191	+72
$7,500	833	957	1,029	+72	+124	+336	+196
$10,000	1,230	1,307	1,389	+82	+77	+464	+159
$12,500	1,672	1,657	1,969	+312	−15	+687	+297
$15,000	2,162	2,007	2,479	+472	−155	+947	+317
$20,000	3,334	2,707	3,769	+1,062	−627	+1,275	+435
$25,000	4,708	3,407	5,059	+1,652	−1,301	+1,401	+351
$35,000	7,980	4,807	8,059	+3,256	−3,173	+1,129	[1] +79
MARRIED COUPLE, NO DEPENDENTS							
$2,000	$28	$93	$56	−$37	+$65	+$28	+$28
$3,000	126	233	200	−33	+107	+74	+74
$5,000	338	513	395	−118	+175	+162	+57
$7,500	630	863	790	−73	+233	+279	+160
$10,000	962	1,213	1,096	−117	+251	+372	+134
$12,500	1,294	1,563	1,548	−15	+269	+534	+254
$15,000	1,666	1,913	1,908	−5	+247	+662	+242
$20,000	2,460	2,613	2,768	+155	+153	+913	+308
$25,000	3,344	3,313	3,748	+435	−31	+1,359	+404
$35,000	5,436	4,713	6,233	+1,520	−723	+2,267	+797
MARRIED COUPLE, 2 DEPENDENTS							
$3,000	0	$46	0	−$46	+$46	0	0
$5,000	$155	326	$185	−141	+171	+$135	+$30
$7,500	426	676	560	−116	+250	+245	+134
$10,000	734	1,026	858	−168	+292	+362	+124
$12,500	1,066	1,376	1,283	−93	+310	+482	+217
$15,000	1,402	1,726	1,628	−98	+324	+646	+226
$20,000	2,172	2,426	2,488	+62	+254	+876	+316
$25,000	3,035	3,126	3,398	+272	+91	+1,248	+363
$35,000	5,052	4,526	5,813	+1,287	−526	+2,231	+761

[1] Allowance does not result in underwithholding because of limitation provided by the bill.

2. *Payments of estimated social security and hospital insurance taxes by self-employed persons.* (Sec. 102 of the bill and sec. 6015 of the code.)

Present law.—Under existing law, self-employed persons are required to pay their social security tax and their tax for the hospital insurance program when they file their final income tax return for a given year. However, they may pay this tax quarterly with their estimated income tax payments.

The tax, which, beginning in 1966, is based on the initial $6,600 of net earnings from self-employment, is imposed on self-employed individuals who have net earnings from self-employment which total $400 or more. When an individual also has covered wage income, this is subtracted from the $6,600 maximum earnings base, and the self-employment tax is computed on the lesser of this amount or net earnings from self-employment. A taxpayer who has $400 of net self-employment income must file a final return and pay self-employment tax even if he is not required to file an income tax return.

General explanation.—Your committee's bill places self-employed persons on the same current payment basis with respect to the payment of their self-employment tax that they are now on for income tax purposes. It does so by requiring quarterly payments of estimated self-employment tax. It will place self-employed persons on more nearly the same payments basis for social security purposes as

that of employed persons, whose social security tax is withhold from their wages by employers.

The adoption of current payment for self-employment tax is accomplished with a minimum of difficulty for he self-employed taxpayers who currently file declarations of estimated income tax, since the payment of estimated self-employment tax will be integrated with the payment of estimated income tax. For the estimated 1 million self-employed persons who do not file declarations of estimated income tax but who will be required to file such declarations as a result of this bill, the advantages of current payment will outweigh the added compliance requirements.

The payments of the self-employment tax will, as a result of this bill, be received on a quarterly basis instead of generally on an annual basis as under present law. It is understood that the amounts received on a quarterly basis will be estimated and paid over from the general fund to the OASI, DI, and HI trust funds on a current basis.

Tables 7 and 8 show the maximum dollar amount of self-employment tax and tax liability since 1951.

TABLE 7.—*Maximum dollar amount of self-employment tax for individuals, 1951 to 1987*

Year	Maximum net earnings base [1]	Tax rate	Maximum tax per person
		Percent	
1951–53	$3,600	2.25	$81.00
1954	3,600	3.0	108.00
1955–56	4,200	3.0	126.00
1957–58	4,200	3.375	141.75
1959	4,800	3.75	180.00
1960–61	4,800	4.5	216.00
1962	4,800	4.7	225.60
1963–65	4,800	5.4	259.20
1966	6,600	[2] 6.15	405.90
1967–68	6,600	6.40	422.40
1969–72	6,600	7.10	468.60
1973–75	6,600	7.55	498.30
1976–79	6,600	7.60	501.60
1980–86	6,600	7.70	508.20
1987+	6,600	7.80	514.80

[1] The minimum net earnings subject to the self-employment rate has been $400 since 1951.
[2] Includes OASDI (social security) tax rates and HI (hospital insurance) tax rate of 1966 and all following years.

TABLE 8.—*Self-employment tax liability, 1951 to 1966*

Year	Self-employment tax		
	Number of income tax returns reporting self-employment tax	Amount of self-employment tax	Average tax per return [1]
	Millions	*Millions*	
1951	4.1	$211.3	$51.90
1952	4.1	217.5	53.60
1953	4.2	226.6	53.70
1954	4.2	301.5	71.60
1955	6.6	463.2	69.70
1956	7.4	533.1	72.50
1957	7.0	581.2	83.10
1958	7.0	589.2	84.00
1959	7.0	701.5	99.70
1960	6.9	833.5	121.00
1961	6.7	840.1	124.50
1962	6.7	887.2	132.90
1963	6.5	1,002.2	154.60
1964 (preliminary)	6.3	1,009.0	160.00
1965 (estimate) [2]	6.2	1,050.0	169.00
1966 (estimate) [2]	6.3	1,500.0	238.00

[1] Average computed from unrounded figures.
[2] Includes doctors of medicine newly covered by the Social Security Amendments Act of 1965.

Explanation of provisions.—Under the bill, a self-employed person generally will be required to file a declaration of estimated tax whenever the combined total of his estimated income tax liability and his estimated social security and hospital insurance tax liability exceeds $40. Payments of estimated tax will be made as at present with the exception that the amount paid will include both the estimated income tax and the estimated self-employment tax. That is, for calendar-year taxpayers the declaration will have to be filed by April 15 and quarterly payments will be required on April 15, June 15, and September 15 of the current year and on January 15 of the succeeding year.

Persons whose gross income derived from farming and fishing activities will be at least two-thirds of their estimated gross income from all sources will not be required to make quarterly payments of estimated self-employment tax. This treatment conforms to the present provisions for the payment of estimated income tax for farmers and fishermen. Further in conformity with present law regarding estimated income tax, such persons will have until January 15 of the year following the taxable year to file a declaration of estimated tax, and need not file a declaration at all if they choose to file their final tax return by February 15.

A penalty for underpayment of estimated tax will be imposed if amounts paid by the quarterly payment dates equal less than the amounts that would be due on those dates if the estimated tax for the year equaled 80 percent of the combined liability for income and self-employment taxes. The penalty is computed with respect to each installment separately. However, even if the above 80 percent rule is not met, no penalty is imposed with respect to an installment if the estimated tax paid to date equals the amount that would be required to be paid if the estimated tax were the least of the following:

(1) The sum of the income tax and the self-employment tax shown on the return for the prior year;

(2) The sum of the income tax and the self-employment tax that would be due on the prior year's income under current rates and current exemptions;

(3) An amount equal to 80 percent (66⅔ percent for farmers and fishermen) of the combined income and sel-employment taxes due computed by annualizing the taxable income received in the months in the year prior to the month a particular installment is due. Self-employment income for this purpose is only the amount received to date with the maximum of $6,600 reduced by employee social security wage income placed on an annualized basis; or

(4) An amount equal to 90 percent or more of the combined tax payable on the income actually received from the beginning of the year up to the month in which the installment is due.

Effective date.—This provision is effective for taxable years beginning after December 31, 1966.

Revenue effect.—This provision is expected to increase fiscal year 1967 trust fund revenues, which are not reflected in the administrative budget, by $200 million. It will have no effect on revenues in the fiscal year 1966.

3. Underpayment of installments of estimated income tax by individuals. (Sec. 103 of the bill and sec. 6654 of the code.)

Present law.—Under existing law the penalty for underpayment of estimated tax is restricted to the difference between the amount of tax paid through withholding, quarterly installments of estimated tax, or both, and 70 percent of the final liability for the taxable year. This penalty is computed on a quarterly basis, Even if this rule is not met, however, no penalty is imposed if one of four exceptions apply. One of these exceptions provides that the penalty will not be imposed if a quarterly payment equals the amount which would be due if the estimated tax were 70 percent of the tax due on the annualized amount of taxable income received in the months prior to the month the quarterly estimated tax payment is due.

The penalty imposed is a charge equal to 6 percent per year on the amount of underpayment. The penalty is not a deductible expense for tax purposes.

Explanation of provisions.—Your committee's bill increases the proportion of the final liability which is to be paid currently to avoid a penalty from 70 to 80 percent. This amendment restores the pre-1954 requirement. It is consistent with the other provisions of the bill since it more nearly requires current payment of tax. It insures that taxpayers who receive most of their income from sources not subject to withholding will be required to pay a larger share of their

tax liability currently just as wage earners will be required to do through graduated withholding.

The bill also modifies the one alternative exception to the penalty which contains a 70 percent test. This is the annualized income test described above where the 70 percent requirement is raised to 80 percent to conform to the principal amendment.

Effective date.—This provision will apply with respect to taxable years which begin after December 31, 1966.

Revenue effect.—It is estimated that the larger estimated taxpayments required under this rule will result in a temporary increase in tax collections that will add $150 million to revenues in fiscal year 1967.

3. Acceleration of payment of estimated tax by corporations. (Sec. 104 of the bill and sec. 6154 of the code.)

Present law.—Corporations with an estimated tax liability in excess of $100,000 presently are required to make partial payments during the current tax year of their estimated tax in excess of $100,000. Under the provisions of the Revenue Act of 1964, corporations are in the midst of a transition from a system of two partial payments of currently estimated tax to a system of four payments made by calendar year corporations on April 15, June 15, September 15, and December 15.

Under the present schedule, corporations using the calendar year file an initial declaration and pay 9 percent of their estimated 1966 tax liability in excess of $100,000 on April 15 of this year. On June 15 they pay an additional 9 percent of the estimated liability, and they pay installments of 25 percent each on September 15 and December 15. The remaining 32 percent of the estimated tax, as well as the initial $100,000 of tax liability, is paid in equal installments on March 15 and June 15, 1967.

In 1967, the April and June estimated tax payments are each scheduled to be 14 percent of the estimated tax liability above $100,000. The payment schedule under present law is summarized in table 9.

TABLE 9.—*Payment schedule for calendar year corporations under present law showing percentage of estimated tax to be paid* [1]

Calendar year	Current taxable year				Following year	
	Apr. 15	June 15	Sept. 15	Dec. 15	Mar. 15	June 15
1966	9	9	25	25	16	16
1967	14	14	25	25	11	11
1968	19	19	25	25	6	6
1969	22	22	25	25	3	3
1970	25	25	25	25	----------	----------
1971 and subsequent years	25	25	25	25	----------	----------

[1] Tax in excess of $100,000.

General explanation.—This bill as reported by your committee accelerates the transition to full current payment of corporate tax liabilities in excess of $100,000. The transition is completed in 1967 under this bill, instead of 1970 as provided under existing law.

Corporate tax liabilities remain unchanged by the provisions of this bill.

Your committee's bill completes a process which began in 1950. Prior to 1950, corporations were permitted to pay their tax liability for the current year in four quarterly installments in the succeeding year. The Revenue Acts of 1950, 1954, and 1964 [P.L. 88-272, C.B. 1964-1 (Part 2), 6] contained provisions which gradually required corporations to accelerate the payment of their liabilities to the year in which they accrued, just as individuals have done since 1943. The Revenue Act of 1964 required corporations to pay that portion of their tax liability which exceeds $100,000 in four equal installments, which for calendar-year corporations are April 15, June 15, September 15, and December 15 of the year in which the liability occurs. It also provided a 7-year period during which the transition to this collection procedure would be completed. Your committee's bill, in effect, merely reduces the length of the transition period to 4 years.

Under the bill, 12 percent, rather than 9 percent, of the tax in excess of $100,000 is to be payable by a calendar-year corporation in April and June 1966,

and in 1967 and thereafter 25 percent will be payable on each of these two dates. Table 10 shows the schedule of payment dates provided under the bill for a calendar-year corporation for 1966 and subsequent years.

TABLE 10.—*Payment schedule for calendar year corporations under bill showing percentage of estimated tax to be paid* [1]

Calendar year	Current taxable year				Following year	
	Apr. 15	June 15	Sept. 15	Dec. 15	Mar. 15	June 15
1966	12	12	25	25	13	13
1967	25	25	25	25	----------	----------
1968 and subsequent years	25	25	25	25	----------	----------

[1] Tax in excess of $100,000.

The bill does not impose a hardship on corporations. The majority of corporations, those with small- and medium-sized incomes, are excluded from the provision because their tax liability is less than $100,000. It is estimated that only 16,000 corporations will be affected by this acceleration. These corporations are generally the largest and possess considerable financial resources.

Corporations affected by this provision will not be put on a fully current basis with respect to their total tax payments, since only the estimated taxes in excess of $100,000 are affected. Furthermore, the various provisions in existing law that limit the imposition of penalties when estimated payments fall short of actual liabilities are not changed.

Accelerating the corporate tax payments schedule to complete the transition to the current payments basis in 1967 will produce larger payments in 1966 and 1967 than would be made under present law. It also means that the tax payments in 1968, 1969, and 1970 will be lower than those scheduled under present law. These effects of the bill on tax payments are desirable in view of current fiscal policy considerations.

Increased corporate tax payments in 1966 and 1967 will introduce fiscal restraint into the economy during the critical months when the buildup of defense expenditures for Vietnam is greatest. The tax receipts will reduce the budgetary deficit and will reduce the cash flow available to corporations.

The reduction in corporate tax payments in the years 1968 through 1970 below the levels under present law will come when it is hoped the pressures of Federal Government requirements upon the economy's productive capacity have eased off. The corporations affected by this provision then will be in a position to increase their investment expenditures and thereby offset the leveling of Federal Government defense expenditures.

At the present time, investment in industrial plant and equipment is proceeding at record levels. A slowdown in the expected increase in investment spending, therefore, will moderate the demand for productive resources that no longer are in excess supply. Some restraint on increased investment spending under these circumstances appears appropriate. A similar moderation in dividend payments would be reflected in expenditures on consumer goods and would have the same salutary economic effect.

Acceleration of tax payments is preferable to an increase in the corporation income tax rate. Without any further acceleration of tax payments, an increase of 4 or 5 percentage points in the corporation income tax rate probably would be needed to yield the same revenue increase in fiscal year 1967 as the acceleration schedule in this bill.

The acceleration of corporate tax payments will moderate the increase in private investment expenditures and restrain inflationary pressures while permitting employment to continue to expand. The large tax increases necessary to yield as much increased tax receipts as the acceleration of payments might cause sizable reductions of investment expenditures thereby impairing the expansion in economic activity and productive capacity vital to continued stable economic growth.

Effective date.—The revised schedule for corporation tax payments shall apply to taxable years beginning after December 31, 1965.

Revenue effect.—Administrative budget receipts will be increased by $1 billion in fiscal year 1966 and by $3.2 billion in 1967 as a result of enactment of this provision.

4. The excise tax on passenger automobiles. (Sec. 201 of the bill and sec. 4061 of the code)

Present law.—Prior to the passage of the Excise Tax Reduction Act of 1965, a tax of 10 percent was imposed on the manufacturer's price for passenger automobiles. The rate was reduced to 7 percent for the period June 22, 1965, to December 31, 1965. On January 1, 1966, the tax rate was reduced to 6 percent, and it is scheduled to fall to 4 percent on January 1, 1967, and to 2 percent on January 1, 1968. On January 1, 1969, the tax will be reduced to a permanent level of 1 percent. Refunds will be paid to dealers with respect to automobiles held in inventory on any date on which the tax rate is reduced.

Explanation of provisions.—Your committee's bill restores the excise tax rate on passenger automobiles to the 7-percent rate applicable last December. The restoration of the 7-percent rate is for a 2-year period beginning the day after the date of enactment and ending on March 31, 1968. The excise tax rate on automobiles then will become 2 percent, as scheduled under present law for 1968 and 1 percent on January 1, 1969. Thus there is a moratorium on these tax reductions scheduled under present law for a 2-year period. At the end of that time, however, the rate will revert to the level which would have been in effect in the absence of the moratorium.

A tax of 1 percent of the manufacturer's (or importer's) price is imposed upon all new automobiles held in stock by dealers or distributors on the day when the 7-percent-tax rate becomes effective. The tax is to be paid by the dealer and is to be collected from the dealer by the manufacturer (or importer). The Secretary of the Treasury will prescribe regulations which will instruct the dealer to prepare for the manufacturer (or importer) a list of the cars in his inventory on the day when the 7-percent tax becomes effective together with any other information needed for the manufacturer (or importer) to determine the sales price. The manufacturer (or importer) then will prepare a bill for the dealer on which he itemizes the floor stock tax upon each of these automobiles. The dealer then is to pay this tax to the manufacturer (or importer) who transmits it to the Government. If a dealer refuses to submit either the information or the tax to the manufacturer (or importer), no liability for the tax attaches to the manufacturer if he informs the Internal Revenue Service of the failure. In addition, the manufacturer (or importer) is to provide the dealer with information the dealer can use to show the customer a close approximation of the floor stock tax on each car. This is to be made available on, or shortly after, the date the floor stock tax applies. The Treasury Department may authorize the use of averages in any of the above computations to the same extent as already has been done in the case of the floor stock refunds.

The floor stock tax of 1 percent will be paid on a date not earlier than 60 days after the date of enactment as indicated in regulations prescribed by the Secretary or his delegate.

With regard to the reductions scheduled for 1968 and 1969, tax refunds will be made for inventory on hand. These refunds will be paid to dealers and distributors by manufacturers, and the latter will receive reimbursement from the Government.

Effective date.—The tax rate will be restored to 7 percent effective with respect to sales by manufacturers, producers, and importers beginning with the day after the date of enactment.

Revenue effect.—This provision will increase revenues by $60 million in the fiscal year 1966 and by $420 million in the fiscal year 1967.

5. The excise tax on telephone service. (Sec. 202 of the bill and sec. 4251 of the code)

Present law.—Under the law in effect prior to January 1, 1966, a 10-percent tax was levied on amounts paid for general and toll telephone and teletypewriter exchange service. This rate was lowered to 3 percent effective as of January 1, 1966, under the provisions of the Excise Tax Reduction Act of 1965. As presently scheduled, the tax rate will fall to 2 percent on January 1, 1967, to 1 percent on January 1, 1968, and will be repealed on January 1, 1969.

Explanation of provision.—Your committee's bill restores the 10-percent excise tax rate on telephone service, including teletypewriter service, and postpones

further reduction in the tax rate until April 1, 1968. On that date, the tax rate will fall to the 1-percent rate scheduled under present law to be effective in 1968. Then (as under present law) the tax is repealed on January 1, 1969.

The taxes on communications service which were repealed as of January 1, 1966, are not affected by this bill. Thus, private communications systems, telegraph service, and wire and equipment service will remain exempt from the excise tax.

Exemptions for hospitals.—Your committee's bill provides an exemption from the excise tax for telephone services furnished to nonprofit hospitals exempt from income tax. This is to accord such hospitals the same treatment accorded Government hospitals under present law.

Effective date.—The 10-percent rate on telephone and teletypewriter service is to become effective with respect to bills rendered on or after the first day of the first month which begins more than 15 days after the effective date of this legislation. The exemption for nonprofit hospitals is to go into effect at the same time.

Revenue effect.—This provision will increase revenues by $785 million in the fiscal year 1967.

V. TECHNICAL EXPLANATION OF THE BILL

SECTION 1. SHORT TITLE, ETC.

(*a*) *Short title.*—Subsection (a) of section 1 of the bill provides that the bill may be cited as the "Tax Adjustment Act of 1966".

(*b*) *Amendment of 1954 Code.*—Subsection (b) of section 1 of the bill provides that whenever in the bill an amendment or repeal is expressed in terms of an amendment to or repeal of a section or other provision, the reference is considered to be made to a section or other provision of the Internal Revenue Code of 1954.

TITLE I. ADJUSTMENT OF CERTAIN COLLECTION PROCEDURES

SECTION 101. INCOME TAX COLLECTED AT SOURCE

In general, section 101 of the bill amends section 3402 of the code (relating to income tax collected at source) to provide for new wage withholding rates which are graduated and take into account the minimum standard deduction and to provide new wage bracket withholding tables based upon the new rates. In addition, such section provides for withholding allowances, under certain circumstances, in the case of an employee who has a large amount of itemized deductions.

(*a*) *Percentage method of withholding.*—Subsection (a) of section 101 of the bill amends section 3402(a) of the code (relating to requirement of withholding). Existing law prescribes a 14-percent withholding rate, which is applied to the amount of the employee's wages reduced by the value of his personal exemptions to the extent he claims them. The amended section 3402(a) of the code contains a number of tables providing graduated percentage withholding rates geared to the payroll period of the employee and the amount of the wage payment. Under these tables no withholding is provided on the first $200 of wages on an annual basis to reflect the basic $200 minimum standard deduction granted each single person or married couple. Separate withholding tables are provided for employees who have the status of single persons (including heads of households) and for employees who have the status of married persons. The tables are applicable in respect of wages paid after April 30, 1966.

(*b*) *Amount of withholding exemption.*—Subsection (b) of section 101 of the bill amends paragraph (1) of section 3402(b) of the code (relating to percentage method of withholding) by changing in the percentage method withholding table the figures representing the amount of one withholding exemption for each specified payroll period. The new figures are based on an annual value of $700 for one withholding exemption in lieu of the value of $667 under existing law.

(*c*) *Wage-bracket withholding.*—Subsection (c) of section 101 of the bill amends paragraph (1) of section 3402(c) of the code (relating to wage-bracket withholding) by providing new wage-bracket withholding tables for wages paid

after April 30, 1966. Separate tables are provided in respect of wages paid to employees who are not married and to employees who are married.

(*d*) *Disclosure of marital status; determination of marital status; treatment of surviving spouse.*—Subsection (d) of section 101 of the bill amends section 3402 of the code by adding a new subsection (*l*).

Section 3402(l). Determination and disclosure of marital status

(*1*) *Determination of status by employer.*—The new section 3402(l)(1) provides that an employer, in applying the new tables contained in subsections (a) and (c) of section 3402 of the code (as amended by section 101 of the bill), shall treat an employee as a single person unless there is in effect with respect to such payment of wages a withholding exemption certificate (furnished to the employer after the date of enactment of the bill) which indicates that the employee is married.

(*2*) *Disclosure of status by employee.*—The new section 3402(l)(2) provides that an employee may furnish to his employer a withholding exemption certificate indicating that he is married only if the employee is married on the day such certificate is furnished to the employer (determined with the application of the rules in the new subsection (l)(3) of section 3402). Thus, an employee who is contemplating marriage may not, prior to his actual marriage, furnish to his employer a withholding exemption certificate indicating that he is married. An employee who has furnished to his employer a withholding exemption certificate indicating that he is married shall furnish his employer a new withholding exemption certificate if his marital status changes from married to single. A new withholding exemption certificate indicating a change in marital status from married to single shall be furnished to the employer at such time as the Secretary of the Treasury may by regulations prescribe. An employee whose marital status changes from single to married may, but is not required to, furnish his employer with a new withholding exemption certificate indicating such change.

(*3*) *Determination of marital status.*—The new section 3402(l)(3) provides rules for determining whether an individual is considered to be single or married for purposes of new section 3402(l)(2) relating to disclosure of marital status by employee. An employee shall on a particular day be considered as not married (1) if on that day the employee is legally separated from his spouse under a decree of divorce or separate maintenance, or (2) if on that day either he or his spouse is a nonresident alien or if on any preceding day within the calendar year in which that day occurs either he or his spouse was a nonresident alien. An employee shall on a particular day be considered as married if (1) his spouse (other than a spouse referred to in the preceding sentence) died within the portion of the employee's taxable year which precedes such day, or (2) his spouse died during one of the two taxable years immediately preceding the taxable year in which such day occurs and it may reasonably be expected, on the basis of the facts existing at the beginning of such day, that the employee, at the close of the taxable year of the employee in which such day occurs, will be a surviving spouse (as that term is defined in section 2(b) of the code).

(*e*) *Withholding allowances for itemized deductions.*—Subsection (e)(1) of section 101 of the bill amends section 3402(f)(1) of the code, relating to withholding exemptions, by adding at the end thereof a new subparagraph (F). Existing section 3402(f)(1) of the code provides that an employee receiving wages shall on any day be entitled to the withholding exemptions specified in subparagraphs (A) through (E) thereof. New subparagraph (F) of section 3402(f)(1) provides that an employee shall on any day be entitled to a withholding exemption for each withholding allowance to which he is entitled under section 3402(m) (added by the bill) and which is not claimed on a withholding exemption certificate in effect for his spouse. As under present law with respect to withholding exemptions, an employee is not required to claim any withholding allowance to which he is entitled.

Subsection (e)(2) of section 101 of the bill amends section 3402 of the code by adding at the end thereof a new subsection (m), relating to withholding allowances based on itemized deductions.

Section 3402(m). Withholding allowances based on itemized deductions

(*1*) *General rule.*—Under new subsection (m)(1) of section 3402 of the code, an employee may be entitled to one or more withholding allowances depending on the amount of his estimated itemized deductions in relation to his estimated

wages. The number of withholding allowances to which an employee is entitled under new section 3402(m)(1) with respect to a payment of wages is equal to the number obtained by dividing by $700 the excess of—

(A) the employee's estimated itemized deductions, over

(B) an amount equal to the sum of 12 percent of the first $7,500 of his estimated wages and 17 percent of the remainder of his estimated wages.

For purposes of determining the number of withholding allowances to which an employee is entitled under new subsection (m)(1), fractional numbers are disregarded.

(2) *Definitions.*—New subsection (m)(2) of section 3402 contains definitions of the terms "estimated itemized deductions" and "estimated wages," which terms appear in subsection (m)(1), and a definition of the term "estimation year".

Estimated itemized deductions.—The term "estimated itemized deductions" means the aggregate amount which the employee may reasonably expect will be allowable as deductions under chapter 1 of the code (exclusive of deductions referred to in section 141 (relating to standard deduction) and section 151 (relating to the allowance of deductions for personal exemptions) and those deductions which are required to be taken into account in determining adjusted gross income under section 62) for the employee's "estimation year". If the aggregate amount of deductions (computed in accordance with the preceding sentence) for an estimation year exceeds the amount of such deductions shown on the employee's Federal income tax return for his taxable year immediately preceding the estimation year, the employee's estimated itemized deductions for such estimation year are an amount equal to the amount of such deductions shown on the employee's Federal income tax return for such preceding taxable year. If, for the taxable year immediately preceding the estimation year, the employee elected under section 144 of the code to use the standard deduction, his estimated itemized deductions for such estimation year are zero.

Estimated wages.—The term "estimated wages" means the aggregate amount which the employee reasonably expects will constitute wages (as that term is used in chapter 24 of the code) for his estimation year. However, if the aggregate amount of wages (computed in accordance with the preceding sentence) is less than the amount of wages (as that term is used in the preceding sentence) shown on the employee's Federal income tax return for his taxable year immediately preceding the estimation year, the employee's estimated wages for the estimation year shall be an amount equal to the amount of wages shown on such income tax return.

Estimation year.—In the case of an employee who files his Federal income tax return on the basis of a calendar year, the term "estimation year" may, with respect to a payment of wages, mean the calendar year in which such payment is made or the immediately preceding calendar year, as explained below. The estimation year with respect to any payment of wages made to a calendar year taxpayer during the period May 1 to December 31, inclusive, is always the calendar year in which the payment is made. The estimation year with respect to any payment of wages made to a calendar year taxpayer during the period January 1 to April 30, inclusive, is the calendar year in which the payment of wages is made if the following conditions are met:

(1) The employee has, prior to the date on which the payment of wages is made, filed his Federal income tax return for the calendar year immediately preceding the calendar year in which such payment is made, and

(2) The employee has in effect, at the time of the payment of wages, one or more withholding allowances based on itemized deductions, and

(3) The withholding allowances referred to in item (2) were determined by using the calendar year in which the payment of wages is made as the estimation year.

The estimation year with respect to a payment of wages made to a calendar year taxpayer during the period January 1 to April 30, inclusive, is the calendar year immediately preceding the calendar year in which the payment is made in any case where, at the time the payment is made, any of the conditions set forth in items (1), (2), and (3) above is not met.

A taxpayer shall not be entitled to any withholding allowance the determination of which is made by use of an estimation year which begins before January 1, 1967 (see the discussion of sec. 101(e)(6) of the bill). Moreover, a taxpayer shall on any day be entitled to a withholding allowance determined by use of a particular estimation year only if, on or before such day, he has filed his Federal income tax return for his taxable year preceding such estimation year.

The determination of an employee's estimation year with respect to a payment of wages may be illustrated by the following examples:

Example (1).—Employee A, a calendar year basis taxpayer, is first employed by X on January 15, 1968. On that day, employee A makes a determination of the number of withholding allowances to which he is entitled in connection with furnishing a withholding exemption certificate to employer X. Employee A, on January 15, 1968, has not filed his income tax return for the calendar year 1967, and, accordingly, in making the determination, employee A must use as his estimation year the calendar year 1967. (Under the special rule relating to the termination of the effectiveness of a withholding exemption certificate contained in new subsection (m)(3)(C), if employee A claimed a withholding allowance on his exemption certificate furnished on January 15, 1968, the portion of that certificate on which the withholding allowance was claimed is not effective with respect to any payment of wages made to employee A after April 30, 1968).

Example (2).—Assume that employee A (referred to in example (1)) files his income tax return for 1967 on February 15, 1968. Thereafter, employee A may make a determination of the number of withholding allowances to which he is entitled using as his estimation year the calendar year 1968, and furnish to his employer a new withholding exemption certificate on which he claims such withholding allowances. The portion of the exemption certificate on which such allowances are claimed will, unless a new certificate is filed by the employee, remain in effect with respect to all payments of wages made to the employee before May 1, 1969.

If an employee files his Federal income tax return on a basis other than the calendar year, his estimation year in respect of any payment of wages (and the amounts deducted and withheld to be governed by such estimation year) shall be determined under regulations prescribed by the Secretary of the Treasury or his delegate.

Computations of withholding allowances.—The computation of withholding allowances under new section 3402(m) may be illustrated by the following example:

Employee B, a single person, filed his income tax return for calendar year 1967 on March 15, 1968. B's wages shown on his return for the calendar year 1967 were $9,000, but he estimates that for 1968 his wages will be $10,000. Accordingly, the amount of his estimated wages for the estimation year (1968) is $10,000. The deductions for calendar year 1967 shown on his return, other than for personal exemptions and other than the deductions required to be taken into account in computing adjusted gross income, were $2,600. B estimates that for 1968 such deductions will be $3,000. Accordingly, the amount of B's estimated itemized deductions for the estimation year (1968) is $2,600. B is entitled to one withholding allowance under section 3402(m), since the excess of the estimated itemized deductions over the sum of 12 percent of the first $7,500 of estimated wages plus 17 percent of the balance is $1,275.

(3) Special rules.—New subsection (m)(3) of section 3402 contains special rules relating to the withholding allowances to which an employee may be entitled under new subsection (m)(1).

Married individuals.—Subsection (m)(3)(A) provides that the number of withholding allowances to which a husband and wife are entitled under new subsection (m)(1) shall be determined (except as otherwise provided in the immediately succeeding sentence) on the basis of their combined wages and deductions; that is, by aggregating the wages of the husband and wife and by aggregating their deductions. If a husband and wife—

(1) filed separate Federal income tax returns for the taxable year preceding the estimation year, and

(2) expect to file separate returns for the estimation year,

the rule set forth in the preceding sentence does not apply and each shall make his own determination on the basis of his own wages and deductions.

If a husband and wife who file joint returns are both employed, one or the other may claim the total number of withholding allowances determined on the basis of their combined wages and itemized deductions or they may allocate such withholding allowances between themselves. However, such a husband and wife may not both have a withholding exemption certificate in effect claiming the same withholding allowance.

Only one certificate to be in effect.—Subsection (m)(3)(B) provides that an employee who is entitled to one or more withholding allowances under new subsection (m)(1) and who has, at the same time, two or more employers

may claim such withholding allowance or allowances with only one of his employers. Thus, if employee A is entitled to two withholding allowances and performs services for both employer X and employer Y, he may claim one or both of his allowances with either employer X or employer Y; he may not, however, claim one allowance with employer X and one allowance with employer Y.

Termination of effectiveness.—Subsection (m)(3)(C) provides that if an employee who files his Federal income tax returns on a calendar year basis has in effect a withholding exemption certificate on which he claims one or more withholding allowances, the portion of such certificate relating to such allowances shall not be effective with respect to any payment of wages made to him after April 30 of the calendar year immediately following the calendar year which was his estimation year for purposes of determining the withholding allowance or allowances claimed on such withholding exemption certificate. For illustrations of the application of this special rule, see examples set forth above in the discussion of the term "estimation year."

The period for which withholding allowances claimed by fiscal year taxpayers are to remain effective is to be prescribed in regulations issued by the Secretary of the Treasury or his delegate under the authority contained in new section 3402(m)(2)(C).

Limitation.—Under subsection (m)(3)(D), the Secretary of the Treasury may by regulations provide that the number of withholding allowances to which an employee may otherwise be entitled under subsection (m)(1) is to be reduced if his estimated wages are above the level at which the amounts deducted and withheld under chapter 24 of the code (collection of income tax at source on wages) are generally sufficient to offset the income tax liability with respect to the wages subject to such withholding.

Authority to prescribe tables.—Subsection (m)(3)(E) authorizes the Secretary of the Treasury to prescribe tables under which an employee shall determine the number of withholding allowances to which he is entitled under new section 3402(m). Tables prescribed pursuant to such authorization may be based on reasonable wage and itemized deduction brackets. If such tables are prescribed, the number of withholding allowances to which an employee is entitled under section 3402(m) will be determined under such tables in lieu of the computation prescribed by section 3402(m)(1) (relating to the general rule).

Treatment of allowances.—Subsection (m)(3)(F) provides that, for purposes of the code, any witholding allowance to which an employee may be entitled under new subsection (m) is to be treated as if it were denominated a withholding exemption. Thus, for example, if an employee furnishes his employer a withholding exemption certificate on which he claims three withholding exemptions and one withholding allowance, he will be treated, for purposes of the percentage method withholding table (see sec. 3402(b)(1) of the code) and the wage bracket withholding tables (see sec. 3402(c)(1) of the code), as claiming four withholding exemptions.

(3) *Status determination date.*—Section 101(e)(3) of the bill amends section 3402(f)(3)(B) of the code which provides rules for determining when a withholding exemption certificate (which replaces an existing certificate) shall take effect. Under existing law, a certificate which is to take the place of an existing certificate (exclusive of a certificate which reflects a change of status affecting the next calendar year, see section 3402(f)(2)(C) of the code) takes effect with respect to the first payment of wages made on or after the first status determination date which occurs at least 30 days from the date on which such certificate is furnished to the employer, except that the employer may elect to make the certificate effective with respect to any payment of wages on or after the date on which the certificate is furnished to the employer. Under existing law, the term "status determination date" means January 1 and July 1 of each year. Section 3402(f)(3)(B) as amended provides that the term "status determination date" means January 1, May 1, July 1, and October 1 of each year.

(4) *Civil penalty.*—Subsection (e)(4) of section 101 of the bill amends subchapter B of chapter 68 of the code (relating to assessable penalties) by adding at the end thereof a new section 6682.

Civil penalty.—Under new section 6682(a), if any individual, in claiming a withholding allowance under section 3402(f)(1)(F) of the code, states—

(1) as the amount of the wages (within the meaning of chapter 24 of the code, relating to collection of income tax at source on wages) shown on his

return for any taxable year, an amount which is less than such wages actually shown, or

(2) as the amount of the itemized deductions referred to in section 3402(m) of the code on his income tax return for any taxable year, an amount which is greater than such itemized deductions actually shown on such return.

he shall pay a penalty of $50 for each such statement, unless—

(3) such statement did not result in a decrease in the amounts deducted and withheld under chapter 24, or

(4) the taxes imposed with respect to the individual under subtitle A of the code for the succeeding taxable year do not exceed the sum of—

(A) the credits against such taxes allowed by part IV of subchapter A of chapter 1 of the code, and

(B) the payments of estimated tax which are considered payments of such taxes.

Deficiency procedures not to apply.—New section 6682(b) provides that the provisions of subchapter B of chapter 63 of the code (relating to deficiency procedures for income, estate, and gift taxes) are not to apply in respect of the assessment or collection of any penalty imposed by new section 6682(a).

(5) *Criminal penalty.*—Section 101(e)(5) of the bill amends section 7205 of the code (relating to fraudulent withholding exemption certificate or failure to supply information). Section 7205, as amended, applies in respect of any information which an individual is required to supply to his employer under section 3402 of the code (relating to income tax collected at source), whereas existing section 7205 applies only in respect of information required to be supplied under section 3402(f) of the code. Section 7205, as amended, provides that the criminal penalty imposed by that section for the willful failure to supply information, or for willfully supplying false or fraudulent information, shall not be in lieu of the civil penalty under section 6682 (added to the code by sec. 101(e)(4) of the bill).

(6) *Effective date.*—Section 101(e)(6) of the bill provides that the amendments made by paragraphs (1) and (2) of section 101(e) (relating to withholding allowances for itemized deductions) shall apply only with respect to remuneration paid after December 31, 1966, but only with respect to withholding allowances based on estimation years beginning after such date. Under this provision, a calendar year basis taxpayer is not entitled to a withholding allowance under section 3402(m) of the code, as amended by the bill, unless the determination of the number of withholding allowances to which he is entitled is made on the basis of an estimation year which is a calendar year subsequent to the calendar year 1966.

(f) *Transitional determination status date.*—Subsection (f) of section 101 of the bill provides a special rule for determining when certain withholding exemption certificates, which are furnished for the purpose of taking the place of existing certificates, shall take effect. Section 101(f) of the bill applies only in respect of withholding exemption certificates furnished to employers after the date of the enactment of the bill and before May 1, 1966. A certificate furnished to an employer after such enactment date and before May 1, 1966, is to be effective with respect to the first payment of wages made on or after—

(1) May 1, 1966, or

(2) the 10th day after the date on which the certificate is furnished to the employer.

whichever is the later. However, an employer, at his election, may make a certificate furnished to him during such period effective with respect to any payment of wages made on or after the date on which the certificate is furnished. If an employer elects to make such a certificate effective with respect to a payment of wages made on or before April 30, 1966, the amount to be deducted and withheld from such wages shall be determined under subsection (a) or (c) of section 3402 of the code prior to amendment by the bill (see sec. 101(g) of the bill relating to effective date).

(g) *Effective date.*—The amendments made by section 101 of the bill (other than the amendments made by subsec. (e) thereof) are to apply only with respect to remuneration paid after April 30, 1966. For effective date provisions relating to the amendments made by section 101(e) of the bill, see paragraph (6) thereof.

SECTION 102. ESTIMATED TAX IN CASE OF INDIVIDUALS

(*a*) *Inclusion of self-employment tax in estimated tax.*—Subsection (a) of section 102 of the bill amends section 6015(c) of the code (relating to definition of estimated tax in the case of an individual). Section 6015(c) of the code presently defines the term "estimated tax" to mean the amount which an individual estimates as the amount of the income tax imposed by chapter 1 for the taxable year, minus the amount estimated as the sum of any credits against tax provided by part IV of subchapter A of chapter 1. Section 6015(c) as amended provides that for purposes of the code the term "estimated tax" also includes the amount which an individual estimates as the amount of the self-employment tax imposed by chapter 2 for the taxable year.

This section of the bill makes no change in the language of the existing provisions of the code which specify the time when a declaration of estimated tax must be filed (sec. 6073), the number of installment payments of estimated tax to be made for the taxable year and the time for payment of each installment (sec. 6153), which individuals must file a declaration (sec. 6015(a)), and the circumstances under which failure to pay estimated tax constitutes a criminal offense (sec. 7203). However, the amendment made by section 102(a) of the bill adds estimated self-employment tax under chapter 2 to estimated income tax under chapter 1 for purposes of these provisions of the code. Thus, for example, individuals whose combined estimated income tax (if any) and estimated self-employment tax (if any) can reasonably be expected to be $40 or more are required to file a declaration if they otherwise meet the requirements of section 6015(a).

In determining the amount of an installment payment of estimated tax under sections 6015 and 6153, the computation includes both the income and self-employment tax. For example, assume that self-employed individual (other than a farmer or fisherman) estimates that his income and self-employment tax liability for the calendar year 1967 will be $1,600 and $400, respectively. He is required to pay his estimated tax of $2,000 in four equal installments of $500.

(*b*) *Addition to tax for underpayment of estimated tax.*—Subsection (b) of section 102 of the bill amends section 6654 (a), (d), and (f), section 7701(a), and section 1403(b) of the code.

ADDITION TO THE TAX

Paragraph (1) of section 102(b) of the bill amends section 6654(a) of the code (relating to addition to the tax for underpayment of estimated tax by an individual). Section 6654(a) of the code presently provides for an addition to the income tax under chapter 1 in the case of an underpayment of estimated tax by an individual, except as provided in subsection (d). Section 6654(a), as amended, provides that such addition is to be imposed with respect to the sum of the income tax under chapter 1 (if any) and the self-employment tax under chapter 2 (if any) for the taxable year.

EXCEPTION FROM ADDITION TO THE TAX

Paragraph (2) of section 102(b) of the bill amends section 6654(d) of the code (relating to exception from the addition to the tax for underpayment of estimated tax by individuals). Section 6654(d) presently provides that the addition to the tax is not imposed with respect to any installment where the installment payment of estimated tax is not less than an amount based on (1) the previous year's tax (sec. 6654(d)(1)(A)); or (2) the tax based on the facts shown on the previous year's return but computed on the basis of current rates and current exemptions (sec. 6654(d)(1)(B)); or (3) 70 percent (66⅔ percent in the case of farmers and fishermen) of the tax computed on the basis of annualized taxable income for the months of the taxable year preceding the month in which the installment is due (sec. 6654(d)(1)(C); or (4) 90 percent of the tax computed on the actual taxable income (not annualized) for the months of the taxable year preceding the month in which the installment is due as if such months constituted the taxable year (sec. 6654(d)(2)).

LAST YEAR'S TAX

Paragraph (1) of section 6654(d), as amended, is identical with existing section 6654(d)(1)(A). However, by reason of the change in the meaning of

the word "tax" made by section 102(b)(3) of the bill, effective with respec to declarations for taxable years beginning after 1966, the tax shown on th return for the preceding taxable year will be the combined chapters 1 and taxes.

ANNUALIZATION

Paragraph (2) of section 6654(d), as amended, is a modification of existin section 6654(d)(1)(C). Section 6654(d)(1)(C) of existing law provides a exception where the estimated tax payments equal at least 70 percent (66⅔ percent in the case of farmers and fishermen) of the tax computed on the basi of annualized taxable income for the months in the taxable year preceding th month in which the installment is due. Under the provisions of paragraph (2) of section 6654(d), as amended, the tax on adjusted self-employment income i included for purposes of this exception if net earnings from self-employmen for the taxable year equal or exceed $400.

The method by which taxable income is annualized is set forth in subpara-graph (A) of section 6654(d)(2) and is identical with existing law. The term "adjusted self-employment income" is defined in subparagraph (B) of section 6654(d)(2) to mean—

(1) the net earnings from self-employment (as defined in sec. 1402(a)) for the months in the taxable year preceding the month in which the installment is due, as if such months constituted the taxable year, but not more than

(2) the excess of (A) $6,600, over (B) the amount of the wages (within the meaning of section 1402(b)) for the months in the taxable year preceding the month in which the installment is due placed on an annualized basis. For this purpose wages are annualized in a manner consistent with clauses (i) and (ii) of subparagraph (A); that is, by multiplying by 12 (or the number of months in the taxable year in the case of a taxable year of less than 12 months) the wages for the months in the taxable year preceding the month in which the installment is due, and dividing the resulting amount by the number of such months.

The application of this provision is illustrated by the following examples:

Example 1.—Assume that X, a calendar year taxpayer who is self-employed (other than as a farmer or fisherman), has annualized taxable income of $6,900 for the period January 1, 1967, through August 31, 1967, the income tax on which is $1,171. For the same period his net earnings from self-employment are $5,000 and his wages are $1,000. The adjusted self-employment income is $5,000, computed as follows:

(1) Net earnings from self-employment	$5,000
(2) But not more than $6,600 minus annualized wages ($6,600—$1,500 ($1,000×12÷8))	5,100
(3) Lesser of (1) or (2)	5,000

The tax on X's adjusted self-employment income is $320 ($5,000×6.4 percent). X's total estimated tax payments required to be paid by September 15, 1967, for purposes of this exception, must equal or exceed $1,192.80; that is, 80 percent[3] of $1,491 ($1,171+$320).

Example 2.—Assume the same facts as in example 1, except that X's wages for the period January 1, 1967, through August 31, 1967, are $2,000. The adjusted self-employment income is $3,600, computed as follows:

(1) Net earnings from self-employment	$5,000
(2) But not more than $6,600 minus annualized wages ($6,600—$3,300 ($2,000×12÷8))	3,600
(3) Lesser of (1) or (2)	3,600

The tax on X's adjusted self-employment income is $230.40 ($3,600×6.4 percent). X's total estimated tax payments required to be paid by September 15, 1967, for purposes of this exception, must equal or exceed $1,121.12; that is, 80 percent of $1,401.40 ($1,171+$230.40).

THE 90 PERCENT TEST

Paragraph (3) of section 6654(d), as amended, is a modification of existing section 6654(d)(2). Section 6654(d)(2) presently provides an exception where

[3] The 70 percent referred to in sec. 6654(d)(2) is changed to 80 percent by sec. 103 of the bill.

the total amount of estimated tax payments is at least 90 percent of the tax computed, at the rates applicable to the taxable year, on the basis of the actual taxable income for the months in the taxable year preceding the month in which the installment is due as if such months constituted the taxable year. Under the provisions of paragraph (3) of section 6654(d), the tax on actual self-employment income is included for purposes of this exception. Actual self-employment income means the net earnings from self-employment (as defined in sec. 1402(a)) for the months in the taxable year preceding the month in which the installment is due as if such months constituted the taxable year, but not more than $6,600 minus the wages (within the meaning of sec. 1402(b)) for such months. Section 6654(d)(3) provides, consistent with existing law, that the months of the taxable year for which the determination of actual taxable income and actual self-employment income is made for purposes of this exception are treated as constituting the taxable year. The application of this provision is illustrated by the following example:

Example.—Assume that X, a calendar year taxpayer who is self-employed (other than as a farmer or fisherman), has actual taxable income of $3,800 for the period January 1, 1967, through August 31, 1967, the income tax on which is $586. For the same period his net earnings from self-employment are $5,000 and his wages are $2,000. His actual self-employment income for such period is $4,600, computed as follows:

(1) Net earnings from self-employment, $5,000.
(2) But not more than $6,600 minus wages ($6,600—$2,000), $4.600.
(3) Lesser of (1) or (2), $4,600.

The tax on X's actual self-employment income is $294.40 ($4,600 times 6.4 percent). X's total estimated tax payments required to be paid by September 15, 1967, for purposes of this exception, must equal or exceed $792.36; that is, 90 percent of $880.40 ($586 plus $294.40).

TAX BASED ON LAST YEAR'S INCOME

Paragraph (4) of section 6654(d) as amended is identical with existing section 6654(d)(1)(B). By reason of the change in the meaning of the word "tax" made by section 102(b)(3) of the bill, the tax includes the tax (computed at the rates applicable to the taxable year) on the self-employment income shown on the return for the preceding taxable year.

DEFINITION OF TAX

Paragraph (3) of section 102(b) of the bill amends section 6654(f) of the code (relating to definition of tax for purposes of subsections (b) and (d) of section 6654). Section 6654(f) presently provides that, for purposes of subsections (b) and (d) of section 6654, the term "tax" means the income tax imposed by chapter 1 reduced by certain credits. Section 6654(f) as amended provides that the term "tax" also includes the self-employment tax imposed by chapter 2, for purposes of such subsections.

DEFINITION OF ESTIMATED INCOME TAX

Paragraph (4) of section 102(b) of the bill amends section 7701(a) (relating to definitions) by adding a new paragraph (34) which defines the term "estimated income tax" as used in the code to mean, in the case of an individual, the estimated tax as defined in section 6015(c), or, in the case of a corporation, the estimated tax as defined in section 6016(b).

CROSS REFERENCE

Paragraph (5) of section 102(b) of the bill amends section 1403(b) of the code (relating to cross references) to provide a cross reference to section 6015 of the code.

(c) *Ministers, members of religious orders, and Christian Science practitioners.*—Section 102(c) of the bill amends section 1402(e)(3) of the code (relating to effective date of waiver certificates) to provide a special rule in the case of ministers, members of religious orders, and Christian Science practitioners who file waiver certificates (as described in sec. 1402(e)(1).

Section 1402(e)(3) as amended contains a new subparagraph (E) which provides that, for purposes of sections 6015 and 6654, a waiver certificate de-

scribed in section 1402(e)(1) is treated as taking effect on the first day of the first taxable year beginning after the date on which such certificate is filed. Thus, for example, if a minister who is a calendar year taxpayer files a waiver certificate (pursuant to sec. 1402(e)) on April 15, 1968, such certificate will not be effective for purposes of sections 6015 and 6654 until the taxable year 1969. Accordingly, although such minister may be liable for self-employment tax for 1967 and 1968, he is not required to include an estimate of such liability in his declaration of estimated tax for such years and is not subject to an addition to the tax (under sec. 6654(a)) with respect to his self-employment tax liability for such years.

(d) *Effective date.*—Subsection (d) of section 102 of the bill provides that the amendments made by subsections (a), (b), and (c) of section 102 of the bill shall apply with respect to taxable years beginning after December 31, 1966.

SECTION 103. UNDERPAYMENT OF INSTALLMENTS OF ESTIMATED INCOME TAX IN CASE OF INDIVIDUALS

(a) *In general.*—Under section 6654(b) of the code the amount of the underpayment of estimated tax for purposes of computing the addition to tax on account of underpayment is the excess of (1) the amount of the installment which would be required to be paid if the estimated tax were equal to 70 percent (66⅔ percent in the case of farmers or fishermen) of the tax shown on the return for the taxable year or, if no return was filed, 70 percent (or 66⅔ percent) of the tax for such year, over (2) the amount, if any, of the installment paid on or before the last date prescribed for such payment. Under section 6654(d)(2), as amended by section 102(b)(2) of the bill, the addition to tax with respect to any underpayment of an installment is not to apply if the total amount of all payments of estimated tax made on or before the last date prescribed for the payment of the installment equals or exceeds 70 percent (66⅔ percent in the case of farmers or fishermen) of the tax for the taxable year computed as provided in such section.

Subsection (a) of section 103 of the bill amends section 6654(b) (relating to amount of underpayment), and section 6654(d) (relating to exception) as amended by section 102(b)(2) of the bill, by striking out "70 percent" each place it appears and inserting in lieu thereof "80 percent."

(b) *Effective date.*—Subsection (b) of section 103 of the bill provides that the amendments made by subsection (a) shall apply with respect to taxable years beginning after December 31, 1966.

SECTION 104. INSTALLMENT PAYMENTS OF ESTIMATED INCOME TAX BY CORPORATIONS

(a) *In general.*—Section 6154(a) of the code sets forth the amount of, and time for payment of, each installment payment of estimated income tax by a corporation required to file a declaration of estimated income tax under section 6016 of the code (i.e., a corporation the tax of which under subtitle A for the taxable year, after reduction by credits, can reasonably be expected to exceed $100,000).

Section 104 of the bill does not make any change in the requirements for filing a corporate declaration of estimated income tax, nor does it make any change in the time for paying installments of such estimated tax. However, it does make changes in the amount of the installments. Under existing law, a corporation required to pay estimated tax for a taxable year in four installments has a third and fourth installment each of which is equal to 25 percent of the estimated tax. However, its first and second installments are each as follows:

For taxable years beginning in—	*Percentage of estimated tax*
1966	9
1967	14
1968	19
1969	22
1970 or any subsequent year	25

Under section 104 of the bill, the first and second installments of estimated tax of such a corporation will each be as follows:

For taxable years beginning in—	*Percentage of estimated tax*
1966	12
1967 or any subsequent year	25

The bill makes comparable changes for those corporations which are required to pay estimated income tax in three, two, or one installments (i.e., those corporations which are not required to file a declaration by the 15th day of the 4th month of their taxable year but are required to file declarations later in the taxable year by reason of liability for income tax then reasonably expected). The effect of these changes for these corporations is that, for a taxable year beginning in 1966, 74 percent of the estimated tax will be payable in installments, and that, for any taxable year beginning after 1966, 100 percent will be payable in installments.

(*b*) *Effective date.*—The amendment to section 6154(a) of the code applies with respect to taxable years beginning after December 31, 1965. Thus, in the case of a calendar year corporation required to pay four installments of estimated tax during 1966, the amendment first applies with respect to the installment due on April 15, 1966.

TITLE II—POSTPONEMENT OF CERTAIN EXCISE TAX REDUCTIONS

SECTION 201. PASSENGER AUTOMOBILES

(*a*) *Postponement of rate reductions.*—Subsection (a) of section 201 of the bill amends section 4061(a)(2)(A) of the code (relating to tax on automobiles) to restore the excise tax on passenger automobiles to 7 percent and to defer further reductions in this tax until April 1, 1968.

Section 4061(a)(2) of existing law imposes an excise tax on sales, by a manufacturer or importer, of passenger automobiles and trailers (other than house trailers) suitable for use with passenger automobiles, under the following rate schedule:

Seven percent for the period June 22, 1965, through December 31, 1965,
Six percent for the period January 1, 1966, through December 31, 1966,
Four percent for the period January 1, 1967, through December 31, 1967,
Two percent for the period January 1, 1968, through December 31, 1968, and
One percent for the period after December 31, 1968.

The new rate reduction schedule under section 4061(a)(2)(A), as amended by subsection (a) of section 201 of the bill, is:

Seven percent for the period beginning with the day after enactment of the bill through March 31, 1968,
Two percent for the period April 1, 1968, through December 31, 1968, and
One percent for the period after December 31, 1968.

(*b*) Floor stocks tax.—Subsection (b)(1) of section 201 of the bill adds a new paragraph (8) to section 4226 (a) of the code (relating to floor stocks taxes) which imposes a floor stocks tax of 1 percent on each passenger automobile [4] which was subject to tax under section 4061 (a)(2) and which is held by a dealer, has not been used, and is intended for sale, on the day after the bill is enacted. The 1-percent floor stocks tax is computed on the price for which the automobile was sold by the manufacturer or importer.

Under regulations to be prescribed by the Secretary of the Treasury or his delegate, the floor stocks tax is to be paid by the dealer holding the automobile on which it is imposed and collected from him by the manufacturer or importer of the automobile.

Subsection (b)(2) of section 201 of the bill amends section 4226(d) to provide that the new floor stocks tax shall be paid at such times after 60 days after the day on which the bill is enacted as may be prescribed by the Secretary of the Treasury or his delegate.

(*c*) *Conforming amendments.*—Section 6412(a)(1) of the code presently provides for floor stocks refunds with respect to automobiles in dealers' inventories

[4] Includes trailers (other than house trailers) suitable for use with passenger automobiles.

on each of the dates on which a reduction in the excise tax is scheduled. Subsection (c)(1) of section 201 of the bill amends section 6412(a)(1) to conform the floor stock refund dates to the revised rate reduction schedule.

Subsection (c)(2) of section 201 of the bill makes a technical amendment to section 209(c)(1)(G) of the Highway Revenue Act of 1956 [P.L. 84-627, C.B. 1956-2, 1150] (relating to general provisions for transfer to the highway trust fund) under which the revenue received from the floor stocks tax imposed by new section 4226(a)(8) will go into the general fund instead of the highway trust fund.

(*d*) *Effective date.*—Subsection (d) of section 201 of the bill provides that the amendment made by subsection (a) shall apply with respect to articles sold after the date on which the bill is enacted.

SECTION 202. COMMUNICATION SERVICES

(*a*) *Postponement of rate reductions.*—Subsection (a) of section 202 of the bill amends section 4251 of the code (relating to tax on communications) to restore the excise tax on local and toll telephone service (and teletypewriter exchange service) to 10 percent and to defer further reductions in this tax until April 1, 1968.

Section 4251 of existing law imposes an excise tax on amounts paid for local and toll telephone service and teletypewriter exchange service under the following rate scredule:

Amounts paid pursuant to bills first rendered—	*Tax rate in percent*
During 1966	3
During 1967	2
During 1968	1
After 1968	[1]

[1] No tax.

The new rate reduction schedule under section 4251, as amended by subsection (a)(1) of section 201 of the bill, is:

Amounts paid pursuant to bills first rendered—	*Tax rate in percent*
Before Apr. 1, 1968	10
After Mar. 31, 1968, and before Jan. 1, 1969	1
After 1968	[1]

[1] No tax.

Subsection (a)(2) of section 202 of the bill amends section 4251(c) to conform the special rule contained therein to the new rate reduction schedule.

(*b*) *Nonprofit hospitals.*—Subsection (b) of section 202 of the bill adds a new subsection (h) to section 4253. The new subsection (h) provides that no tax shall be imposed under section 4251 on any amount paid by a nonprofit hospital for communication services furnished to such hospital. A "nonprofit hospital" is defined in the new subsection (h) to mean a hospital referred to in section 503(b)(5) which is exempt from income tax under section 501(a). Under this amendment, private nonprofit hospitals will receive the same tax-exempt treatment on their payments for communication services as is applicable under section 4292 to hospitals operated by a State or local government.

(*c*) *Effective date.*—The amendments made by subsections (a) and (b) of section 202 of the bill are to apply to amounts paid pursuant to bills first rendered on or after the first day of the first month which begins more than 15 days after the date on which the bill is enacted for services rendered on or after such first day. In the case of amounts paid pursuant to bills rendered on or after such first day for services which were rendered before such first day and for which no previous bill was rendered, such amendments are to apply except with respect to such services as were rendered more than 2 months before such first day. In the case of services rendered more than 2 months before such first day, the provisions of subchapter B of chapter 33 of the code in effect at the time such services were rendered, subject to the provisions of section 701(b)(2) of the Excise Tax Reduction Act of 1965, are to apply to the amounts paid for such services.

VI. SEPARATE VIEWS OF REPRESENTATIVE PAT JENNINGS

FISCAL RESPONSIBILITY

The Revenue Act of 1964 [P.L. 88-272, C.B. 1964-1 (Part 2), 6] gave the American taxpayer the largest tax cut in the history of our country, and in doing so, the Congress acted in a fiscally responsible manner.

That act, which I wholeheartedly supported, was designed to bring about a balance of our Federal budget, and I think would have accomplished that purpose except for the Vietnam conflict.

Before enactment of the Excise Tax Reduction Act of 1965, I cautioned the Members of Congress that each measure must be judged in terms of its impact on the Federal budget and in the light of our defense posture in Asia, and elsewhere. Fiscal responsibility should be stressed, I said, and should be the guiding force and dominant feature in any future tax legislation.

In his budget message to the Congress this year, the President estimates a budget deficit of $6.4 billion for fiscal year 1966 and a deficit of $1.8 billion for fiscal year 1967.

These deficits will exist although the Congress has been asked to approve a tax measure which will result in a revenue increase of $4.8 billion when the measure is fully effective.

In this connection, we should ask ourselves whether we, as representatives of the people, have accepted fully our responsibilities. Our goal under present circumstances should be one of achieving a balanced budget, and all efforts should be aimed in that direction.

American lives are being sacrificed on the battlefield, and I am convinced Americans at home are willing to make the necessary sacrifice to pay for the support of our fighting forces in Vietnam.

This legislation is titled the "Tax Adjustment Act of 1966." But, in my estimation it fails to meet the needs. It is unfair in the treatment of the excise taxes. I believe the American people would desire that our revenues be obtained in a different manner.

The bill makes several adjustments in tax collection procedures that will speed up income tax payments by individuals and corporations. No additional tax burdens are imposed. This I favor. It restores the excise tax on automobiles and communications to the levels of January 1, 1966. It delays the scheduled reductions in the taxes on automobiles and telephones—which apply to essentials for the American people. I believe it is unfair to restore and delay further cuts in the excise taxes on automobiles and telephones and not consider restoring the cuts on the luxury and other items not as essential to our economy and our people.

Why raise excise taxes on automobiles and communications and not restore the excises on such items as furs, jewelry, luggage and handbags, and toilet preparations in the retail field? Why not restore manufacturers' taxes on such items as television sets and sporting goods, just to name two items on the list reduced last year. And, what about restoring the taxes on cabarets and clubs?

Personally, I do not wish to restore any of these excise taxes, which are considered regressive in nature. I reiterate that we should not raise the excise rates that affect automobiles and telephones, however, unless we turn to other less essential items.

It seems to me that it would be more fiscally responsible to ask the American taxpayers—both individuals and corporations—to give up half of the income tax cut received under the 1964 Act as his contribution to the war effort. This would result in revenue increases, at a minimum, of more than $5.5 billion annually. The American public, I am sure, would support such a "victory tax." It would bring about a balance in the Federal budget, and in my judgment would be a much more fiscally responsible approach to our domestic and world situation today.

Needless to say, this tax would apply to taxpayers who could best afford it. The excise or "nuisance taxes" apply to those least able to afford them—except in the so-called luxury items.

Finally, the "victory tax" increase could be eliminated swiftly and we could all feel much better over the results—revenues to finance the Vietnam war and a balanced budget.

W. PAT JENNINGS.

VII. SEPARATE VIEWS OF MESSRS. BYRNES, CURTIS, SCHNEEBELI, COLLIER, BROYHILL (VA.), AND BATTIN ON H.R. 12752

Faced with a major war in Vietnam and a real danger of inflation at home, the administration continues to enlarge and to expand domestic programs of dubious value without regard to the consequences. By this action, the administration courts disaster.

While attention has been focused on what the administration projects as a deficit of $1.8 billion for fiscal 1967, without the additional revenue provided for in this bill by the administration's own estimate this deficit would be $6.6 billion. To this must also be added the deficit now projected by the administration in its revised budget for fiscal 1966, amounting to $6.4 billion. Without this bill, the projected deficit for fiscal 1966 would be $7.5 billion.

It is becoming more and more apparent that we cannot continue to pile deficit upon deficit through increased Government spending, as the administration seeks to do, without reaping the consequences. This practice has already given rise to a deficit in our balance of payments, a threat to international monetary stability, a "run" on our gold reserves, serious problems in debt management, and finally we are now faced with a real threat of serious inflation.

Our problem today does not stem from a lack of revenue, but from a lack of control over Government spending. Even without this bill, our tax revenues will have increased from $78 billion in fiscal 1961 to more than $106 billion in fiscal 1967, an increase of $28 billion.

The high level of prosperity which was achieved by the fall of 1965, did not result from increased Government expenditures. On the contrary, expenditures for fiscal 1964 were held to $97.7 billion and expenditures for fiscal 1965 were held to $96.5 billion, which was below the level proposed by the Republicans as essential for a sound program of tax reduction when the Tax Reduction Act of 1964 was before the House. Our position was fully vindicated. Tax reduction, when coupled with a leveling off of Government expenditures, was all that was needed to produce a healthy growth in our economy. However, the administration was not satisfied.

Beginning in the fall of 1965, the administration abandoned its attitude of restraint. Government spending was stepped up, not only on account of the war in Vietnam, but for nondefense purposes as well. As a result, by fiscal 1967 the administration's reported spending will have increased to $112.8 billion, to which should be added an additional $6 billion realized from the sale of loans and other Government assets which has been used to reduce expenditures in fiscal 1967. We are thus dealing with an expenditure budget of $118.8 billion for fiscal 1967, or a $37 billion increase in the level of Federal spending since fiscal 1961. Less than one-third of this increase can be attributed to the war in Vietnam.

When these increased Government expenditures at home, coupled with the expenditures incident to the war in Vietnam, are imposed on an already record private demand, there is an invitation to disaster. A slight miscalculation can bring on controls over wages, prices and credit, as well as ruinous inflation. The administration is asking for "trouble." In a recent (Jan. 25, 1966) editorial, entitled "A Troubled Budget," the New York Times points up this danger. The New York Times said:

> All budgets of course contain an element of optimism, but the estimates in the administration's new budget seem to possess more than the usual amount of wishful thinking, especially in appraising the cost of Vietnam and the threat of inflation. It is understandable that the administration is in this frame of mind. It has boldly pursued expansionary policies without as yet inducing outright inflation as its critics had predicted. So it still thinks there is room for a little more of the same. But now the margin for error is dangerously slim. The only way the President has been able to limit the budget deficit is by projecting a very big increase in revenues and a relatively moderate rise in military expenditures.
>
> This may be the popular thing to do. Indeed, as budgets go, the new design, which pushes up spending and holds down taxes, qualifies as an exercise in pop art. It also indulges in some pop art illusions. Mr. Johnson admitted as much in warning that he would ask for tax increases if the Pentagon needs more funds or if inflation gets out of

hand; but for the moment the impact of the budget will be at least mildly expansionary when the state of the economy suggests that it should be at least mildly restrictionist. In this respect, the budget is asking for trouble.

Our troops in Vietnam have our full support. Their needs must be fully met. In order to meet these needs, however, there must be more "belt tightening" at home. In this bill, the administration is asking the American taxpayers to tighten their belts to the extent of some $6 billion in increased taxes and accelerated tax payments. The administration should make a commensurate effort to tighten its belt. Nonessential expenditures should be cut back and the initiation of new programs deferred until after the emergency. We must be prepared also to win the war at home—the war on inflation.

In urging a cutback in domestic programs, the Republicans are not unmindful of the plight of the less fortunate—the so-called poor—in a highly industrialized society. Yet, inflation strikes hardest at the poor, who are least equipped to meet it. No amount of Federal aid can offset its effect. The war on poverty cannot be won, if we lose the war on inflation.

Instead of being willing to tighten its belt, the administration has resorted to a series of temporary measures, not looking beyond fiscal 1967. Proposals for the "speedup" of tax collections, the postponement of reductions in excise taxes, and additional so-called user taxes, are counted on to produce approximately $5 billion in additional revenues. Seigniorage earnings, representing the savings in taking the silver out of the coins, produce a "windfall" profit of $1.6 billion. Revenues from the sale of private financing of Government-held loans, and the sale of commodities and strategic materials, are scheduled to produce a "saving" in expenditures of more than $6 billion. Thus, for fiscal 1967, the administration is relying largely upon a series of "one shot" measures for nonrecurring revenues of more than $12 billion.

Notwithstanding the inclusion in the budget for fiscal 1967 of nonrecurring revenues of more than $12 billion, coupled with an unprecedented projected level of economic growth and tax revenues, the administration's budget shows a deficit of $1.8 billion. If the administration cannot present a balanced budget under these conditions, when does the administration propose to balance the budget?

If there were any assurance that the war in Vietnam would not extend beyond the fiscal year 1967, there might be some justification for financing that war through a series of temporary expedients. On the contrary, however, we are told to prepare for a long struggle in Vietnam. If this is correct, and domestic spending continues even at the present level, how does the administration propose to raise the additional revenues which will be required for fiscal 1968?

The administration knows that increased expenditures for social programs at home and abroad, in the face of the escalating costs of the war in Vietnam, have already created dangerous inflationary pressures. The administration may be forced to seek controls over wages, prices and credit as well as further increases in taxes, if it continues on its present course. Apparently, the administration is willing to take this risk if the "day of truth" can be postponed until after the November congressional elections.

We are unalterably opposed to the fiscal policies which make it necessary to raise an additional $5 billion in revenues for fiscal 1967. Under present circumstances, however, it is our judgment that the failure to raise additional revenues at this time will increase the danger of inflation and aggravate the problems with respect to our balance of payments, gold flow, and debt management. We therefore reluctantly support this bill. We caution, however, that unless the administration and the Congress are willing to establish strict priorities for its nondefense programs, and put some of them "on the shelf" for a later day, this bill will be only the first in a series of bills increasing taxes and imposing controls on our economy.

JOHN W. BYRNES.
THOMAS B. CURTIS.
HERMAN T. SCHNEEBELI.
HAROLD R. COLLIER.
JOEL T. BROYHILL.
JAMES F. BATTIN.

VIII. DISSENTING VIEWS OF MESSRS. UTT AND BETTS

Portions of this bill which increase withholding of income taxes and acceleration of payment of corporate income taxes are desirable and in our opinion overdue. But we find it impossible to support the provisions which restore excise taxes on automobile sales and the use of telephones. We are in complete agreement with the purpose of securing revenue for the prosecution of the war in Vietnam but firmly believe it should be accomplished in other ways.

If the Congress does not enact this bill, it will be incumbent upon the administration to reduce nonessential expenditures in order to make up for the revenue loss. This bill merely relieves the administration of that responsibility.

Notwithstanding the increased costs of the war in Vietnam, an increase in taxes at this time would have been wholly unnecessary if the administration had not elected to increase expenditures for wasteful and ineffective social programs beyond the levels of prior years. It is indeed anomaly that with increased prosperity, more jobs, and less unemployment, we are asked to appropriate more and more funds for social welfare. We think that it is time that the Congress took a good hard look at these programs before increasing taxes.

It is easy to understand why the administration chose the automobile and telephone industries as the areas for raising revenue. Both are enjoying unprecedented prosperity. The tax is not a burden on the industries because both thrive on a captive market. The telephone and automobile are necessities in American life. But this is no justification for selecting the car buyer and telephone user to finance the war and check inflation.

In support of the bill we are told that the car manufacturers and the larger telephone companies do not object to this tax restoration. Actually this is no argument at all. It is the car buyers and telephone users who ultimately pay the taxes—not the companies.

Furthermore, limiting the tax restoration to these two fields leaves the purchasers of mink coats, jewelry, and luxury items free of the burden of checking inflation and supporting the war effort.

In our prosperous economy we freely admit that this bill will probably not affect the car or telephone business to any serious extent. But as a matter of principle we object to singling out specific areas to bear the burden of raising revenue. We feel that inflation and the war effort are serious enough to warrant support from the entire economy by further reduction of domestic spending or, if necessity requires, an income tax increase.

For these reasons we cannot support the bill.

JAMES B. UTT.
JACKSON E. BETTS.

[H.R. 12752] [1]

TAX ADJUSTMENT ACT OF 1966

[Senate Report No. 1010, Eighty-ninth Congress, Second Session, Calendar No. 985]

[March 2, 1966]

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following report together with supplementary views to accompany H.R. 12752.

The Committee on Finance, to which was referred the bill (H.R. 12752) to provide for graduated withholding of income tax from wages, to require declarations of estimated tax with respect to self-employment income, to accelerate current payments of estimated income tax by corporations, to postpone certain excise tax rate reductions, and for other purposes, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

I. SUMMARY

Your committee has reported H.R. 12752, the tax adjustment bill of 1966, with four substantive amendments in addition to other technical amendments. Your committee's amendments will increase slightly the revenue to be obtained under this bill.

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[1] Public Law 89-368, page 379, this Bulletin.

H.R. 12752 is designed to contribute revenues to aid in financing the increased cost of Government associated with operations in Vietnam. It is designed to help finance these costs in a manner which will avoid the creation of serious inflationary pressures.

Two of the amendments made by your committee relate to matters in the House version of the bill and two deal with separate measures not included in the House bill. One of the provisions relating to material in the House bill concerns the withholding allowances provided in connection with graduated withholding and is discussed below with the discussion of that provision. The second amendment relates to a House measure which deals with the floor stocks tax of 1 percent on dealers' inventories of passenger cars (provided in connection with the 1 percentage point restored to the manufacturer's excise tax rate on passenger automobiles). Your committee's amendment deletes this floor stocks tax.

One of the two provisions added to the bill by your committee requires the Department of Agriculture to send to farmers copies of information returns they send to the Internal Revenue Service with respect to payments of over $600 a year. The second new provision added by an amendment made by your committee denies any deduction for amounts paid for advertising in a convention program of a political party, or in any other publication if any part of the proceeds inures to a political party or candidate. Deduction is also denied for payments for admission to dinners or programs if any part of the proceeds inures to a political party or candidate. In addition, deduction is denied for payments for admission to an inaugural ball or a similar event.

The provisions of the bill, which are based upon recommendations made by the President with certain important modifications, are grouped under two headings. Most important from a revenue standpoint are the provisions which affect the procedures for collecting tax, but which do not affect tax liabilities. They include graduated withholding on wage income, strengthening the payment requirements for declarations, the acceleration of corporate estimated tax payments, and quarterly payments of estimated self-employment social security tax. The remaining provisions superimpose a 2-year moratorium on rate reductions scheduled under existing law for the excise taxes on passenger automobiles and telephone service. When this moratorium ends, these tax rates will immediately fall to the levels which would otherwise have been applicable under present law at that time, and will thereafter continue to be reduced as scheduled under existing law.

Revenue effect.—It is anticipated that these provisions will increase administrative budget revenues in the fiscal year 1966 by $1.1 billion and the revenues in the fiscal year 1967 by $4.8 billion relative to the levels that would be achieved under existing law. The temporary effects of the change in the timing of tax payments will be responsible for almost all of the 1.1 billion of the added administrative budget revenues in the fiscal year 1966 and $3.4 billion of the increase in revenues in the fiscal year 1967. The quarterly payment of estimated self-employment tax will increase trust fund receipts, which are reflected in the consolidated cash budget but not in the administrative budget, by $200 million in the fiscal year 1967. The moratorium on excise tax reduction will retain $35 million in revenue which would otherwise be foregone in the fiscal year 1966 and $1.2 billion in revenue which would otherwise be foregone in the fiscal year 1967.

The provisions.—(1) *Graduated withholding.*—For wages paid after April 30, 1966, the bill replaces the present withholding tax rate with a series of six graduated rates ranging from 14 to 30 percent which are grouped in a system that takes account of the minimum standard deduction or deductions of 10 percent of wages and of the taxpayer's marital status as well as the statutory tax rates which apply to the first $12,000 of taxable income for single persons and $24,000 of taxable income for married persons. The 30-percent rate also will apply to all higher levels of taxable income.

Included in the bill is a provision, not a part of the President's recommendations, which is designed to reduce overwithholding. This provision, beginning in 1967, will permit taxpayers whose itemized deductions as a percentage of their wages are in excess of certain limits to claim withholding allowances. These allowances will have the effect of additional withholding exemptions. Withholding allowances will be based on the excess of estimated itemized deductions (which cannot exceed the deductions itemized in the previous year) over a prescribed amount of estimated wage income (which cannot be less than the wage income received in the previous year). The prescribed amount under the House bill would

be a composite of 12 percent of the first $7,500 of estimated wages plus 17 percent of estimated wages in excess of $7,500. Under your committee's bill the prescribed amount is to be a composite of 10 percent of the first $7,500 of estimated wages plus 17 percent of estimated wages in excess of $7,500. Under the House bill, beginning in 1967, withholding allowances could be claimed with respect to each full $700 of itemized deductions above the prescribed percentage amounts, except that the first allowance could be claimed if this excess amount equaled $350 or more. Under your committee's amendments, withholding allowances may be claimed only with respect to full units of $700 of itemized deductions above the prescribed percentage limitation, whether it is the first or a subsequent withholding allowance which is involved. Under both versions of the bill the Internal Revenue Service is authorized, and expected, to compile a table which will help taxpayers to determine the number of withholding allowances they may claim.

(2) *Quarterly payments of estimated self-employment tax.*—Effective for taxable years beginning after December 31, 1966, self-employed persons will be required to file declarations with respect to the total of their estimated income tax and self-employment tax and to make quarterly payments based on this declaration. The rules which now apply with regard to the requirement for filing a declaration of estimated income tax and the rules which govern the assessment of penalties for the underpayment of estimated tax will henceforth apply to the combined amount of estimated income tax and estimated self-employment tax.

(3) *Underpayment of estimated tax by individuals.*—Under existing law, a penalty may be incurred by a taxpayer when the total of the amounts withheld from his wages and the amounts paid through quarterly payments of estimated tax are equal to less than 70 percent of the tax shown on his return. Effective for taxable years beginning after December 31, 1966, the present 70 percent provision is raised to 80 percent.

(4) *Acceleration of corporation income tax payments.*—The schedule bringing corporation payments of estimated income tax liabilities above $100,000 to a current basis will be accelerated so that the current payments basis will be reached in 1967 instead of 1970 as scheduled under present law. Calendar year corporations will pay 12 percent of their estimated tax liabilities in April and June 1966, instead of the presently scheduled 9 percent. In 1967 and in following years, they will pay 25 percent of estimated tax liabilities on each payment date.

(5) *Excise tax on passenger automobiles.*—The excise tax rate on passenger automobiles effective on the day after enactment of the bill will revert to 7 percent (the rate before January 1, 1966) from 6 percent, and there will be a moratorium through March 31, 1968, on further tax rate reductions scheduled under present law. At the expiration of the moratorium, the excise tax on passenger automobiles will fall to 2 percent, as presently scheduled for 1968, and then to 1 percent as presently scheduled for 1969. Under your committee's amendments no floor stocks tax is to be imposed on the inventories of dealers and distributors.

(6) *Excise tax on telephone service.*—The excise tax rate on telephone service will revert to 10 percent (the rate before January 1, 1966), from 3 percent, on general and toll telephone and teletypewriter exchange services. It will be in effect through March 31, 1968, when it will decline to 1 percent and will be repealed on January 1, 1969, as scheduled under present law. Nonprofit hospitals will be exempt from the tax on telephone services. These provisions will be effective with respect to bills rendered on or after the first day of the first month which begins more than 15 days after the effective date of this bill.

(7) *Indirect political contributions.*—No deduction from income is to be allowed to an individual or a business for advertising, admissions to dinners, programs, or any similar events, if any part of the net proceeds inures to the benefit of a political party or political candidate. In addition, no deduction is to be allowed for payments for admissions to inaugural balls, etc., identified with a political party or a political candidate. The provision is to be applicable to taxable years beginning after December 31, 1965, but only with respect to amounts paid after the date of enactment of the bill.

(8) *Information returns supplied to farmers.*—The Department of Agriculture will be required to supply farmers with copies of information returns which now are sent to the Internal Revenue Service with respect to all payments of $600 or more made in any 1 year to an individual. The statements may be made through the national office of the Department of Agriculture, any of its State or local offices, or any of its agencies. The provision will be effective for reports sent out after the date of enactment of the bill.

II. REVENUE EFFECTS

As indicated in table 1, the bill is expected to increase fiscal year 1966 administrative budget receipts by $1,130 million and fiscal year 1967 receipts by $4,800 million. This latter figure is about the same as that recommended by the President. In addition, consolidated cash budget receipts will be further increased by $200 million in the fiscal year 1967. This increase differs from the recommendation of the President only in that the $200 million under his recommendation was spread over the fiscal years 1966 and 1967.

The largest single source of additional revenue provided by the bill is attributable to advancing the payment dates for corporate tax. This is expected to increase revenues in the fiscal year 1966 by $1 billion and revenues in fiscal year 1967 by $3.2 billion. The excise reduction moratorium with respect to the taxes on automobiles and communications represents the second major revenue source under the bill. It is estimated that this will raise revenues by $35 million in the fiscal year 1966 and by $1,205 million in the fiscal year 1967. The provisions with respect to graduated withholding and the increase in the declaration requirement under the individual income tax from 70 to 80 percent of actual tax liability are expected to increase revenues by $395 million in the fiscal year 1967. The provision with respect to graduated withholding is expected to increase revenues in the fiscal year 1966 by $95 million.

TABLE 1.—*Estimated revenue increase under H.R. 12752 as reported by the Senate Committee on Finance, for the fiscal years 1966 and 1967*

[In millions of dollars]

	Fiscal year 1966	Fiscal year 1967
Excises:		
Communications	---	785
Automobiles	35	420
Total excises	35	1, 205
Corporate speed-up	1, 000	3, 200
Graduated withholding	95	245
Increase in declaration requirement under individual income tax from 70 to 80 percent	---	150
Total, administrative budget	1, 130	4, 800
Self-employment tax, social security, quarterly payments (goes into a trust fund)	---	200
Total, cash budget	1, 130	5, 000

Table 2 shows the revenue impact of the graduated withholding system and the declaration requirement change approved by your committee. Only the six-rate graduated withholding system has an impact in the fiscal year 1966. As previously indicated, this is expected to increase revenues in that year by $95 million. In the fiscal year 1967 a six-rate graduated withholding system with no allowances for excess itemized deductions would increase revenues by $400 million. If two-thirds of those eligible decrease overwithholding due to itemized deductions under the version of the provision approved by your committee, this gain will be reduced by $155 million in the fiscal year 1967, resulting in a net gain from graduated withholding of $245 million in the fiscal year 1967. However, the provision in raising the declaration requirement from 70 to 80 percent effective for the fiscal year 1967 is expected to increase revenues by $150 million. As a result these actions, taken together, give rise to an estimated revenue gain of $395 million for the fiscal year 1967, or about the same as that recommended by the President. In the fiscal year 1968 the decrease in overwithholding attributable to allowances for itemized deductions will result in a loss of $230 million. This fiscal year 1968 loss of $230 million is a loss over and above any which would be incurred under the President's recommenda-

TABLE 2.—*Revenue effect of provisions of H.R. 12752 as reported by the Senate Committee on Finance, relating to graduated withholding and declarations of estimated tax*

[In millions of dollars]

Provisions	Effective date	Full year effect	Change in receipts		
			Fiscal year 1966	Fiscal year 1967	Fiscal year 1968
6-rate graduated withholding	May 1, 1966	+1,240	+95	+400	------
Extra withholding allowance for excess deductions [1]	Jan. 1, 1967	−935	------	−155	−230
Increase requirement for estimated tax from 70 to 80 percent	Jan 1, 1967	+300	------	+150	------
Total for individuals	----------	+605	+95	+395	−230

[1] Assumes ⅔ utilization by eligible taxpayers.

tions. However, there is a net gain of $65 million in that year arising from extending the excise tax rates for passenger cars and communication services until April 1, 1968, which also would not be realized under the President's recommendations.

III. REASONS FOR THE BILL

1. Fiscal and economic impact

The tax adjustment bill of 1966 will help provide the additional revenues which your committee is advised will be required by the conflict in Vietnam. This bill is designed to help finance the additional expenditures required for this purpose without generating serious inflationary pressures in the domestic economy. The additional revenues will be derived from two general types of provisions. The first consists of improvements in tax collection procedures which, without affecting tax liabilities, involve a temporary increase in the amount of revenues by making payments more current. The remaining provisions restore excise rates in effect on December 31, 1965, and impose a 2-year moratorium on presently scheduled reductions in the excise taxes on passenger automobiles and telephone service.

Were it not for special Vietnam costs, your committee has been informed the increase in Federal revenue attributable to the growth of the economy—growth largely in response to the tax reductions enacted in recent years—would be sufficient not only to meet the regular requirements of Federal operations but also to provide a surplus. The President's budget message indicates that special Vietnam expenses will account for an estimated $10.5 billion of administrative budget expenditures for the fiscal year 1967. These expenses account for $5.8 billion of the $6.4 billion increase in expenditures in the fiscal year 1967 over those for the fiscal year 1966. It is estimated that revenues would increase by $7.3 billion between the 2 fiscal years if no change were made in existing tax laws, an amount that would be sufficient to produce a substantial budget surplus were it not for the extraordinary defense requirements. It will be recalled that when the Senate was considiering the Revenue Act of 1964 [P.L. 88–272, C.B. 1964–1 (Part 2), 6], which provided a reduction of $11.5 billion, the largest reduction ever provided—the then Secretary of the Treasury Douglas Dillon indicated that despite this reduction, it might be possible to balance the budget in the fiscal year 1967. It should be noted that this objective of a balanced budget in the fiscal year 1967 would be obtained were it not for the extraordinary defense expenditures arising from the conflict in Vietnam. Thus, were it not for the special Vietnam expenses of $10.5 billion, there would be no need at this time for the 2-year excise tax reduction moratorium or for an advancement of the corporate tax payments at a more rapid rate than originally planned.

As a result of these extraordinary defense requirements, this bill provides additional temporary revenues designed to improve the budgetary outlook for both the fiscal years 1966 and 1967 as indicated in table 3.

TABLE 3.—*Comparison of administrative budget receipts and expenditures with and without H.R. 12752 as reported by the Senate Committee on Finance, fiscal years 1966 and 1967*

[In billions of dollars]

	Fiscal year 1966	Fiscal year 1967	Change fiscal year 1967 over fiscal year 1966
Expenditures	106.4	112.8	+6.4
Receipts without bill	98.8	106.2	+7.3
Deficit without bill	7.6	6.7	−.9
Increase in receipts under bill	+1.1	+4.8	+3.7
Total receipts (including those under this bill)	100.0	111.0	+11.0
Deficit after taking account of revenues under this bill	6.5	1.9	−4.6

NOTE.—Figures are based on President's budget message and therefore totals include estimated effects of proposed legislation other than H.R. 12752. Figures are rounded and will not necessarily add to totals.

Its provisions will increase revenues over present law yields in the current fiscal year by an estimated $1.1 billion on an administrative budget basis and by $4.8 billion in the following fiscal year. As a result, the deficit in the administration's budget expected for fiscal 1966 without the bill will be reduced from $7.6 to $6.5 billion, and will fall sharply to $1.7 billion in fiscal 1967. Viewed from the basis of the consolidated cash budget, the results of the bill will be even more significant. The anticipated consolidated cash budget deficit for the fiscal year 1966 is expected to be $7 billion. In the fiscal year 1967, this deficit will be eliminated and a small surplus achieved as a consequence of the $5 billion that will be added to cash receipts by this bill in that year. Moreover, the bill will increase fiscal 1966 cash receipts by $1.1 billion.

The modifications in collection procedures enacted in this bill—that is, graduated withholding, tighter declaration requirements, quarterly self-employment tax payments, and faster corporate income tax payments—will have a significant effect on revenues even though they will not increase tax liabilities. These changes in timing will result in the collection of some revenues in fiscal 1966 and fiscal 1967 which would otherwise not be collected until the following years. Once the transition to the new collection procedures is completed, however, tax payments by individuals and corporations during each fiscal year will (apart from the effect of growth in the economy) be no greater than under present law.

It is expected that the increased tax collections that result from this bill will have a moderating influence on the expenditures of individuals and business firms. This influence will tend to offset the expansionary effects of increased defense expenditures. Such a policy is appropriate in view of the near capacity levels of output and employment at which the economy is now operating. In the absence of the moderating influence of increased tax collections, the total of private demand and Government requirements would threaten to exceed the present capacity of the Nation's productive resources, and in that manner constitute a threat to price stability.

The Nation has enjoyed 5 years of uninterrupted economic expansion, the longest period of peacetime expansion in U.S. business cycle annals. In 1961, at the start of the expansion, civilian labor force unemployment reached 7 percent and 22 percent of manufacturing capacity remained idle. The Revenue Acts of 1962 [P.L. 87-834, C.B. 1962-3, 111] and 1964 [P.L. 88-272, C.B. 1964-1 (Part 2), 6] and the Excise Tax Reduction Act of 1965 [P.L. 89-44, C.B. 1965-2, 568], were

in large part directed at the removal of restraints to growth in the private sector of the economy arising from tax rates that were too high. Largely as a result of these measures, the rate of unemployment fell to 4 percent of the labor force in January 1966, and the capacity utilization index in manufacturing rose to 91 percent in the fourth quarter of 1965.

Today the gap between potential and actual output has thus been greatly narrowed. This is suggested by the recent behavior of the consumer and wholesale prices indexes. After 4 years of virtual stability, the index of wholesale prices increased 2 percent from 1964 to 1965. The percentage increases in the Consumer Price Index from 1960 to 1964 averaged 1.2 percent a year. In 1965 the percentage increase was 1.7 percent and would have been 1.9 or 2 percent but for the effect of excise tax reductions enacted in the Excise Tax Reduction Act of 1965.

Evidence of the approach to the full use of our capacity is also indicated in statistics on capacity utilization rates in various industries. In December 1965, several important industries were operating at or above their preferred operating rates and the overall utilization index was only 1 point below the average preferred operating rate.

As pointed out to your committee by the Secretary of the Treasury, the various provisions of the bill will have a restraining influence on demands on available capacity. Following the enactment of this bill, the amounts withheld from individual wages will increase by $1.24 billion at annual rates under the six-rate graduated withholding system. While these increased collections of $1.24 billion will be reflected in reduced amounts of tax due when final returns are filed in the spring of 1967 and, to a limited extent, in increased tax refunds, they will tend to reduce consumer purchases during the remaining portion of 1966 and during the early months of 1967.

The fiscal effect of more accurate withholding will be reinforced by the requirement that taxpayers pay at least 80 percent of their liability for the year through withholding, payments of estimated tax, or both, to avoid penalties for underpayments of estimated tax. This, too, will tend to lessen consumer spending during this period of extraordinary military expenditures. Presently only 70 percent of the final liability need to be paid to avoid the application of penalties. (As under present law, however, penalties will not be imposed where payments equal the prior year's tax or are based on the prior year's income, or certain other conditions are met.)

The postponement of some corporate investment expenditures, as will occur as a result of the acceleration of corporate tax payments for the larger corporations, will be favorable to continued economic stability. Current levels of corporate investment in new plant and equipment are high. Outlays for business fixed investment rose by 11.5 percent in 1964 and by 15.4 percent in 1965 as compared with an average annual rate of increase of 7.5 percent in 1962 and 1963. Present announced plans indicate that investment will again increase at a rapid rate in the first half of 1966. Mild restraint, therefore, may well promote better balance between the rate of growth of output and investment in expanded capacity. It will also support our effort to reduce the deficit in our balance of payments to manageable levels. A source of strength in the balance-of-payments outlook in recent years has been the comparative stability in the prices of U.S. goods as compared to rising prices of the goods of other nations.

2. Correlating withholding with tax liabilities

Apart from their beneficial budgetary and economic effects, improved collection techniques will mean important benefits to taxpayers. Under graduated withholding, amounts withheld will more nearly approximate final liabilities. In particular, fewer taxpayers will have substantial amounts of tax to pay when they file their final return for the year. Last year for many taxpayers the fact that such bills remained to be paid in the spring of 1965 caused a measure of financial hardship and considerable resentment which tended to blunt the very substantial benefits provided by the Revenue Act of 1964. Unless graduated withholding is enacted, this experience is likely to be repeated in future years. Another result of the graduated withholding is that fewer employees will have overwithholding. Thus, this is a desirable improvement in collection procedures wholly apart from the temporary revenue increase.

The bill incorporates a special withholding allowance which provides relief for those taxpayers who itemize deductions and would otherwise find that with-

holding resulted in substantial unwanted overpayment of tax. This feature will also promote more accurate withholding as is shown subsequently in table 4 in this report.

3. Change in corporate payments merely an advance in timing

The proposal regarding corporate tax payments accomplishes by 1967 what would otherwise be accomplished by 1970. The Revenue Act of 1964 provided that corporations were to estimate and pay currently that portion of their tax liability expected to exceed $100,000, but the transition to current payment was scheduled over a period which was to end in 1970. This bill simply achieves that transition by 1967. Instead of paying 9 percent of their estimated liabilities in excess of $100,000 in April and June of 1966, calendar-year corporations will be required to pay 12 percent. In the final two quarters of 1966, these corporations will pay the same percentage, 25 percent, of these estimated liabilities as they are required to pay under present law. In 1967, these corporations will be required to pay in each quarter amounts equal to 25 percent of their estimated liabilities in excess of $100,000. Under existing law, they would pay installments of 14 percent of this estimated liability in April and June 1967 and installments of 25 percent in September and December 1967. Tables 9 and 10, presented subsequently in this report, show the schedules of payments under present law and under the bill.

4. Self-employment social security tax placed on current basis

This bill makes provision, for the first time, for the declaration and quarterly payment of estimated social security tax liabilities with respect to self-employment income. This bill places self-employed persons on the same current payment basis for social security tax purposes as they are on now for income tax purposes, and does so with a minimum degree of added complication. The declaration and estimated tax payment system now in effect is simply broadened to include estimated self-employment social security tax.

5. Two-year moratorium for auto and telephone excise reductions.

The excise tax rate reductions scheduled under present law for 1966 and later years in the case of telephone service and passenger automobiles are not rescinded by this bill. They are merely postponed for 2 years. This bill makes explicit provision for reduction on April 1, 1968, of these rates to the levels which would prevail under existing law, emphasizing the fact that the moratorium on rate reduction, while necessary in view of current budgetary and economic conditions, is not intended to cancel the eventual reductions of the 1965 act. Thus, the bill in this respect differs to a significant degree from the proposals of the administration: the administration would have postponed the auto and telephone excise tax reductions for 2 years—not only the reductions occurring in the next 2 years, but also the reductions occurring after that time. The bill, on the other hand, merely provides a moratorium for the reductions which would under present law occur in the next 2 years. Under the bill, the rates will fall at the end of the 2-year period to the rates scheduled to be in effect at that time under present law, and subsequent reductions under present law are not further postponed.

The excises on telephone service and passenger automobiles are selected for a number of reasons in addition to the fact that they yield substantial revenues. They are currently in effect, so that a moratorium on rate reduction is a much simpler matter administratively for business firms and the Government (since the payment and collection machinery is still in effect) than the reinstitution of excises previously repealed. The fact that these excises were not repealed outright by the Excise Tax Reduction Act of 1965 but were scheduled for gradual reduction also is indicative of the order of priorities in excise tax reduction established by the Congress in 1965. Moreover, the burden of these taxes is widely dispersed over the population, and, therefore, a disproportionate burden will not be imposed on a narrow segment of the population as a result of the moratorium.

IV. GENERAL EXPLANATION

1. Graduated withholding (sec. 101 of the bill and sec. 3402 of the code)

Present law.—Under present law, employers withhold Federal income tax from wages and salaries at the rate of 14 percent after recognizing the withholding exemptions claimed by an employee for himself, his wife and any dependents. The 14-percent rate is equivalent to the average of the four tax rates which

apply to the initial $2,000 of taxable income ($4,000 for married couples), reduced to reflect the 10-percent standard deduction. To further reflect the standard deduction, the value of exemptions is increased from $600 to $667 for withholding purposes.

Employees claim withholding exemptions by filing withholding exemption certificates with their employers. These certificates remain in force until superseded by the submission of later ones. The number of exemptions, claimed may be less than, but cannot exceed, the number of allowable exemptions. If the employer agrees, the employee may arrange to have extra amounts withheld from his wages.

The present 14-percent withholding rate went into effect on March 5, 1964, implementing the rate reductions enacted in the Revenue Act of 1964. It superseded the withholding rate of 18 percent which had been in effect since 1954. The latter was equivalent to the 20-percent tax rate on the first $2,000 of taxable income ($4,000 for married couples) reduced to reflect the 10-percent standard deduction.

General explanation of provision.—Under the present withholding system, taxpayers, including those who derive all their income from wages subject to withholding, often find that the amount of tax withheld from their wages differs substantially from their income tax liability for the year. As a result, if the present system were continued, an estimated 12.5 million tax returns would show a tax liability for the year 1966 significantly in excess of the amount of tax withheld. At the same time, an estimated 39.8 million taxpayers, 20 million of them with incomes of $5,000 or less, would have tax liabilities significantly less than the amounts withheld from them. Those taxpayers who are underwithheld, in the sense that withholding falls short of their tax liability, must make payments when they file their final return for the year. When such payments are unexpected, as they were for many taxpayers in 1965, they can cause resentment and, at times, financial hardship. While taxpayers who are overwithheld receive a tax refund when they file their final returns, for some, particularly those whose refund is large relative to their income, it can be a hardship to wait for such a refund.

In the past the single-rate withholding structure resulted both in substantial underwithholding and overwithholding. However, the problem has become worse. With respect to underwithholding, the steady rise in individual and family incomes has lifted many taxpayers into income brackets where the present withholding rate falls substantially short of their effective rate of tax. Moreover, important structural provisions enacted in the Revenue Act of 1964 are not reflected in the present system.

Formerly, the first taxable income bracket covered the initial $2,000 of taxable income for single persons and the initial $4,000 of taxable income for married couples. In 1964 this range of taxable income was divided into four smaller brackets. To preserve the relationship between the withholding rate and taxable income that existed in the past, Congress adopted a withholding rate that reflected the average of the first four statutory rates rather than the lowest such tax rate. The Revenue Act of 1964 also introduced the minimum standard deduction. This provision permits taxpayers with incomes which are low in relation to the size of their family to deduct an amount which exceeds 10 percent of their adjusted gross income even though they do not itemize deductions. The present withholding system, however, still takes into account only the 10-percent standard deduction.

As a result of the structural changes enacted in 1964, the present 14-percent withholding rate overwithholds on persons whose taxable income is less than $2,000 if single or $4,000 if married. This is true even though such persons claim only the standard or minimum standard deduction, derive all their income from wages subject to withholding, are steadily employed during the year, and experience no increase in exemptions during the year.

At the same time, persons with incomes above these limits are likely to experience underwithholding, since they are subject to income tax rates well in excess of 14 percent. Thus, of the 63.1 million tax returns expected to be filed in 1966 upon which wages and salaries will be listed and with respect to which no declaration payments will be made, only 10.8 million returns would tax withholding which comes within $10 of the actual liability under the present withholding system. Of the remaining 52.3 million returns, 39.8 millon would show overwithholding and 12.5 million, underwithholding.

The withholding system proposed in the bill will insure that for most wage earners amounts withheld will more closely approximate the final tax liability. The proposed system reflects fully the graduated rates in the income tax rate scale for taxable incomes up to $12,000 for single persons and $24,000 for married couples. Even for returns with higher taxable incomes which show wage income, graduated withholding will be far more accurate than the existing system. Moreover, these returns number only an estimated 600,000.

The proposed system also reflects the minimum standard deduction. This fact, taken in conjunction with the graduated rates and the withholding allowances, will reduce the amount of overwithholding from those with low and middle incomes, as is shown in table 4. It is estimated, for example, that on returns listing income of $5,000 or less, the total amount of overwithholding will decline by $605 million. This will be sufficient to reduce the number of returns in this group on which overwithholding exceeds $10 from 20 to 12.9 million and to increase the number of returns on which withheld tax comes to within $10 of the final liability from 8.4 to 15.4 million. On returns with incomes of $5,000 but less than $10,000, overwithholding will be reduced by $455 million, largely as a result of the provision for withholding allowances described below.

The bill includes a special relief provision which persons with substantial itemized deductions may elect and which further improves the accuracy of the withholding system. This feature, which was not included in the President's recommendations, permits taxpayers to claim withholding allowances with their employer, which will have the same effect as withholding exemptions, when their estimated itemized deductions exceed a specified amount of their estimated wage and salary income.

The special relief provision is included in recognition of the fact that taxpayers with substantial itemized deductions are likely to be overwithheld under both the existing withholding rate and the proposed rates. Overwithholding occurs because most of those who itemize have deductions which, in total, exceed the allowance for deductions which is built into both the existing withholding system and the system provided in this bill. In both cases, the allowance for deductions built into the withholding rates, apart from the allowance for the minimum standard deduction, is equal to 10 percent of wage and salary income. In 1962, for example, itemized deductions were equal on the average to 19.6 percent of the adjusted gross incomes listed on the 26.5 million returns upon which the standard deduction was not employed. Under the 14 percent withholding system, the resulting overwithholding arising from the use of these itemized deductions is estimated to account for 44 percent of the overwithholding at 1966 income levels.

Under the graduated withholding rates, the importance of itemized deductions as a cause of overwithholding would increase substantially in the absence of the special relief provision. It is estimated that under the graduated withholding under the bill but without any withholding allowances overwithholding due to itemized deductions would increase to $3.7 billion at 1966 income levels and would comprise 59 percent of the expected amount of overwithholding. Moreover, if voluntary adjustments are disregarded as a source of overwithholding, the percentage of involuntary overwithholding attributable to itemized deductions in this case would approximate 70 percent.

The special provision is not intended for the use of all taxpayers with wage income who itemize their deductions, but is designed for the relief of those persons for whom overwithholding might otherwise become a burden. Therefore, when estimated wages are $7,500 or less, the withholding allowances provided by your committee's amendments are based on the amount of itemized deductions estimated to exceed 10 percent of wage and salary income and, when estimated wage income exceeds $7,500, they are based on the sum of $750 (10 percent of $7,500) and 17 percent of wage and salary income in excess of $7,500. For wage income above $7,500 withholding allowances are not based on the excess of estimated itemized deductions over 10 percent of estimated wage and salary income in recognition of the fact that many taxpayers receive some income that is not subject to withholding and that the average amount of such income is greater at high-income levels than at low-income levels. The method of computing withholding allowances minimizes the possibility that a taxpayer who receives dividends, interest or other nonwage sources of income will inadvertently overcompensate for his itemized deductions and have a bill due at the end of the year which he would not otherwise have incurred. It also reduces the effect of overestimates of deductions, or underestimates of income, leading to underwithholding.

Table 4 indicates the effect of the graduated withholding provision of the bill and contrasts that effect with the present system and the 6-rate system recommended by the President.

Explanation of graduated withholding rates.—The bill substitutes six graduated rates for the present withholding rate and incorporates features designed to reflect the minimum standard deduction. Moreover, it permits employees who would otherwise be overwithheld to make adjustments if their itemized deductions exceed specified amounts.

The graduated rates, which range from 14 percent to 30 percent, are included in two separate rate schedules, one for single persons and heads of households, and the other, with wider brackets to take account of statutory income splitting, for married persons and surviving spouses.

TABLE 4.—*Effect of graduated withholding provisions of H.R. 12752* [1] *as reported by the Senate Committee on Finance*

	Present 14 percent withholding	Change resulting from—			Graduated withholding
		6-rate system	Extra $700 allowance [2]	Combined total	
All returns:					
A. Number of returns (millions):					
1. Overwithholding	39.8	−6.3	−0.8	−7.1	32.7
2. Underwithholding	12.5	−3.5	+0.7	−2.8	9.7
3. Breakeven [3]	10.8	+9.8	+0.1	+9.9	20.7
4. Total	63.1				63.1
B. Amount (millions of dollars):					
1. Overwithholding	6,130	+50	−850	−800	5,330
2. Underwithholding	2,700	−1,190	+85	−1,105	1,595
3. Total withholding	36,440	+1,240	−935	+305	36,745
Under $5,000 adjusted gross income:					
A. Number of returns (millions):					
1. Overwithholding	20.0	−7.0	−0.1	−7.1	12.9
2. Underwithholding	3.0	(4)	+0.1	+0.1	3.1
3. Breakeven [3]	8.4	+7.0	(4)	+7.0	15.4
4. Total	31.4				31.4
B. Amount (millions of dollars):					
1. Overwithholding	2,130	−500	−105	−605	1,525
2. Underwithholding	340	(4)	+5	+5	345
3. Total withholding	5,720	−500	−110	−610	5,110
$5,000 to $10,000 adjusted gross income:					
A. Number of returns (millions):					
1. Overwithholding	15.0	−1.4	−0.5	−1.9	13.1
2. Underwithholding	5.7	−1.2	+0.4	−0.8	4.9
3. Breakeven [3]	2.0	+2.6	+0.1	+2.7	4.7
4. Total	22.7				22.7
B. Amount (millions of dollars):					
1. Overwithholding	3,000	−20	−435	−455	2,545
2. Underwithholding	760	−250	+30	−220	540
3. Total withholding	17,140	+230	−465	−235	16,905

See footnotes at end of table.

TABLE 4.—*Effect of graduated withholding provisions of H.R. 12752* [1] *as reported by the Senate Committee on Finance*—Continued

	Present 14 percent withholding	Change resulting from—			Graduated withholding
		6-rate system	Extra $700 allowance[2]	Combined total	
$10,000 and over adjusted gross income:					
A. Number of returns (millions):					
1. Overwithholding	4.8	+2.1	−0.2	+1.9	6.7
2. Underwithholding	3.8	−2.3	+0.2	−2.1	1.7
3. Breakeven [3]	0.4	+0.2	([4])	+0.2	0.6
4. Total	9.0				9.0
B. Amount (millions of dollars):					
1. Overwithholding	1,000	+570	−310	+260	1,260
2. Underwithholding	1,600	−940	+50	−890	710
3. Total withholding	13,580	+1,510	−360	+1,150	14,730

[1] Based on taxable and nontaxable returns with no declaration payments.
[2] Assumes ⅔ utilization by eligible persons.
[3] Breakeven defined as within $10 of the tax liability.
[4] Negligible.

NOTE.—Based on calendar year 1966 levels of income. The terms "overwithholding," and "underwithholding," in this table means the difference between actual tax liabilities (based on all types of income, deductions, etc.) and the amount of tax withheld from wages and salaries.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

The minimum standard deduction is taken into account by raising the value of the exemption to $700 for withholding purposes and by establishing an initial band of wage income after exemptions, equal to $200 on an annual basis, from which no tax will be withheld. This is consistent with the provisions regarding the minimum standard deduction, which provide a deduction equal to a basic $200 amount for a single person, a head-of-household, or a married couple, and an additional $100 amount for each exemption claimed. The rate schedule reflects an allowance for deductions of approximately 10 percent of wage and salary income at wage levels where the minimum standard deduction is not used.

The withholding rate schedules for single persons and married persons as applied to an annual basis are as follows:

SINGLE PERSON

If the amount of wages reduced by $700 times the number of exemptions is:	*The amount of income tax to be withheld is:*
Not over $200	$0.
Over $200 but not over $700	14% of wages in excess of $200.
Over $700 but not over $1,200	$70 plus 15% of wages in excess of $700.
Over $1,200 but not over $4,400	$145 plus 17% of wages in excess of $1,200.
Over $4,400 but not over $8,800	$689 plus 20% of wages in excess of $4,400.
Over $8,800 but not over $11,000	$1,569 plus 25% of wages in excess of $8,800.
Over $11,000	$2,119 plus 30% of wages in excess of $11,000.

MARRIED PERSON

If the amount of wages reduced by $700 times the number of exemptions is:	*The amount of income tax to be withheld is:*
Not over $200	$0.
Over $200 but not over $1,200	14% of wages in excess of $200.
Over $1,200 but not over $4,400	$140 plus 15% of wages in excess of $1,200.
Over $4,400 but not over $8,800	$620 plus 17% of wages in excess of $4,400.
Over $8,800 but not over $17,700	$1,368 plus 20% of wages in excess of $8,800.
Over $17,700 but not over $22,000	$3,148 plus 25% of wages in excess of $17,700.
Over $22,000	$4,223 plus 30% of wages in excess of $22,000.

As under present law, employers will be permitted to compute withholding by means of either wage-bracket tables or by means of a percentage method. Wage-bracket tables for the various payroll periods now recognized, as set forth in the bill, will be distributed by the Internal Revenue Service. Instructions for applying the percentage method will also be supplied.

With regard to any irregular supplemental wage payment, such as a bonus, employers will be permitted either to compute withholding by treating the payment as if it were part of the current or preceding regular wage payment or by applying a flat percentage rate to the supplemental wage payment without making any allowance for exemptions. It is expected that the regulations will provide for a flat rate of around 20 percent.

For the purpose of graduated withholding, married persons will be required to file new withholding exemption certificates with their employers if they wish to have the tax withheld from them based on the rates applicable to married couples. A person who is married to a nonresident alien, or a person legally separated from his spouse under a decree of divorce or separate maintenance, will be considered single for withholding purposes. A "surviving spouse"—i.e., a person whose spouse died during one of the two immediately preceding taxable years—and also a person whose spouse died during the taxable year, will be considered married for withholding purposes unless the deceased spouse was either a nonresident alien or was legally separated from the taxpayer under a decree of divorce or separate maintenance at the time of his death.

Employers are required to compute withholding on the basis of the rates applicable to single persons if an employee fails to submit a new withholding exemption certificate.

Withholding allowances for persons with substantial itemized deductions.—The House bill establishes a procedure whereby taxpayers with relatively large itemized deductions may claim withholding allowances in addition to the regular withholding exemptions. Each of these allowances will have the same effect on withholding from wages and salaries as a claimed exemption; that is, it will exempt $700 from withholding on an annual basis.

Taxpayers who wish to utilize this procedure will be required to estimate their wage and salary income and the amount of their itemized deductions. The amount of estimated wage and salary income for this purpose, however, may not be less than the amount shown on the return for the previous year, while the estimated amount of itemized deductions may not exceed the amount of such deductions claimed on the tax return filed for the previous year. Where a standard deduction was used in the prior year the deduction for that year is taken as 10 percent of his wages for that year, or $1,000, whichever is the lower.

Under the House bill for those with estimated wage or salary incomes of $7,500 or less, the number of withholding allowances would be based on the amount by which estimated itemized deductions exceed 12 percent of estimated wage and salary income. For those with higher estimated wages, the allowances would be based on the excess over the total of $900 (12 percent of $7,500) plus 17 percent of estimated wage and salary income in excess of $7,500. One allowance could be claimed under the House-passed bill with respect to each full $700 of such excess, except that the first withholding allowance could be claimed when the excess reached $350 or more. This would mean, for example, that a taxpayer with an estimated wage income of $7,000 for the year would under the House-passed bill be permitted to claim one withholding allowance if his itemized deductions exceed 12 percent of his estimated wages ($840) plus $350 or, in other words, if his itemized deductions equal $1,190.

Your committee has modified this House-passed provision slightly. It has reduced the percentage by which an individual's itemized deductions must exceed his estimated wage income from 12 percent of the first $7,500 to 10 percent of the first $7,500 (but made no change in the 17 percent requirement with respect to estimated wage and salary income in excess of $7,500). It has also removed the provision in the House bill which permitted an individual to obtain his first withholding allowance where the itemized deductions in excess of the percentage requirements equal or exceed $350, but not $700. Thus, your committee's action provides that in order to obtain any withholding allowance—either the first or a subsequent allowance—the taxpayer must have itemized deductions of a full $700 in excess of the percentage minimum requirement for each such allowance claimed.

Your committee removed this provision because its attention was directed to the fact that the allowance in numerous cases led to underwithholding of income tax. This is illustrated in a number of examples shown in table 6. This table, shown subsequently in this report, indicates in specific cases the tax liability and withholding under present law and House bill and your committee's action for persons with itemized deductions of various sizes. Your committee believed that underwithholding in such cases was especially unfortunate because the individuals involved in such cases would not expect to be underwithheld. Your committee recognized nevertheless that the House action was taken in order to minimize overwithholding particularly for those with wage incomes below $10,000 and was in accord with the desire to reduce overwithholding in this area. For that reason, although your committee removed the privilege of an individual to claim a withholding allowance for his itemized deductions where those over the percentage requirement do not equal a full $700, it nevertheless provided relief from overwithholding for individuals in these income brackets by reducing the minimum percentage requirement from 12 to 10 percent with respect to the first $7,500 of wage or salary income. This reduction minimizes overwithholding for these income levels to the full extent possible without resulting in underwithholding in an appreciable number of cases. It will also have the effect of reducing some overwithholding in other income levels as well.

The House bill provided that the Secretary of the Treasury or his delegate could, by regulations, provide in certain cases that some or all of the withholding allowances were not to be available. The authority to disallow the withholding allowances was designed to provide for those cases where the employee's income was sufficiently high that the 30 percent top withholding rate would not result in withholding of the full tax liability. In such cases, the withholding allowances might merely increase the underwithholding. Your committee has accepted the House provision but made a technical change designed to make it clear that the wage levels where the withholding rate does not generally collect the full tax liabilities could be determined on an approximate basis. This recognizes the fact that due to the different deduction and exemption status of individuals and also due to variations in the extent of underwithholding which will result from the 30-percent rate for varying sizes of incomes, it is not possible to compensate precisely for this underwithholding by disallowance of withholding allowances. Therefore, at these income levels an approximation must be used. This is made clear in your committee's amendment.

Claims for withholding allowances under both the House bill and your committee's amendments will be filed by employees with their employers on withholding exemption certificates or similar forms. The employer will then withhold tax on the basis of the total of the claimed exemptions and withholding allowances. For a calendar year taxpayer, claims for withholding allowances will remain in effect during the period in the calendar year which remains after the claim is filed and, unless a claim for the next year is filed, for the first 4 months of that year. Withholding allowances must be claimed anew each year. After May 1 of each year, employers will be required to disregard withholding allowances claimed on withholding exemption certificates filed in a prior calendar year. The fact that withholding allowances must be disregarded when a new claim is not filed will not affect the number of exemptions for dependents, etc., to be taken into account. The employer will continue to compute withholding on the basis of the number of these exemptions shown on the last withholding exemption certificate filed by the employee.

The Secretary of the Treasury or his delegate is authorized to design ready reference tables, to be supplied employers for the guidance of their employees, which will simplify the determination of the number of withholding allowances to which an employee is entitled and it is the committee's understanding that this will be done. When these tables are provided, they are to be the exclusive method for determining the number of withholding allowances. These tables are to be based on reasonable wage and itemized deduction brackets and may increase or decrease the number of withholding allowances computed under the 10 and 17 percent otherwise allowable to the extent such departure results in withholding which more closely equals the tax liability with respect to the wage or salary income (not taking into account other income).

To facilitate the above procedure, the bill increases the number of dates on which employers will be required to recognize changes in the number of exemptions and withholding allowances claimed by employees. In addition to the existing January 1 and July 1 status determination dates upon which such changes must now be recognized, the bill adds the further dates of May 1 and October 1. As under existing law, employers will be permitted to give effect to amended withholding exemption certificates prior to the given dates if they wish to do so.

The bill also provides that for married couples the computation as to whether they are entitled to withholding allowances must be made on a joint basis unless they file separate returns for the prior year and expect to file separate returns for the current year. Married couples may divide the exemptions and withholding allowances to which they are jointly entitled if both receive wages subject to withholding. Furthermore, the bill requires that employees who work simultaneously for two or more employers may claim withholding allowances with only one of these employers.

The bill also provides a civil penalty of $50 to be imposed when a taxpayer lists wage and salary income of less than the amount received in the previous year or if he lists itemized deductions in excess of the amount claimed in the previous year. The civil penalty does not apply, however, if the misstatement does not result in reduced withholding or the tax liability does not exceed the amount withheld plus the payments of estimated tax.

Present law (sec. 7205) already provides that where an individual who is required to supply information to his employer under the withholding tax provision willfully supplies false or fraudulent information or willfully fails to supply information he is to be fined not more than $500 or imprisoned for not more than 1 year, or both. This presently applies to withholding tax exemptions and, under the bill, is extended to withholding allowances since for purposes of the internal revenue laws these allowances are treated as withholding exemptions. It should be noted, however, that this criminal penalty applies only in the case of "willful violations," and in practice it is applied only where the omission or failure results in a substantial amount of underwithholding.

Effective date.—Withholding under the new graduated rates is to apply with respect to remuneration paid after April 30, 1966. The special relief procedures for persons with substantial itemized deductions will apply in years beginning after December 31, 1966. It was thought that this latter provision should not apply before 1967 because time was needed to acquaint taxpayers with the basic 6-rate graduated withholding system. Moreover, since the graduated system is not in effect for the first 4 months of 1966, any overwithholding attributable to these rates is not expected to be serious in 1966.

Revenue effect.—It is estimated that the proposals relating to graduated withholding will increase the amount of tax withheld by $1,240 million at annual rates during the calendar year 1966. When the procedures for claiming withholding allowances become effective, this amount will be reduced, if two-thirds of those eligible avail themselves of the procedure, to $305 million. As a result of the increase in amounts withheld, there will be a temporary increase in Federal tax collections of $95 million in budget receipts in the fiscal year 1966 and an increase of $245 million in budget receipts for the fiscal year 1967. A decrease in present revenues of $230 million is expected in the fiscal year 1968, the year in which the withholding allowance system becomes fully effective.

Effect of graduated withholding at different income levels.—Table 5 compares the average amount of overwithholding and underwithholding under present law and under the graduated withholding system for all returns, for those with adjusted gross income under $5,000, for those with income between $5,000 and

TABLE 5.—*Comparison of average amounts of underwithholding and overwithholding under present law and as approved by the Senate Finance Committee*

	Present 14 percent withholding			Graduated withholding including withholding allowances		
	Returns [1]	Amount	Average	Returns [1]	Amount	Average
	Millions	*Millions*		*Millions*	*Millions*	
All returns:						
Overwithholding	45. 2	$6, 130	$136	43. 0	$5, 330	$124
Underwithholding	17. 9	2, 700	151	20. 1	1, 595	79
Under $5,000 adjusted gross income:						
Overwithholding	24. 2	2, 130	88	20. 6	1, 525	74
Underwithholding	7. 2	340	47	10. 8	345	32
$5,000 to $10,000 adjusted gross income:						
Overwithholding	16. 0	3, 000	188	15. 4	2, 545	165
Underwithholding	6. 7	760	113	7. 3	540	74
$10,000 and over adjusted gross income:						
Overwithholding	5. 0	1, 000	200	7. 0	1, 260	180
Underwithholding	4. 0	1, 600	400	2. 0	710	355

[1] Returns from the $10 tolerance breakeven class have been assigned equally to overwithholding and underwithholding.

$10,000, and for those with such income over $10,000. As is indicated in this table, H.R. 12752 makes a substantial reduction in underwithholding, decreasing this in the average case from $151 to $79. In addition, the bill, although primarily concerned with underwithholding, also substantially decreases overwithholding as well. This is attributable both to the provision for the minimum standard deduction in the lower brackets and also to the provision for a withholding allowance for those with substantial overwithholding. It should be noted that in the average case overwithholding is decreased in all three of the major income categories as well as on an overall basis.

Tables 6–A through 6–G show the tax liability for single persons, married couples with no dependents, and married couples with two dependents for various wage income levels. This tax liability is shown for varying assumed levels of standard (or minimum standard) or itemized deductions. The assumptions shown are for a 10-percent deduction, a 15-percent deduction, a 20-percent deduction, a 22½-percent deduction, a 25-percent deduction, a 27½-percent deduction, and a 30-percent deduction. With the tax liability in each of these cases, there is shown the amount withheld at the 14-percent flat rate of existing law, the graduated withholding passed by the House of Representatives and the amendment provided by your committee's bill. The special withholding allowance for those with substantial itemized deductions begins to decrease overwithholding above the 15-percent level.[2] Thus the impact of this allowance is shown only on tables 6–C through 6–G. For these tables the effect of the withholding allowance is taken into account in the amount of withholding under the graduated withholding system. These tables show both the change in withholding from present law and the overwithholding or underwithholding under present law, under the graduated withholding system passed by the House of Representatives and as amended by your committee.

[2] Although itemized deductions are taken into account on the first $7,500 of income where they exceed 10 percent, this nevertheless does not result in the availability of a special withholding allowance below the 15-percent level because this allowance is available only when there is a full $700 above the 10 percent.

TABLE 6-A.—*Underwithholding and overwithholding under present law, under H.R. 12752 as passed by the House of Representatives, and under the Finance Committee amendment; selected taxpayers with deductions the greater of the minimum standard deduction or 10 percent of wage income*

Wage income	Tax liability	Amount of withholding		Overwithholding (+) or underwithholding (−)	
		Present 14 percent	House bill and committee amendment	Present 14 percent	House bill and committee amendment
SINGLE INDIVIDUAL					
$1,000	$16	$47	$14	+$31	−$2
$2,000	163	187	162	+24	−1
$3,000	329	327	332	−2	+3
$5,000	671	607	672	−64	+1
$7,500	1,168	957	1,169	−211	+1
$10,000	1,742	1,307	1,694	−435	−48
$12,500	2,398	1,657	2,359	−741	−39
$15,000	3,154	2,007	3,109	−1,147	−45
$20,000	4,918	2,707	4,609	−2,211	−309
$25,000	6,982	3,407	6,109	−3,575	−873
$35,000	11,627	4,807	9,109	−6,820	−2,518
MARRIED COUPLE, NO DEPENDENTS					
$2,000	$58	$93	$56	+$35	−$2
$3,000	204	233	200	+29	−4
$5,000	501	513	500	+12	−1
$7,500	914	863	909	−51	−5
$10,000	1,342	1,213	1,334	−129	−8
$12,500	1,831	1,563	1,828	−268	−3
$15,000	2,335	1,913	2,328	−422	−7
$20,000	3,484	2,613	3,373	−871	−111
$25,000	4,796	3,313	4,703	−1,483	−93
$35,000	7,997	4,713	7,703	−3,284	−294
MARRIED COUPLE, 2 DEPENDENTS					
$3,000	$4	$46	0	+$42	−$4
$5,000	290	326	$290	+36	0
$7,500	686	676	671	−10	+5
$10,000	1,114	1,026	1,096	−88	−18
$12,500	1,567	1,376	1,548	−191	−19
$15,000	2,062	1,726	2,048	−336	−14
$20,000	3,160	2,426	3,048	−734	−112
$25,000	4,412	3,126	4,283	−1,286	−129
$35,000	7,529	4,526	7,283	−3,003	−246

TABLE 6–B.—*Underwithholding and overwithholding under present law, under H.R. 12752 as passed by the House of Representatives, and under the Finance Committee amendment; selected taxpayers with deductions the greater of the minimum standard deduction or 15 percent of wage income*

Wage income	Tax liability	Amount of withholding		Overwithholding (+) or underwithholding (−)	
		Present 14 percent	House bill and committee amendment	Present 14 percent	House bill and committee amendment
SINGLE INDIVIDUAL					
$1,000	$16	$47	$14	+$31	−$2
$2,000	161	187	162	+26	+1
$3,000	302	327	332	+25	+30
$5,000	624	607	672	−17	+48
$7,500	1,080	957	1,169	−123	+89
$10,000	1,605	1,307	1,694	−298	+89
$12,500	2,198	1,657	2,359	−541	+161
$15,000	2,884	2,007	3,109	−877	+225
$20,000	4,498	2,707	4,609	−1,791	+111
$25,000	6,382	3,407	6,109	−2,975	−273
$35,000	10,700	4,807	9,109	−5,893	−1,591
MARRIED COUPLE, NO DEPENDENTS					
$2,000	$58	$93	$56	+$35	−$2
$3,000	192	233	200	−41	+8
$5,000	458	513	500	+55	+42
$7,500	843	863	909	+20	+66
$10,000	1,247	1,213	1,334	−34	+87
$12,500	1,694	1,563	1,828	−131	+134
$15,000	2,161	1,913	2,328	−248	+167
$20,000	3,210	2,613	3,373	−597	+163
$25,000	4,396	3,313	4,703	−1,083	+307
$35,000	7,314	4,713	7,703	−2,061	+389
MARRIED COUPLE, 2 DEPENDENTS					
$3,000	$4	$46	0	+$42	−$4
$5,000	268	326	$290	+58	+22
$7,500	616	676	671	+60	+55
$10,000	1,019	1,026	1,096	+7	+77
$12,500	1,430	1,376	1,548	−54	+118
$15,000	1,897	1,726	2,048	−171	+151
$20,000	2,910	2,426	3,048	−484	+138
$25,000	4,058	3,126	4,283	−932	+225
$35,000	6,866	4,526	7,283	−2,340	+417

TABLE 6-C.—*Underwithholding and overwithholding under present law, under H.R. 12752 as passed by the House of Representatives, and under the Finance Committee amendment; selected taxpayers with deductions the greater of the minimum standard deduction or 20 percent of wage income*

Wage income	Tax liability	Amount of withholding			Overwithholding (+) or underwithholding (−)		
		Present 14 percent	Under H.R. 12752		Present 14 percent	Under H.R. 12752	
			House bill [1]	Committee amendment [2]		House bill [1]	Committee amendment [2]
SINGLE INDIVIDUAL							
$1,000	$16	$47	$14	$14	+$31	−$2	−$2
$2,000	145	187	162	162	+42	+17	+17
$3,000	276	327	332	332	+51	+56	+56
$5,000	576	607	553	672	+31	−23	+96
$7,500	998	957	1,029	1,029	−41	+31	+31
$10,000	1,480	1,307	1,529	1,529	−173	+49	+49
$12,500	2,022	1,657	2,149	2,149	−365	+127	+127
$15,000	2,638	2,007	2,899	2,899	−631	+261	+261
$20,000	4,096	2,707	4,399	4,399	−1,389	+303	+303
$25,000	5,800	3,407	5,899	5,899	−2,393	+99	+99
$35,000	9,772	4,807	9,109	9,109	−4,965	[3] −663	[3] −663
MARRIED COUPLE, NO DEPENDENTS							
$2,000	$56	$93	$56	$56	+$37	0	0
$3,000	170	233	200	200	+63	+$30	+$30
$5,000	418	513	395	500	+95	−23	+82
$7,500	772	863	790	790	+91	+18	+18
$10,000	1,152	1,213	1,215	1,215	+61	+63	+63
$12,500	1,556	1,563	1,688	1,688	+7	+132	+132
$15,000	1,996	1,913	2,188	2,188	−83	+192	+192
$20,000	2,960	2,613	3,198	3,198	−347	+238	+238
$25,000	4,044	3,313	4,493	4,493	−731	+449	+449
$35,000	6,668	4,713	7,283	7,283	−1,955	+615	+615
MARRIED COUPLE, 2 DEPENDENTS							
$3,000	0	$46	0	0	+$46	0	0
$5,000	$230	326	$185	$290	+96	−$45	+$60
$7,500	552	676	560	560	+124	+8	+8
$10,000	924	1,026	977	977	+102	+53	+53
$12,500	1,304	1,376	1,408	1,408	+72	+104	+104
$15,000	1,732	1,726	1,908	1,908	−6	+176	+176
$20,000	2,660	2,426	2,908	2,908	−234	+248	+248
$25,000	3,708	3,126	4,098	4,098	−582	+390	+390
$35,000	6,236	4,526	6,863	6,863	−1,710	+627	+627

[1] With an extra $700 exemption for withholding purposes for each $700 by which 12 percent of the first $7,500 of estimated wages plus 17 percent of the remainder of estimated wages is exceeded by estimated itemized deductions, except that a single additional allowance is allowed where the itemized deductions above the floor equal or exceed $350 rather than $700.

[2] With an extra $700 exemption for withholding purposes for each $700 by which 10 percent of the first $7,500 of estimated wages plus 17 percent of the remainder of estimated wages is exceeded by estimated itemized deductions.

[3] Allowance does not increase underwithholding because of limitation provided by the bill.

TABLE 6–D.—*Underwithholding and overwithholding under present law, under H.R. 12752 as passed by the House of Representatives, and under the Finance Committee amendment; selected taxpayers with deductions the greater of the minimum standard deduction or 22½ percent of wage income*

Wage income	Tax liability	Amount of withholding			Overwithholding (+) or underwithholding (−)		
		Present 14 percent	Under H.R. 12752		Present 14 percent	Under H.R. 12752	
			House bill [1]	Committee amendment [2]		House bill [1]	Committee amendment [2]
SINGLE INDIVIDUAL							
$1,000	$16	$47	$14	$14	+$31	−$2	−$2
$2,000	138	187	162	162	+49	+24	+24
$3,000	263	327	332	332	+64	+69	+69
$5,000	552	607	553	672	+55	+1	+120
$7,500	957	957	1,029	1,029	0	+72	+72
$10,000	1,418	1,307	1,529	1,529	−111	+111	+111
$12,500	1,935	1,657	2,149	2,149	−278	+214	+214
$15,000	2,518	2,007	2,899	2,899	−511	+381	+381
$20,000	3,901	2,707	4,189	4,189	−1,194	+288	+288
$25,000	5,519	3,407	5,689	5,689	−2,112	+170	+170
$35,000	9,308	4,807	9,109	9,109	−4,501	[3] −199	[3] −199
MARRIED COUPLE, NO DEPENDENTS							
$2,000	$49	$93	$56	$56	+$44	+$7	+$7
$3,000	159	233	200	200	+74	+41	+41
$5,000	398	513	395	500	+115	−3	+102
$7,500	736	863	790	790	+127	+54	+54
$10,000	1,104	1,213	1,215	1,215	+109	+111	+111
$12,500	1,487	1,563	1,688	1,688	+76	+201	+201
$15,000	1,914	1,913	2,188	2,188	−1	+274	+274
$20,000	2,835	2,613	3,048	3,048	−222	+213	+213
$25,000	3,869	3,313	4,283	4,283	−556	+414	+414
$35,000	6,353	4,713	7,073	7,073	−1,640	+720	+720
MARRIED COUPLE, 2 DEPENDENTS							
$3,000	0	$46	0	0	+$46	0	0
$5,000	$211	326	$185	$290	+115	−$26	+$79
$7,500	520	676	560	560	+156	+40	+40
$10,000	876	1,026	977	977	+150	+101	+101
$12,500	1,245	1,376	1,408	1,408	+131	+163	+163
$15,000	1,650	1,726	1,908	1,908	+76	+258	+258
$20,000	2,535	2,426	2,768	2,768	−109	+233	+233
$25,000	3,533	3,126	3,923	3,923	−407	+390	+390
$35,000	5,921	4,526	6,653	6,653	−1,395	+732	+732

[1] With an extra $700 exemption for withholding purposes for each $700 by which 12 percent of the first $7,500 of estimated wages plus 17 percent of the remainder of estimated wages is exceeded by estimated itemized deductions, except that a single additional allowance is allowed where the itemized deductions above the floor equal or exceed $350 rather than $700.

[2] With an extra $700 exemption for withholding purposes for each $700 by which 10 percent of the first $7,500 of estimated wages plus 17 percent of the remainder of estimated wages is exceeded by estimated itemized deductions.

[3] Allowance does not increase underwithholding because of limitation provided by the bill.

TABLE 6-E.—*Underwithholding and overwithholding under present law, under H.R. 12752 as passed by the House of Representatives, and under the Finance Committee amendment; selected taxpayers with deductions the greater of the minimum standard deduction or 25 percent of wage income*

Wage income	Tax liability	Amount of withholding			Overwithholding (+) or underwithholding (−)		
		Present 14 percent	Under H.R. 12752		Present 14 percent	Under H.R. 12752	
			House bill [1]	Committee amendment [2]		House bill [1]	Committee amendment [2]
SINGLE INDIVIDUAL							
$1,000	$16	$47	$14	$14	+$31	−$2	−$2
$2,000	130	187	162	162	+57	+32	+32
$3,000	250	327	213	332	+77	−37	+82
$5,000	528	607	553	553	+79	+25	+25
$7,500	916	957	1,029	1,029	+41	+113	+113
$10,000	1,355	1,307	1,529	1,529	−48	+174	+174
$12,500	1,847	1,657	2,149	1,969	−190	+302	+122
$15,000	2,398	2,007	2,689	2,689	−391	+291	+291
$20,000	3,706	2,707	4,189	3,979	−999	+483	+273
$25,000	5,238	3,407	5,479	5,479	−1,831	+241	+241
$35,000	8,855	4,807	8,899	8,899	−4,048	[3] +44	[3] +44
MARRIED COUPLE, NO DEPENDENTS							
$2,000	$42	$93	$56	$56	+$51	+$14	+$14
$3,000	148	233	98	200	+85	−50	+52
$5,000	378	513	395	395	+135	+17	+17
$7,500	701	863	790	790	+162	+89	+89
$10,000	1,057	1,213	1,215	1,215	+156	+158	+158
$12,500	1,418	1,563	1,688	1,548	+145	+270	+130
$15,000	1,831	1,913	2,048	2,048	+82	+217	+217
$20,000	2,710	2,613	3,048	2,908	−97	+338	+198
$25,000	3,694	3,313	4,098	4,098	−381	+404	+404
$35,000	6,038	4,713	6,863	6,863	−1,325	+825	+825
MARRIED COUPLE, 2 DEPENDENTS							
$3,000	0	$46	0	0	−$46	0	0
$5,000	$192	326	$185	$185	+134	−$7	−$7
$7,500	488	676	560	560	+188	+72	+72
$10,000	829	1,026	977	977	+197	+148	+148
$12,500	1,185	1,376	1,408	1,283	+191	+223	+98
$15,000	1,567	1,726	1,768	1,768	+159	+201	+201
$20,000	2,410	2,426	2,768	2,628	+16	+358	+218
$25,000	3,358	3,126	3,748	3,748	−232	+390	+390
$35,000	5,612	4,526	6,443	6,443	−1,086	+831	+831

[1] With an extra $700 exemption for withholding purposes for each $700 by which 12 percent of the first $7,500 of estimated wages plus 17 percent of the remainder of estimated wages is exceeded by estimated itemized deductions, except that a single additional allowance is allowed where the itemized deductions a ove the floor equal or exceed $350 rather than $700.

[2] With an extra $700 exemption for withholding purposes for each $700 by which 10 percent of the first $7,500 of estimated wages plus 17 percent of the remainder of estimated wages is exceeded by estimated itemized deductions.

[3] Allowance does not result in underwithholding because of limitation provided by the bill.

TABLE 6–F.—*Underwithholding and overwithholding under present law, under H.R. 12752 as passed by the House of Representatives, and under the Finance Committee amendment; selected taxpayers with deductions the greater of the minimum standard deduction or 27½ percent of wage income*

Wage income	Tax liability	Amount of withholding			Overwithholding (+) or underwithholding (−)		
		Present 14 percent	Under H.R. 12752		Present 14 percent	Under H.R. 12752	
			House bill [1]	Committee amendment [2]		House bill [1]	Committee amendment [2]
SINGLE INDIVIDUAL							
$1,000	$16	$47	$14	$14	+$31	−$2	−$2
$2,000	122	187	162	162	+65	+40	+40
$3,000	238	327	213	332	+89	−25	+94
$5,000	505	607	553	553	+102	+48	+48
$7,500	874	957	1,029	1,029	+83	+155	+155
$10,000	1,292	1,307	1,389	1,389	+15	+97	+97
$12,500	1,760	1,657	1,969	1,969	−103	+209	+209
$15,000	2,278	2,007	2,689	2,479	−271	+411	+201
$20,000	3,514	2,707	3,979	3,979	−807	+465	+465
$25,000	4,970	3,407	5,269	5,269	−1,563	+299	+299
$35,000	8,418	4,807	8,479	8,479	−3,611	[3]+61	[3]+61
MARRIED COUPLE, NO DEPENDENTS							
$2,000	$35	$93	$56	$56	+$58	+$21	+$21
$3,000	136	233	98	200	+97	−38	+64
$5,000	358	513	395	395	+155	+37	+37
$7,500	665	863	790	790	+198	+125	+125
$10,000	1,010	1,213	1,096	1,096	+203	+86	+86
$12,500	1,354	1,563	1,548	1,548	+209	+194	+194
$15,000	1,748	1,913	2,048	1,908	+165	+300	+160
$20,000	2,585	2,613	2,908	2,908	+28	+323	+323
$25,000	3,519	3,313	3,923	3,923	−206	+404	+404
$35,000	5,723	4,713	6,653	6,443	−1,010	+930	+720
MARRIED COUPLE, 2 DEPENDENTS							
$3,000	0	$46	0	0	+$46	0	0
$5,000	$174	326	$185	$185	+152	+$11	+$11
$7,500	456	676	560	560	+220	+104	+104
$10,000	782	1,026	858	858	+244	+76	+76
$12,500	1,126	1,376	1,283	1,283	+250	+157	+157
$15,000	1,484	1,726	1,768	1,628	+242	+284	+144
$20,000	2,285	2,426	2,628	2,628	+141	+343	+343
$25,000	3,191	3,126	3,573	3,573	−65	+382	+382
$35,000	5,332	4,526	6,233	6,023	−806	+901	+691

[1] With an extra $700 exemption for withholding purposes for each $700 by which 12 percent of the first $7,500 of estimated wages plus 17 percent of the remainder of estimated wages is exceeded by estimated itemized deductions, except that a single additional allowance is allowed where the itemized deductions above the floor equal or exceed $350 rather than $700.

[2] With an extra $700 exemption for withholding purposes for each $700 by which 10 percent of the first $7,500 of estimated wages plus 17 percent of the remainder of estimated wages is exceeded by estimated itemized deductions.

[3] Allowance does not result in underwithholding because of limitation provided by the bill.

TABLE 6–G.—*Underwithholding and overwithholding under present law, under H.R. 12752 as passed by the House of Representatives, and under the Finance Committee amendment; selected taxpayers with deductions the greater of the minimum standard deduction or 30 percent of wage income*

Wage income	Tax liability	Amount of withholding			Overwithholding (+) or underwithholding (−)		
		Present 14 percent	Under H.R. 12752		Present 14 percent	Under H.R. 12752	
			House bill [1]	Committee amendment [2]		House bill [1]	Committee amendment [2]
SINGLE INDIVIDUAL							
$1,000	$14	$47	$14	$14	+$33	0	0
$2,000	115	187	56	162	+72	−$59	+$47
$3,000	225	327	213	332	+102	−12	+107
$5,000	481	607	553	553	+126	+72	+72
$7,500	833	957	1,029	889	+124	+196	+56
$10,000	1,230	1,307	1,389	1,389	+77	+159	+159
$12,500	1,672	1,657	1,969	1,794	−15	+297	+122
$15,000	2,162	2,007	2,479	2,479	−155	+317	+317
$20,000	3,334	2,707	3,769	3,769	−627	+435	+435
$25,000	4,708	3,407	5,059	5,059	−1,301	+351	+351
$35,000	7,980	4,807	8,059	8,059	−3,173	[3] +79	[3] +79
MARRIED COUPLE, NO DEPENDENTS							
$2,000	$28	$93	0	$56	+$65	−$28	+$28
$3,000	126	233	$98	200	+107	−28	+74
$5,000	338	513	395	395	+175	+57	+57
$7,500	630	863	790	671	+233	+160	+41
$10,000	962	1,213	1,096	1,096	+251	+134	+134
$12,500	1,294	1,563	1,548	1,408	+269	+254	+114
$15,000	1,666	1,913	1,908	1,908	+247	+242	+242
$20,000	2,460	2,613	2,768	2,768	+153	+308	+308
$25,000	3,344	3,313	3,748	3,748	−31	+404	+404
$35,000	5,436	4,713	6,233	6,233	−723	+797	+797
MARRIED COUPLE, 2 DEPENDENTS							
$3,000	0	$46	0	0	+$46	0	0
$5,000	$155	326	$185	$185	+171	+$30	+$30
$7,500	426	676	560	455	+250	+134	+29
$10,000	734	1,026	858	858	+292	+124	+124
$12,500	1,066	1,376	1,283	1,164	+310	+217	+98
$15,000	1,402	1,726	1,628	1,628	+324	+226	+226
$20,000	2,172	2,426	2,488	2,488	+254	+316	+316
$25,000	3,035	3,126	3,398	3,398	+91	+363	+363
$35,000	5,052	4,526	5,813	5,813	−526	+761	+761

[1] With an extra $700 exemption for withholding purposes for each $700 by which 12 percent of the first $7,500 of estimated wages plus 17 percent of the remainder of estimated wages is exceeded by estimated itemized deductions, except that a single additional allowance is allowed where the itemized deductions above the floor equal or exceed $350 rather than $700.

[2] With an extra $700 exemption for withholding purposes for each $700 by which 10 percent of the first $7,500 of estimated wages plus 17 percent of the remainder of estimated wages is exceeded by estimated itemized deductions.

[3] Allowance does not result in underwithholding because of limitation provided by the bill.

2. Payments of estimated social security and hospital insurance taxes by self-employed persons (sec. 102 of the bill and sec. 6015 of the code)

Present law.—Under existing law, self-employed persons are required to pay their social security tax and their tax for the hospital insurance program when they file their final income tax return for a given year. However, they may voluntarily pay this tax quarterly with their estimated income tax payments.

The tax, now based on the initial $6,600 of net earnings from self-employment, is imposed on self-employed individuals who have net earnings from self-employment which total $400 or more. When an individual also has covered wage income, this is subtracted from the $6,600 maximum earnings base, and the self-employment tax is computed on the lesser of this amount or net earnings from self-employment. A taxpayer who has $400 of net self-employment income must file a final return and pay self-employment tax even if he is not required to file an income tax return.

General explanation.—The bill places self-employed persons on the same current payment basis with respect to the payment of their self-employment tax that they are now on for income tax purposes. It does so by requiring quarterly payments of estimated self-employment tax. It will place self-employed persons on more nearly the same payments basis for social security purposes as that of employed persons, whose social security tax is withheld from their wages by employers.

The adoption of current payment for self-employment tax is accomplished with a minimum of difficulty for the self-employed taxpayers who currently file declarations of estimated income tax, since the payment of estimated self-employment tax will be integrated with the payment of estimated income tax. For the estimated 1 million self-employed persons who do not now file declarations of estimated income tax but who will be required to file such declarations as a result of this bill, the advantages of current payment will outweigh the added compliance requirements.

The payments of the self-employment tax will, as a result of this bill, be received on a quarterly basis instead of generally on an annual basis as under present law. It is understood that the amounts received on a quarterly basis will be estimated and paid over from the general fund to the OASI, DI, and HI trust funds on a current basis.

Tables 7 and 8 show the maximum dollar amount of self-employment tax and tax liability since 1951.

TABLE 7.—*Maximum dollar amount of self-employment tax for individuals, 1951 to 1987*

Year	Maximum net earnings base [1]	Tax rate	Maximum tax per person
		Percent	
1951–53	$3,600	2.25	$81.00
1954	3,600	3.0	108.00
1955–56	4,200	3.0	126.00
1957–58	4,200	3.375	141.75
1959	4,800	3.75	180.00
1960–61	4,800	4.5	216.00
1962	4,800	4.7	225.60
1963–65	4,800	5.4	259.20
1966	6,600	[2] 6.15	405.90
1967–68	6,600	6.40	422.40
1969–72	6,600	7.10	468.60
1973–75	6,600	7.55	498.30
1976–79	6,600	7.60	501.60
1980–86	6,600	7.70	508.20
1987+	6,600	7.80	514.80

[1] The minimum net earnings subject to the self-employment rate has been $400 since 1951.
[2] Includes OASDI (social security) tax rates and HI (hospital insurance) tax rate of 1966 and all following years.

TABLE 8.—*Self-employment tax liability, 1951 to 1966*

Year	Self-employment tax		
	Number of income tax returns reporting self-employment tax	Amount of self-employment tax	Average tax per return [1]
	Millions	*Millions*	
1951	4.1	$211.3	$51.90
1952	4.1	217.5	53.60
1953	4.2	226.6	53.70
1954	4.2	301.5	71.60
1955	6.6	463.2	69.70
1956	7.4	533.1	72.50
1957	7.0	581.2	83.10
1958	7.0	589.2	84.00
1959	7.0	701.5	99.70
1960	6.9	833.5	121.00
1961	6.7	840.1	124.50
1962	6.7	887.2	132.90
1963	6.5	1,002.2	154.60
1964 (preliminary)	6.3	1,009.0	160.00
1965 (estimated) [2]	6.2	1,050.0	169.00
1966 (estimate) [2]	6.3	1,500.0	238.00

[1] Average computed from unrounded figures.
[2] Includes doctors of medicine newly covered by the Social Security Amendments Act of 1965.

Explanation of provision.—Under the bill, a self-employed person generally will be required to file a declaration of estimated tax whenever the combined total of his estimated income tax liability and his estimated social security and hospital insurance tax liability exceeds $40. Payments of estimated tax will be made as at present with the exception that the amount paid will include both the estimated income tax and the estimated self-employment tax. That is, for calendar-year taxpayers the declaration will have to be filed by April 15 and quarterly payments will be required on April 15, June 15, and September 15 of the current year and on January 15 of the succeeding year.

Persons whose gross income derived from farming and fishing activities will be at least two-thirds of their estimated gross income from all sources will not be required to make quarterly payments of estimated self-employment tax. This treatment conforms to the present provisions for the payment of estimated income tax for farmers and fishermen. Further in conformity with present law regarding estimated income tax, such persons will have until January 15 of the year following the taxable year to file a declaration of estimated tax, and need not file a declaration at all if they choose to file their final tax return by February 15.

A penalty for underpayment of estimated tax will be imposed when amounts paid by the quarterly payment dates are less than the amounts that would be due on those dates if the estimated tax for the year equaled 80 percent of the combined liability for income and self-employment taxes. The penalty is computed with respect to each installment separately. However, even if the above 80-percent rule is not met, no penalty is imposed with respect to an installment if the estimated tax paid to date equals the amount that would be required to be paid if the estimated tax were the least of the following:

(1) The sum of the income tax and the self-employment tax shown on the return for the prior year;

(2) The sum of the income tax and the self-employment tax that would be due on the prior year's income under current rates and current exemptions;

(3) An amount equal to 80 percent (66⅔ percent for farmers and fishermen) of the combined income and self-employment taxes due computed by

annualizing the taxable income received in the months in the year prior to the month a particular installment is due. Self-employment income for this purpose is only the amount received to date with the maximum of $6,600 reduced by employee social security wage income placed on an annualized basis; or

(4) An amount equal to 90 percent or more of the combined tax payable on the income actually received from the beginning of the year up to the month in which the installment is due.

Effective date.—This provision is effective for taxable years beginning after December 31, 1966.

Revenue effect.—This provision is expected to increase fiscal year 1967 trust fund revenues, which are not reflected in the administrative budget, by $200 million. It will have no effect on revenues in the fiscal year 1966.

3. Underpayment of installments of estimated income tax by individuals (sec. 103 of the bill and sec. 6654 of the code)

Present law.—Under existing law the penalty for underpayment of estimated tax is restricted to the difference between the amount of tax paid through withholding, quarterly installments of estimated tax, or both, and 70 percent of the final liability for the taxable year. This penalty is computed on a quarterly basis. Even if this rule is not met, however, no penalty is imposed if one of four exceptions apply. One of those exceptions provides that the penalty will not be imposed if a quarterly payment equals the amount which would be due if the estimated tax were 70 percent of the tax due on the annualized amount of taxable income received in the months prior to the month the quarterly estimated taxpayment is due.

The penalty imposed is a charge equal to 6 percent per year on the amount of underpayment. The penalty is not a deductible expense for tax purposes.

Explanation of provisions.—The bill increases the proportion of the final liability which is to be paid currently to avoid a penalty from 70 to 80 percent. This amendment restores the pre-1954 requirement. It is consistent with the other provisions of the bill since it more nearly requires current payment of tax. It insures that taxpayers who receive most of their income from sources not subject to withholding will be required to pay a larger share of their tax liability currently just as wage earners will be required to do through graduated withholding.

The bill also modifies the one alternative exception to the penalty which contains a 70 percent test. This is the annualized income test described above where the 70 percent requirement is raised to 80 percent to conform to the principal amendment.

Effective date.—This provision will apply with respect to taxable years which begin after December 31, 1966.

Revenue effect.—It is estimated that the larger estimated taxpayments required under this rule will result in a temporary increase in tax collections that will add $150 million to revenues in fiscal year 1967.

4. Acceleration of payment of estimated tax by corporations (sec. 104 of the bill and sec. 6154 of the code)

Present law.—Corporations with an estimated tax liability in excess of $100,000 presently are required to make partial payments during the current tax year of their estimated tax in excess of $100,000. Under the provisions of the Revenue Act of 1964, corporations are in the midst of a transition from a system of two partial payments of currently estimated tax to a system of four payments made by calendar year corporations on April 15, June 15, September 15, and December 15.

Under the present schedule, corporations using the calendar year file an initial declaration and pay 9 percent of their estimated 1966 tax liability in excess of $100,000 on April 15 of this year. On June 15 they pay an additional 9 percent of the estimated liability, and they pay installments of 25 percent each on September 15 and December 15. The remaining 32 percent of the estimated tax, as well as the initial $100,000 of tax liability, is paid in equal installments on March 15 and June 15, 1967.

In 1967, the April and June estimated tax payments are each scheduled to be 14 percent of the estimated tax liability above $100,000. The payment schedule under present law is summarized in table 9.

TABLE 9.—*Payment schedule for calendar year corporations under present law showing percentage of estimated tax to be paid* [1]

Calendar year	Current taxable year				Following year	
	Apr. 15	June 15	Sept. 15	Dec. 15	Mar. 15	June 15
1966	9	9	25	25	16	16
1967	14	14	25	25	11	11
1968	19	19	25	25	6	6
1969	22	22	25	25	3	3
1970	25	25	25	25	------	------
1971 and subsequent years	25	25	25	25	------	------

[1] Tax in excess of $100,000.

General explanation.—This bill accelerates the transition to full current payment of corporate tax liabilities in excess of $100,000. The transition is completed in 1967 under this bill, instead of 1970 as provided under existing law.

Corporate tax liabilities remain unchanged by the provisions of this bill.

The bill completes a process which began in 1950. Prior to 1950, corporations were permitted to pay their tax liability for the current year in four quarterly installments in the succeeding year. The Revenue Acts of 1950, 1954, and 1964 contained provisions which gradually required corporations to accelerate the payment of their liabilities to the year in which they accrued, just as individuals have done since 1943. The Revenue Act of 1964 required corporations to pay that portion of their tax liability which exceeds $100,000 in four equal installments, which for calendar-year corporations are April 15, June 15, September 15, and December 15 of the year in which the liability occurs. It also provided a 7-year period during which the transition to this collection procedure would be completed. Your committee's bill, in effect, merely reduces the length of the transition period to 4 years.

Under the bill, 12 percent, rather than 9 percent, of the tax in excess of $100,000 is to be payable by a calendar-year corporation in April and June 1966, and in 1967 and thereafter 25 percent is to be payable on each of these two dates. Table 10 shows the schedule of payment dates provided under the bill for a calendar-year corporation for 1966 and subsequent years.

TABLE 10.—*Payment schedule for calendar-year corporations under bill showing percentage of estimated tax to be paid* [1]

Calendar year	Current taxable year				Following year	
	Apr. 15	June 15	Sept. 15	Dec. 15	Mar. 15	June 15
1966	12	12	25	25	13	13
1967	25	25	25	25	------	------
1968 and subsequent years	25	25	25	25	------	------

[1] Tax in excess of $100,000.

The bill does not impose a hardship on corporations. The majority of corporations, those with small- and medium-sized incomes, are excluded from the provision because their tax liability is less than $100,000. It is estimated that only 16,000 corporations will be affected by this acceleration. There corporations are generally the largest and possess considerable financial resources.

Corporations affected by this provision will not be put on a fully current basis with respect to their total taxpayments, since only the estimated taxes in excess of $100,000 are affected. Furthermore, the various provisions in existing law that limit the imposition of penalties when estimated payments fall short of actual liabilities are not changed.

Accelerating the corporate taxpayments schedule to complete the transition to the current payments basis in 1967 will produce larger payments in 1966 and 1967 than would be made under present law. It also means that the taxpayments in 1968, 1969, and 1970 will be lower than those scheduled under present law. These effects of the bill on taxpayments are desirable in view of current fiscal policy considerations.

Increased corporate taxpayments in 1966 and 1967 will introduce fiscal restraint into the economy during the critical months when the buildup of defense expenditures for Vietnam is greatest. The tax receipts will reduce the budgetary deficit and will reduce the cash flow available to corporations.

The reduction in corporate taxpayments in the years 1968 through 1970 below the levels under present law will come when it is hoped the pressures of Federal Government requirements upon the economy's productive capacity will have eased off. The corporations affected by this provision then will be in a position to increase their investment expenditures and thereby offset the leveling of Federal Government defense expenditures.

At the present time, investment in industrial plant and equipment is proceeding at record levels. A slowdown in the expected increase in investment spending, therefore, will moderate the demand for productive resources that no longer are in excess supply. Some restraint on increased investment spending under these circumstances appears appropriate. A similar moderation in dividend payments would be reflected in expenditures on consumer goods and would have the same salutary economic effect.

Acceleration of tax payments is preferable to an increase in the corporation income tax rate. Without any further acceleration of tax payments, an increase of 4 or 5 percentage points in the corporation income tax rate probably would be needed to yield the same revenue increase in fiscal year 1967 as the acceleration schedule in this bill.

The acceleration of corporate tax payments will moderate the increase in private investment expenditures and restrain inflationary pressures while permitting employment to continue to expand. The large tax increases necessary to yield as much increased tax receipts as the acceleration of payments might cause sizable reductions of investment expenditures thereby impairing the expansion in economic activity and productive capacity vital to continued stable economic growth.

Effective date.—The revised schedule for corporation tax payments is to apply to taxable years beginning after December 31, 1965.

Revenue effect.—Administrative budget receipts will be increased by $1 billion in fiscal year 1966 and by $3.2 billion in 1967 as a result of enactment of this provision.

5. The excise tax on passenger automobiles (sec. 201 of the bill and sec. 4061 of of the code)

Present law.—Prior to the passage of the Excise Tax Reduction Act of 1965, a tax of 10 percent was imposed on the manufacturer's price for passenger automobiles. The rate was reduced to 7 percent for the period June 22, to December 31, 1965. On January 1, 1966, the tax rate was reduced to 6 percent, and it is scheduled to fall to 4 percent on January 1, 1967, and to 2 percent on January 1, 1968. On January 1, 1969, the tax will be reduced to a permanent level of 1 percent. Refunds will be paid to dealers with respect to automobiles held in inventory on any date on which the tax rate is reduced.

Explanation of provisions.—The bill restores the excise tax rate on passenger automobiles to the 7-percent rate applicable last December. The restoration of the 7-percent rate is for a 2-year period beginning the day after the date of enactment and ending on March 31, 1968. The excise tax rate on automobiles then is to become 2 percent, as scheduled under the present law for 1968 and 1 percent on January 1, 1969. Thus there is a moratorium on these tax reductions scheduled under present law for a 2-year period. At the end of that time, however, the rate will revert to the level which would have been in effect in the absence of the moratorium.

The House bill would have imposed a tax of 1 percent of the manufacturers (or importers) price upon all new automobiles held in stock by dealers or distributors on the day the 7-percent tax rate becomes effective. Your committee has not retained this provision and, therefore, the bill as amended by it will not provide for a floor stock tax payable by the dealers.

The decision not to impose the floor stock tax was taken by your committee because dealers pointed out to the committee the many problems which they

would have with respect to this tax. They would have difficulty, for example, in gaining customers' acceptance to the inclusion of this tax in the retail price of cars since this amount would not be included in the sticker attached to the new cars reflecting the intended retail price. They also would have difficulty in determining the exact amount of this tax at the time they sold the cars out of their inventory in the case of sales occurring either on the date of the tax increase, or shortly thereafter. For these reasons your committee concluded that it was appropriate to delete the floor stock tax from the House bill. This will decrease revenues otherwise obtained from the House bill by $25 million in the fiscal year 1966.

With regard to the reductions scheduled for 1968 and 1969, tax refunds will be made for inventory on hand. These refunds will be paid to dealers and distributors by manufacturers, and the latter will receive reimbursement from the Government.

Effective date.—The tax rate is to be restored to 7 percent effective with respect to sales by manufacturers, producers, and importers beginning with the day after the date of enactment.

Revenue effect.—This provision will increase revenues by $35 million in the fiscal year 1966 and by $420 million in the fiscal year 1967.

6. *The excise tax on telephone service* (sec. 202 of the bill and sec. 4251 of the code)

Present law.—Under the law in effect prior to January 1, 1966, a 10-percent tax was levied on amounts paid for general and toll telephone and teletypewriter exchange service. This rate was lowered to 3 percent effective as of January 1, 1966, under the provisions of the Excise Tax Reduction Act of 1965. As presently scheduled, the tax rate will fall to 2 percent on January 1, 1967, to 1 percent on January 1, 1968, and will be repealed on January 1, 1969.

Explanation of provision.—The bill restores the 10-percent excise tax rate on telephone service, including teletypewriter service, and postpones further reduction in the tax rate until April 1, 1968. On that date, the tax rate will fall to the 1-percent rate scheduled under present law to be effective in 1968. Then (as under present law) the tax is repealed on January 1, 1969.

The taxes on communications service which were repealed as of January 1, 1966, are not affected by this bill. Thus, private communications systems, telegraph service, and wire and equipment service will remain exempt from the excise tax.

Exemption for hospitals.—The bill provides an exemption from the excise tax for telephone services furnished to nonprofit hospitals exempt from income tax. This is to accord such hospitals the same treatment accorded Government hospitals under present law.

Effective date.—The 10-percent rate on telephone and teletypewriter service is to become effective with respect to bills rendered on or after the first day of the first month which begins more than 15 days after the effective date of this legislation. The exemption for nonprofit hospitals is to go into effect at the same time.

Revenue effect.—This provision will increase revenues by $785 million in the fiscal year 1967.

7. *Disallowance of deduction for certain indirect contributions to political parties—A provision added by your committee* (sec. 301 of the bill and sec. 276 of the code)

In some cases it has been held that advertising in a convention program of a political party or in other political publications is deductible where the intent of the advertising was to sell the product advertised rather than being designed primarily as a political contribution. In the case of payments for admissions to dinners or programs held for the purpose of raising funds for a political party or candidate, it appears unlikely that a deduction is available under present law even though the expense is incurred by a business (although deductions in some cases may be available for the fair market value of the dinner or the program). In addition, it is probable that under present law amounts paid for admission to an inaugural ball, gala, or similar event are in most cases not deductible.

Your committee believes that the tax treatment of advertising in a political publication, payments for admission to a political fund raising dinner or program, and admissions to inaugural balls, etc., should be clarified. Moreover, since direct political contributions are not deductible under present law to individuals not engaged in business, your committee believes that it is undesirable

to permit a business to take a trade or business expense deduction with respect to any of these amounts which usually in practice represent ways of making indirect political contributions or costs of participating in political activities.

For the reasons indicated above, your committee has added a section to the Internal Revenue Code to insure that no deduction is to be allowed for advertising in a convention program of a political party or in any other publication if any part of the net proceeds of the publication directly or indirectly inures (or is intended to inure) to the use of a political party or to a political candidate. Similarly no deduction is to be allowed for payments made for admissions to any dinner or program if any part of the net proceeds of the dinner or program directly or indirectly inures (or is intended to inure) to the use of a political party or political candidate. In addition, no deduction is to be allowed for payments for admissions to inaugural balls, inaugural galas, inaugural parades, inaugural concerts, or similar events identified with a political party or political candidate.

A political party for purposes of this provision is defined in the same manner as elsewhere in the code with respect to debts owed to political parties (sec. 271). A political party for this purpose includes not only a political party itself, but also any committee of a political party, as well as any committee, association, or organization which accepts contributions or makes expenditures to influence elections of individuals seeking election to public office, whether or not they are elected. In addition, your committee has added language specifically to cover contributions to organizations set up to influence the selection of candidates through primaries, conventions, or otherwise, for election to public office. A political candidate for this purpose includes not only candidates for elective public office but also those who are seeking a nomination through a primary, local convention, or meeting of a political party. Amounts paid to an individual may be treated as inuring to the benefit of a political candidate only if such amounts may be used for the purpose of furthering his candidacy for elective public office. Thus, no proceeds received by a political candidate are treated as inuring to his benefit for these purposes if they are received in the ordinary course of a trade or business other than that of holding elective public office.

This provision is to apply for taxable years beginning after December 31, 1965, but only with respect to amounts paid after the date of enactment of this bill.

8. *Information returns to be supplied by Department of Agriculture—A provision added by your committee* (sec. 302 of the bill and sec, 6041(e) of the code)

Under present law persons engaged in a trade or business and making payments in the course of that trade or business to another person of certain specified types of income are required to supply information returns to the Internal Revenue Service with respect to all payments made in any year to an individual of $600 or more. These information returns must also be supplied the Internal Revenue Service in the case of such payments made by the United States (or officers or employees of the United States. This includes payments by the Department of Agriculture with respect to Commodity Credit Corporation transactions, soil bank payments, etc.

Although these statements with respect to payments of more than $600 a year must be supplied by the Department of Agriculture to the Internal Revenue Service, there is no requirement that copies of such statements must be furnished to the farmers receiving the payments. Such statements under present law are required to be furnished to the recipients of the payments in the case of interest and dividend payments of $10 or more a year.

Your committee believes that farmers should have the same information with respect to the payments which are reported to the Government in their case as is true under present law in the case of the recipients of dividend and interest payments.

Your committee's bill for the reasons indicated above requires the Department of Agriculture, in the case of payments made under programs it administers, to supply the farmers with copies of any statements which under present law the Department of Agriculture must send to the Internal Revenue Service. These statements must be sent to the farmers by January 31, of the next year. The provision added by your committee also provides that these statements may be sent out as the Secretary of Agriculture may designate through the national office of the Department of Agriculture, any State office, or through local offices of the Department of Agriculture or any of its agencies.

This provision is to be effective with respect to reports sent to the Internal Revenue Service after the date of enactment of this bill.

V. TECHNICAL EXPLANATION OF THE BILL

TITLE I—ADJUSTMENT OF CERTAIN COLLECTION PROCEDURES

SECTION 101. INCOME TAX COLLECTED AT SOURCE

In general, section 101 of the bill amends section 3402 of the code (relating to income tax collected at source) to provide for new wage withholding rates which are graduated and take into account the minimum standard deduction and to provide new wage bracket withholding tables based upon the new rates. In addition, such section provides for withholding allowances, under certain circumstances, in the case of an employee who has a large amount of itemized deductions. Subsections (a), (b), (c), (d), (f), and (g) of section 101 of the bill as passed by the House have been approved by your committee without change.

Your committee has made changes in subsection (e) of section 101 of the bill which affect the procedures whereby taxpayers with relatively large itemized deductions in relation to their wages may claim withholding allowances in addition to the regular withholding exemptions. The changes made by your committee in respect of these withholding allowances are described below.

For the technical explanation of section 101 of the bill (other than the amendments made by your committee), see page 33 of the report of the Committee on Ways and Means on the bill. [Page 461 this Bulletin.]

Withholding allowances for itemized deductions.—Section 101(e) of the bill (as passed by the House) amends section 3402 of the code to provide that an employee shall be entitled to claim a withholding exemption for each withholding allowance to which he is entitled under section 3402(m) (added by the bill) and which is not claimed on a withholding exemption certificate in effect for his spouse. Under section 3402(m) as added by the bill as passed by the House, the number of withholding allowances to which an employee is entitled with respect to a payment of wages is equal to the number obtained by dividing by $700 the excess of—

(1) the employee's estimated itemized deductions, over,

(2) an amount equal to the sum of 12 percent of the first $7,500 of his estimated wages and 17 percent of the remainder of his estimated wages.

Such subsection also provided that fractional numbers are disregarded for purposes of determining the number of withholding allowances to which an employee is entitled under this new subsection; except that if the number obtained by applying the above formula is equal to one-half or more but less than one, the employee is entitled to one withholding allowance. Your committee has changed the formula for determining the number of withholding allowances to which an employee is entitled to provide that fractional numbers shall be disregarded in all cases; but that the percentage to be applied to the first $7,500 of estimated wages is 10 (rather than 12) percent.

New section 3402(m)(2)(A) provides a definition of the term "estimated itemized deductions." Under the definition included in the bill as passed by the House, an employee's estimated itemized deductions could not be greater than the amount of the deductions (other than the deductions referred to in secs. 141 and 151 and other than the deductions required to be taken into account in determining adjusted gross income under sec. 62) shown on his Federal income tax return for the taxable year preceding the estimation year. Your committee has changed this provision to provide that if the employee did not show such deductions on his return for the such preceding taxable year (that is, if he took the standard deduction), the amount of his estimated itemized deductions shall not exceed an amount equal to the lesser of $1,000 or 10 percent of the wages shown on such return.

New section 3402(m)(2)(C) defines the term "estimation year." Under this definition, as included in the bill as passed by the House, in the case of payments of wages on or after January 1 and before May 1 of any calendar year the term "estimation year" means the preceding calendar year (or, if the employee has filed a Federal income tax return for the preceding calendar year and has in effect a withholding allowance under the new sec. 3402(m) based on using the current calendar year as the estimation year, such current calendar year is the estimation year). Your committee has made a technical change in

this part of the definition to provide that the current calendar year shall be the "estimation year" with respect to any withholding allowances claimed on a withholding exemption certificate filed after the employee has filed his Federal income tax return for the preceding calendar year.

New section 3402(m)(3)(D), as included in the bill as passed by the House, provided that the Secretary of the Treasury or his delegate may by regulations provide that one or more of the withholding allowances to which an employee would, but for this provision, be entitled shall be denied because such employee's estimated wages are above the level at which the amounts deducted and withheld are generally sufficient to offset the liability for Federal income tax with respect to the wages from which such amounts are deducted and withheld. Your committee has made a technical amendment to this provision to make clear that the relationship between withholding and tax liability may be determined by taking into account a reasonable allowance for deductions and exemptions.

Section 3402(m)(3), as included in the bill as passed by the House, provided in subparagraph (E) that the Secretary of the Treasury or his delegate may prescribe tables pursuant to which employees shall determine the number of allowances to which they are entitled under the new section 3402(m). This provision further provided that the tables could be based on reasonable wage and itemized deduction brackets. Your committee has revised this provision (and included in a new par. (4) of sec. 3402(m)) to make clear that such tables shall be consistent with the provisions of new section 3402(m)(1) and (3) and to provide that such tables may, at the discretion of the Secretary of the Treasury or his delegate, increase or decrease the number of withholding allowances to which employees in the various wage and itemized deduction brackets would, but for this provision, be entitled, to the end that, to the extent practicable, amounts deducted and withheld (1) generally do not exceed the liability for Federal income tax with respect to the wages from which such amounts are deducted and withheld, and (2) generally are sufficient to offset such liability for tax. The new paragraph (4) also makes it clear that, if such tables are prescribed, the number of withholding allowances to which an employee is entitled under section 3402(m) will be determined under such tables in lieu of the computation prescribed by section 3402(m)(1) (relating to the general rule).

Section 101(e)(4) of the bill, as passed by the House, provides for a new civil penalty in new section 6682 of the code (relating to false information with respect to withholding allowances based on itemized deductions). The penalty applied if any individual in claiming a withholding allowance under new section 3402(f)(1)(F) of the code stated (1) that the wages on his income tax return for any taxable year were less than the wages actually shown, or (2) that the itemized deductions on his income tax return for any taxable year were greater than the deductions actually shown. Your committee has clarified this provision to provide that the penalty will apply if any individual in claiming such a withholding allowance states (1) as the amount of the wages shown on his income tax return for any taxable year, an amount less than the wages actually shown, or (2) as the amount of the itemized deductions shown on his income tax return for any taxable year, an amount greater than the itemized deductions actually shown. In addition your committee has made a technical amendment to make it clear that an employee will be subject to only one $50 penalty even though he misstates both the amount of his itemized deductions and wages.

SECTION 102. ESTIMATED TAX IN CASE OF INDIVIDUALS

This section has been approved by your committee except for a technical change which amends subsection (b)(1) of section 6211 (relating to definition of a deficiency) to take account, in the computation of a deficiency, of the inclusion of self-employment tax in the estimated tax. For the technical explanation of this section of the bill see page 40 of the report of the Committee on Ways and Means on the bill. [Page 467, this Bulletin.]

SECTION 103. UNDERPAYMENT OF INSTALLMENTS OF ESTIMATED INCOME TAX IN CASE OF INDIVIDUALS

This section has been approved by your committtee without change. For the technical explanation of this section of the bill see page 45 of the report of the Committee on Ways and Means on the bill. [Page 470, this Bulletin.]

SECTION 104. INSTALLMENT PAYMENTS OF ESTIMATED INCOME TAX BY CORPORATIONS

This section has been approved by your committee without change. For the technical explanation of this section of the bill see page 45 of the report of the Committee on Ways and Means on the bill. [Page 470, this Bulletin.]

TITLE II—POSTPONEMENT OF CERTAIN EXCISE TAX RATE REDUCTIONS

SECTION 201. PASSENGER AUTOMOBILES

Section 201 of the bill, as passed by the House, has been approved by your committee with two modifications. For the technical explanation of this section of the bill (other than the amendments made by your committee), see the report of the Committee on Ways and Means starting at page 46. [Page 471, this Bulletin.]

Your committee has deleted subsections (b) and (c)(2) of section 201 of the bill, as passed by the House, which related to the amendment of section 4226 of the code (relating to floor stocks taxes) to impose a floor stocks tax of 1 percent on each passenger automobile[3] which was subject to tax under section 4061 (a)(2) and which was held by a dealer, has not been used, and is intended for sale on the day after the bill is enacted.

SECTION 202. COMMUNICATION SERVICES

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page 47 of the report of the Committee on Ways and Means on the bill. [Page 472, this Bulletin.]

TITLE III—MISCELLANEOUS PROVISIONS

SECTION 301. DISALLOWANCE OF DEDUCTION FOR CERTAIN INDIRECT CONTRIBUTIONS TO POLITICAL PARTIES

Section 301 of the bill, which is a new section added to the bill as passed by the House, relates to the disallowance of deductions for certain indirect contributions to political parties.

(*a*) *Disallowance of deduction.*—Subsection (a) of section 301 of the bill amends part IX of subchapter B of chapter 1 (relating to items not deductible) of the Internal Revenue Code of 1954 by inserting a new section 276.

SECTION 276. CERTAIN INDIRECT CONTRIBUTIONS TO POLITICAL PARTIES

Subsection (a)(1) of section 276 provides, in part, that no deduction will be allowed for any amount paid or incurred for advertising in a convention program of a political party (as defined in subsec. (b)(1) of sec. 276). This rule applies whether the convention program is published by a political party or by any other person, entity, or organization and whether the advertising revenues therefrom are received by or payable to a political party or any other person, entity, or organization. Thus, for example, no deduction is allowed for advertising in the program of a convention of a political party even if the program is published by a corporation engaged in the business of publishing such programs for profit and that corporation retains all the proceeds of such program and even if there is no showing that the corporation paid for such right.

Subsection (a)(1) of section 276 also provides that no deduction will be allowed for amounts paid or incurred for advertising in any other publication, if any part of the proceeds thereof directly or indirectly inures (or are intended to inure) to or for the use of a political party or political candidate. (Subsec. (b)(2) describes the circumstances under which proceeds shall be treated as inuring to or for the use of a political candidate.) Thus, no deduction is allowed for such advertising expense even if the publication is published at a loss (that is, the proceeds derived from the publication are insufficient to meet the expenses attributable thereto) if, had there been a profit, any part of the proceeds would have inured to or for the use of a political party or a political candidate. A deduction will not be allowed where the proceeds, or any part thereof, indirectly

[3] Includes trailers (other than house trailers) suitable for use with passenger automobiles.

inure to or for the use of a political party or a political candidate. For example, if a local host committee agrees to make a payment to a political party or a political candidate for the purpose of bringing a political convention to a certain locale, and in consideration therefor secures the right to publish a book or pamphlet in connection with such convention and to retain the advertising revenues derived therefrom, amounts paid or incurred for advertising in such publication are not deductible. However, this is not intended to change the rule of present law as to the treatment of direct contributions of persons engaged in a trade or business in a locality to a committee organized for the purpose of bringing a political convention to such locality, if such contributions are made with a reasonable expectation of a financial return commensurate with the amount of the contribution. (See Rev. Rul. 55–265, C.B. 1955–1, 22.)

If any part of the proceeds of a publication (whether or not published in connection with a political convention) inures to a political party or a political candidate, deductions for advertising in such publication will not be allowed regardless of the purposes for which such proceeds are utilized or expended by such party or candidate. Thus, for example, no deduction will be allowed for advertising in a publication, the proceeds of which are used by a political party for purposes other than those directly related to the election of a candidate to a public office (such as permanent office rent, salaries of permanent employees, and voter registration or education programs).

Subsection (a)(2) of section 276 provides that no deduction will be allowed for any amount paid or incurred for admission to any dinner or program, if any part of the proceeds of such dinner or program directly or indirectly inures (or is intended to inure) to or for the use of a political party or a political candidate. Amounts paid for admission to a dinner or program include all charges, whether direct or indirect, for attendance and participation at such dinner or program. (A similar rule applies for admissions to which subsec. (a)(3) is applicable.) Thus, for example, any separate charge for food or drink at such dinner or program is an amount paid for admission. The term "dinner or program" includes, but is not limited to, such events as galas, dances, theatrical or film presentations, cocktail parties, picnics, and sporting events. As in the case of advertising expenses described in subsection (a)(1), the provisions of subsection (a)(2) apply regardless of whether the dinner or program operated at a profit or a loss, and without regard to the purposes for which such proceeds are utilized or expended by such a party or candidate.

Subsection (a)(3) of section 276 provides that no deduction will be allowed for any amount paid or incurred for admission to an inaugural ball, gala, parade, or concert, or to any similar event if such event is identified with a political party or political candidate. No deduction is allowed for admission to such inaugural events regardless of the sponsorship thereof or the disposition of the proceeds and regardless of whether the inaugural celebrated is of a Federal, State, or local official. Thus, for example, the cost of attending an inaugural ball sponsored by a nonpartisan or bipartisan committee or organization is not deductible even if the proceeds are used only to defray the expenses of such ball or similar event. The term "similar event" as used in subsection (a)(3) includes, but is not limited to, such events as dances, theatrical or film presentations, cocktail parties, and sporting events.

Subsection (b)(1) of section 276 defines the term "political party" as used in section 276, to mean a political party as commonly understood; a National, State, or local committee of a political party; or a committee, association, or organization, whether incorporated or not, which directly or indirectly accepts contributions or makes expenditures for the purpose of influencing or attempting to influence the selection, nomination, or election of any individual to any elective public office, or the election of presidential and vice presidential electors, whether or not such individual or electors are selected, nominated, or elected. Thus, for purposes of section 276, a political party includes a committee or other group which seeks to promote the nomination of an individual for an elective public office in a primary election, or in any convention, meeting, or caucus of a political party. A committee, or other group, is considered to be a political party, if, although it does not itself expend any funds, it turns funds over to another person or organization, which does expend funds for such purpose.

Subsection (b)(2) describes the circumstances under which proceeds derived from advertising in publications, or from a dinner or program, are considered as inuring to or for the use of a political candidate. Such proceeds are deemed to inure to or for the use of such a candidate only if they may be used directly or in-

directly for the purpose of furthering his candidacy for selection, nomination, or election to any elective public office, and if such proceeds are not received by the candidate in the ordinary course of his trade or business, other than the trade or business of holding a public office. Thus, for example, if a newspaper publisher is a candidate for public office, advertising in his regularly-published commercial newspaper is not affected by this section merely because such publisher uses the profits from his newspaper to further his campaign.

(*a*) Subsection (c) of section 276 provides a cross-reference to section 274 (relating to disallowance of certain entertainment, etc., expenses). The provisions of section 276 are in addition to, and not in substitution for, the rules provided in section 274.

(*b*) *Clerical amendment.*—Subsection (b) of section 301 of the bill makes a clerical amendment to add to the table of sections of part IX of subchapter B of chapter 1, a reference to section 276.

(*c*) *Effective date.*—Under subsection (c) of section 301 of the bill, the amendments made by subsections (a) and (b) of section 301 of the bill will apply to taxable years beginning after December 31, 1965, but only with respect to amounts paid or incurred after the date of enactment of the bill.

SECTION 302. INFORMATION RETURNS MADE BY DEPARTMENT OF AGRICULTURE

Section 302 of the bill, which is a new section added to the bill as passed by the House relates to information returns furnished by the Department of Agriculture with respect to payments under programs administered by that Department.

(*a*) *Filing by Secretary of Agriculture or designees.*—Subsection (a) of section 302 of the bill amends section 6041 of the code (relating to information at source) by adding a new subsection (e). Paragraph (1) of the new subsection (e) provides that information returns which are required under section 6041(a) with respect to payments under programs administered by the Department of Agriculture are to be rendered by the Secretary of Agriculture or by one or more officers or employees of the Department of Agriculture designated by the Secretary of Agriculture to make such returns on his behalf. Under existing section 6041, such returns are required to be rendered by the officers or employees having information as to the payments and required to do so under regulations.

Paragraph (2) of the new subsection (e) provides that the Secretary of Agriculture, or the officer or employee of the Department of Agriculture designated by him to render any information return to which the new subsection (e)(1) applies, shall furnish to each person whose name is set forth in such return a written statement showing the aggregate amount of payments to the person as shown on such return. This statement is to be furnished to the person on or before January 31 of the year following the calendar year for which the return was made.

(*b*) *Effective date.*—Subsection (b) of section 302 of the bill provides that the provisions of the new subsection (e) of the section 6041 shall apply with respect to information returns made after the date of the enactment of the bill.

VI. CHANGES IN EXISTING LAW

In the opinion of the committee, it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, as reported).

VII. SUPPLEMENTAL VIEWS OF SENATOR ALBERT GORE

This bill, H.R. 12752, is designed to help finance the increasing costs of Government during the next 2 years. By raising additional revenue it will decrease the budget deficit and lessen the amount by which the public debt would otherwise be increased. Some assistance in controlling a nascent inflation should be provided.

Although several provisions of the bill are meritorious, it is poorly designed in certain respects and in all likelihood will prove quite inadequate. Some reinforcement of fiscal policy ought to be provided now, by raising more revenue than this bill will provide, and by placing the increased revenue burden where it will do the most to dampen demand in areas where such demand most clearly threatens price stability.

Oddly, the two most important provisions of the bill, from a revenue standpoint, represent in one instance a speedup of a schedule already adopted by the Congress—for getting corporation tax payments more nearly current—and in the other a complete reversal of a previously adopted congressional schedule for ridding the consumer of two onerous excises. I support the previously established congressional policy in both instances, to place corporation taxes on a current basis, and to eliminate excise taxes. I oppose the proposed reversal of congressional policy with respect to excises.

Since more revenue is needed, and since an increase in excise taxes is regressive in nature, Congress should raise more revenue and do so in a more equitable manner. Suspension of the investment tax credit as a substitute for the proposed excise tax increases would serve both purposes. This would have the additional advantage of selectively dampening demand in an area which seriously threatens to create inflationary pressures.

Suspension of the investment credit, together with a modification of the use of existing carryovers, will produce as much revenue as would the reimposition of the excise taxes on automobiles and on telephone service. Suspension of the credit would add $80 million to revenues in the current fiscal year, while raising excises to their pre-January level would produce only an additional $65 million. In fiscal 1967, it is estimated that $1.2 billion would be raised by either procedure, while in fiscal 1968 the investment credit suspension would add $1.9 billion and the excises only $1.5 billion.

So long as the revenues are this close, then, the choice would hinge on the overall economic effects, as well as on equity considerations.

The present outlook for expenditures on fixed investment clearly raises the threat of inflationary pressures in that sector of the economy. Fixed investment in 1965 was 10.3 percent of gross national product, about the same as it was during the investment boom of 1956 and 1957. The rate of investment at that time could not be sustained and neither can the current rate.

In 1965, investment in plant and equipment increased 15.4 percent over 1964. Recent surveys show an expected increase in 1966 of 15 percent or more over 1965, and surveys taken at this time of year generally underestimate final expenditures. Extending these projections into 1966, we will have by the end of this calendar year a fixed investment expenditure amounting to some 11 percent of gross national product. This is well above the noninflationary level of 10 percent for a full employment economy.

Obviously, in the interest of orderly growth and to avoid inflationary pressures in an important sector of the economy, expenditures for fixed investment should be slowed. Expenditures should not be halted, but marginal projects should be postponed. Suspension of the credit will not halt projects clearly warranted by demand. It would remove this element of artificial stimulation in our economy.

The Finance Committee report on the 1962 Revenue Act, when the investment credit was instituted, gave three specific reasons for the credit:

(1) The investment credit would "stimulate investment * * * by reducing the net cost of acquiring depreciable assets, which in turn increases the rate of return after taxes arising from their acquisition."

(2) The investment credit "by increasing the flow of cash available for investment, will stimulate investment."

(3) The investment credit "can be expected to stimulate investments through a reduction in the 'payoff' period for investment in a particular asset."

The same arguments—in reverse—could now be used to justify suspending the investment credit.

Given current conditions, the artificial stimulation to expenditures for fixed investment should be cut off. The investment credit should be suspended until such time as conditions warrant a return to stimulation.

Another fact which is particularly pertinent today is that production of equipment for fixed investment competes with production of hard goods for defense purposes. This is particularly true with respect to highly skilled manpower, in which there is already a shortage. Continued artificial stimulation of plant and equipment expenditures can only result in bidding up the price of scarce materials, facilities, and manpower needed for defense production, thus setting off a ripple of inflation which might well become a powerful wave carrying all before it.

Looking at restraints already at work through Government action, one is struck by the tight money policy enforced by the Federal Reserve Board. However one may view this monetary policy, fiscal policy must work with and not

against it. In this instance, the suspension of the investment credit will reenforce the tight money policy of the Federal Reserve Board. On the other hand, a tax policy which works counter to it, will but give an excuse to the money managers to tighten the screws even harder, thus giving rise to further undesirable distortions which we have witnessed in the past when monetary policy was misguided.

Little need be said here to support the substitution of this credit suspension for the increase in excises on automobiles and telephone service from the standpoint of equity. The excises bear directly on the consumer and is recognized as a regressive tax. Furthermore, the excise tax increases in this bill affect only one commodity and one service. It is difficult to justify singling them out, particularly when they are virtual necessities. Suspension of the investment credit will work no hardship on any particular group and its effects will be spread broadly, particularly across the corporate sector.

Responsible economists are now expressing concern about the possibility of inflation. It is felt by many that substantial tax increases are needed, and now. In the absence of a general tax increase now, selective tax changes in areas where both economic and equity objectives can be furthered would certainly be in order. Suspension of the investment credit is surely one of the most obvious places to begin.

VIII. SUPPLEMENTAL VIEWS OF SENATOR VANCE HARTKE ON H.R. 12752

Only a few months ago the Treasury Department told us that cuts in excise taxes were desirable for a vibrant economy. Administration spokesmen assured us at that time that the war in Vietnam could best be financed by an expanding and virile economy.

A scant few weeks ago the Treasury Department informed us that certain excise tax cuts, which had already gone into effect, had to be reinstated to finance an escalated war in southeast Asia. Yet, when questioned by the Finance Committee members, the Secretary of the Treasury was unable to tell us what the total needs were for financing the war in the coming months, even though there are strong indications that this will be a long and costly war.

If excise tax cuts were a good idea last summer, they are a good idea now.

It is not fiscally responsible to ask the Congress to reinstate excise taxes providing only $1.2 billion when the war, at present, is costing $10 billion a year. We should not attempt piecemeal, one-shot, stop-gap solutions designed only to raise revenue in a hurry, when what we need is a sound, logical plan to finance this war. Because of this rushed approach, the reimposition of excise taxes, which are admittedly regressive, ask needless selective sacrifices of the American people.

Therefore, I am opposed to the reimposition of excise taxes on telephone service and automobiles.

[H.R. 12752] [1]

TAX ADJUSTMENT ACT OF 1966

[Conference Report No. 1323, Eighty-ninth Congress, Second Session]

[March 14, 1966]

MR. MILLIS, from the committee of conference, submitted the following conference report to accompany H.R. 12752.

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 12752) to provide for graduated withholding of income tax from wages, to require declarations of estimated tax with respect to self-employment income, to accelerate current payments of estimated income tax by corporations, to postpone certain excise tax rate reductions, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

[1] Public Law 89-368, page 379, this Bulletin.

That the Senate recede from its amendments numbered 18, 22, 23, 24, 25 and 34.

That the House recede from its disagreement to the amendments of the Senate numbered 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 19, 20, 21, 26, 27, 28, 29, 30, 31, 32, and 33, and agree to the same.

Amendment numbered 35:

That the House recede from its disagreement to the amendment of the Senate numbered 35, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

Sec. 302. Benefits at age 72 for certain uninsured individuals.

(a) Monthly Benefits.—Title II of the Social Security Act is amended by adding at the end thereof the following new section:

"Benefits At Age 72 For Certain Uninsured Individuals

"Eligibility

"Sec. 228. (a) Every individual who—

"(1) has attained the age of 72,

"(2) (A) attained such age before 1968, or (B) has not less than 3 quarters of coverage, whenever acquired, for each calendar year elapsing after 1966 and before the year in which he attained such age,

"(3) is a resident of the United States (as defined in subsection (e)), and is (A) a citizen of the United States or (B) an alien lawfully admitted for permanent residence who has resided in the United States (as defined in section 210(i)) continuously during the 5 years immediately preceding the month in which he files application under this section, and

"(4) has filed application for benefits under this section, shall (subject to the limitations in this section) be entitled to a benefit under this section for each month beginning with the first month after September 1966 in which he becomes so entitled to such benefits and ending with the month preceding the month in which he dies. No application under this section which is filed by an individual more than 3 months before the first month in which he meets the requirements of paragraphs (1), (2), and (3) shall be accepted as an application for purposes of this section.

"Benefit Amount

"(b)(1) Except as provided in paragraph (2), the benefit amount to which an individual is entitled under this section for any month shall be $35.

"(2) If both husband and wife are entitled (or upon application would be entitled) to benfits under this section for any month, the amount of the husband's benefit for such month shall be $35 and the amount of the wife's benefit for such month shall be $17.50.

"Reduction For Governmental Pension System Benefits

"(c) (1) The benefit amount of any individual under this section for any month shall be reduced (but not below zero) by the amount of any periodic benefit under a governmental pension system for which he is eligible for such month.

"(2) In the case of a husband and wife only one of whom is entitled to benefits under this section for any month, the benefit amount, after any reduction under paragraph (1), shall be further reduced (but not below zero) by the excess (if any) of (A) the total amount of any periodic benefits under governmental pension systems for which the spouse who is not entitled to benefits under this section is eligible for such month, over (B) $17.50.

"(3) In the case of a husband and wife both of whom are entitled to benefits under this section for any month—

"(A) the benefit amount of the wife, after any reduction under paragraph (1), shall be further reduced (but not below zero) by the excess (if any) of (i) the total amount of any periodic benefits under governmental pension systems for which the husband is eligible for such month, over (ii) $35, and

"(B) the benefit amount of the husband, after any reduction under paragraph (1), shall be further reduced (but not below zero) by the excess (if any) of (i) the total amount of any periodic benefits under governmental pension systems for which the wife is eligible for such month, over (ii) $17.50.

"(4) For purposes of this subsection, in determining whether an individual is eligible for periodic benefits under a governmental pension system—

"(A) such individual shall be deemed to have filed application for such benefits,

"(B) to the extent that entitlement depends on an application by such individual's spouse, such spouse shall be deemed to have filed application, and

"(C) to the extent that entitlement depends on such individual or his spouse having retired, such individual and his spouse shall be deemed to have retired before the month for which the determination of eligibility is being made.

"(5) For purposes of this subsection, if any periodic benefit is payable on any basis other than a calendar month, the Secretary shall allocate the amount of such benefit to the appropriate calendar months.

"(6) If, under the foregoing provisions of this section, the amount payable for any month would be less than $1, such amount shall be reduced to zero. In the case of a husband and wife both of whom are entitled to benefits under this section for the month, the preceding sentence shall be applied with respect to the aggregate amount so payable for such month.

"(7) If any benefit amount computed under the foregoing provisions of this section is not a multiple of $0.10, it shall be raised to the next higher multiple of $0.10.

"(8) Under regulations prescribed by the Secretary, benefit payments under this section to an individual (or aggregate benefit payments under this section in the case of a husband and wife) of less than $5 may be accumulated until they equal or exceed $5.

"SUSPENSION FOR MONTHS IN WHICH CASH PAYMENTS ARE MADE UNDER PUBLIC ASSISTANCE

"(d) The benefit to which any individual is entitled under this section for any month shall not be paid for such month if—

"(1) such individual receives aid or assistance in the form of money payments in such month under a State plan approved under title I, IV, X, XIV, or XVI, or

"(2) such individual's husband or wife receives such aid or assistance in such month, and under the State plan the needs of such individual were taken into account in determining eligibility for (or amount of) such aid or assistance,

unless the State agency administering or supervising the administration of such plan notifies the Secretary, at such time and in such manner as may be prescribed in accordance with regulations of the Secretary, that such payments to such individual (or such individual's husband or wife) under such plan are being terminated with the payment or payments made in such month.

"SUSPENSION WHERE INDIVIDUAL IS RESIDING OUTSIDE THE UNITED STATES

"(e) The benefit to which any individual is entitled under this section for any month shall not be paid if, during such month, such individual is not a resident of the United States. For purposes of this subsection, the term 'United States' means the 50 States and the District of Columbia.

"TREATMENT AS MONTHLY INSURANCE BENEFITS

"(f) For purposes of subsections (t) and (u) of section 202, and of section 1840 a monthly benefit under this section shall be treated as a monthly insurance benefit payable under section 202.

"ANNUAL REIMBURSEMENT OF FEDERAL OLD-AGE AND SURVIVORS INSURANCE TRUST FUND

"(g) There are authorized to be appropriated to the Federal Old-Age and Survivors Insurance Trust Fund for the fiscal year ending June 30, 1969, and for each fiscal year thereafter, such sums as the Secretary of Health, Education, and Welfare deems necessary on account of—

"(1) payments made under this section during the second preceding fiscal year and all fiscal years prior thereto to individuals who, as of the beginning of the calendar year in which falls the month for which payment was made, had less than 3 quarters of coverage,

"(2) the additional administrative expenses resulting from the payments described in paragraph (1), and

"(3) any loss in interest to such Trust Fund resulting from such payments and expenses,

in order to place such Trust Fund in the same position at the end of such fiscal year as it would have been in if such payments had not been made.

"DEFINITIONS

"(h) For purposes of this section—

"(1) The term 'quarter of coverage' includes a quarter of coverage as defined in section 5(l) of the Railroad Retirement Act of 1937.

"(2) The term 'governmental pension system' means the insurance system established by this title or any other system or fund established by the United States, a State, any political subdivision of a State, or any wholly owned instrumentality of any one or more of the foregoing which provides for payment of (A) pensions, (B) retirement or retired pay, or (C) annuities or similar amounts payable on account of personal services performed by any individual (not including any payment under any workmen's compensation law or any payment by the Veterans' Administration as compensation for service-connected disability or death).

"(3) The term 'periodic benefit' includes a benefit payable in a lump sum if it is a commutation of, or a substitute for, periodic payments.

"(4) The determination of whether an individual is a husband or wife for any month shall be made under subsection (h) of section 216 without regard to subsections (b) and (f) of section 216."

(b) Certain Applications Under 1965 Amendments.—For purposes of paragraph (4) of section 228(a) of the Social Security Act (added by subsection (a) of this section), an application filed under section 103 of the Social Security Amendments of 1965 [P.L. 89-97, C.B. 1965-2, 601] *before July 1966 shall be regarded as an application under such section 228 and shall, for purposes of such paragraph and of the last sentence of such section 228(a), be deemed to have been filed in July 1966, unless the person by whom or on whose behalf such application was filed notifies the Secretary that he does not want such application so regarded.*

And the Senate agree to the same.

Amendment numbered 36:

That the House recede from its disagreement to the amendment of the Senate numbered 36, and agree to the same with the following amendments:

On page 19 of the Senate engrossed amendments, strike out line 4 and insert:

Sec. 303. Temporary duty-free entry for gifts from members of Armed Forces in combat zones.

(a) Gifts Costing $50 or Less.—Subpart B of part 1 of the appendix to

On page 19 of the Senate engrossed amendments, in the matter following line 7, after "may prescribe" insert a comma.

On page 19 of the Senate engrossed amendments, in the fourth line from the bottom of the page, strike out "(b)" and insert: *(b) Clerical Amendment.—*

On page 19 of the Senate engrossed amendments, in the last line, strike out "(c)" and insert: *(c) Effective Date.—*

And the Senate agree to the same.

W. D. MILLS,
CECIL R. KING,
HALE BOGGS,
EUGENE J. KEOGH,
JOHN W. BYRNES,
JAMES B. UTT,
Managers on the Part of the House.

RUSSELL B. LONG,
GEORGE A. SMATHERS,
CLINTON P. ANDERSON,
JOHN J. WILLIAMS,
FRANK CARLSON,
Managers on the Part of the Senate.

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 12752) to provide for graduated withholding of income tax from wages, to require declarations of estimated tax with respect to self-employment income, to accelerate current payments of estimated income tax by corporations, to postpone certain excise tax rate reductions, and for other purposes, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

The following Senate amendments made technical, clerical, clarifying or conforming changes: 1, 2, 3, 6, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 20, 21, 23, 24, 25, 27, 28, 29, 30, 31, and 32. With respect to these amendments (1) the House recedes, or (2) the Senate recedes in order to conform to other action agreed upon by the committee of conference.

WITHHOLDING ALLOWANCES BASED ON ITEMIZED DEDUCTIONS

Amendments Nos. 4 and 5: The bill as passed by the House and the Senate permits employees to claim withholding allowances (which are to have the same effect as withholding exemptions for purposes of income tax withholding) equal to the number determined by dividing by $700 the excess of (1) estimated itemized deductions, over (2) an amount equal to the sum of a specified percentage of the first $7,500 of estimated wages and 17 percent of the remainder of the estimated wages. Under the bill as passed by the House, the percentage of the first $7,500 of estimated wages was 12 percent. Under Senate amendment No. 4, this percentage is reduced to 10 percent. The House recedes.

Under the bill as passed by the House, any fraction resulting from the computation was to be disregarded except that, if the number determined was one-half or more but less than 1, it was to be increased to 1. Under Senate amendment No. 5, fractional numbers are not be taken into account. The House recedes.

The conferees on the part of the House and on the part of the Senate are concerned about the extent of overwithholding which prevails under existing law and which it appears will continue at a reduced level under the graduated withholding system provided by this bill, even with the withholding allowances as provided in the agreement reached by your conferees. For that reason, it has requested the Treasury Department to continue to survey and study ways and means of reducing overwithholding, particularly in the case of seasonal and intermittent employment, and has asked the Treasury Department, as it gains some experience under the system provided by the bill, to report back from time to time to the House Committee on Ways and Means and the Senate Committee on Finance as to any practicable means of reducing the remaining overwithholding.

Amendment No. 7: Under the bill as passed by the House, an employee's estimated itemized deductions for any estimation year could not be greater than the amount of the deductions (other than the deductions referred to in secs. 141 and 151 of the code and other than the deductions required to be taken into account in determining adjusted gross income under sec. 62 of the code) shown on his Federal income tax return for the taxable year preceding his estimation year. Under Senate amendment No. 7, if the employee did not show such deductions on his return for such preceding taxable year, the amount of his estimated itemized deductions is not to exceed the lesser of $1,000 or 10 percent of the wages shown on such return.

The House recedes.

OPTION OF INDIVIDUALS TO DISREGARD BALANCES DUE AND OVERPAYMENTS OF $5 OR LESS

Amendment No. 18: This amendment added a new section 5 to the code under which individuals were given an election to disregard balances due and overpayments of $5 or less where their withholding and other tax credits and payments of estimated tax for a year were within $5 of their tax liability for the year as shown on their returns. This election would have been effective for taxable years after 1966.

The Senate recedes.

Although the House conferees did not agree to Senate amendment No. 18, they recognize the desirability of simplifying tax collection and refund procedures, an

objective toward which this amendment was directed. For this reason, the conferees, both on the part of the House and on the part of the Senate, are requesting the Treasury Department to study and report back to the House Committee on Ways and Means and the Senate Committee on Finance as to the practicability and desirability of forgoing taxpayments and refunds in cases where the amount due at the time and final return is filed is small because of substantial payments through withholding or payments of estimated tax, or both. This study and report to the committees is to be made in conjunction with the study on ways of relieving overwithholding referred to earlier in this statement.

FLOOR STOCKS TAX ON PASSENGER AUTOMOBILES, ETC.

Amendment No. 19: The bill as passed by the House provided for a floor stocks tax on passenger automobiles and trailers (other than house trailers) suitable for use in connection with passenger automobiles which on the day after the enactment of the bill are held by dealers and have not been used and are intended for sale. Under this provision the tax was 1 percent of the price for which the article was sold by the manufacturer, producer, or importer. The tax was to be paid by the dealer and be collected from him by the manufacturer, producer, or importer. The tax was to be paid at such time after 60 days after the date of enactment of the bill as may be prescribed by the Secretary of the Treasury or his delegate.

Senate amendment No. 19 strikes out this provision of the bill.

The House recedes.

LOCAL RESIDENTIAL TELEPHONE SERVICE

Amendment No. 22: The bill, as passed by the House, increased the tax on communication services to 10 percent (the rate in effect on December 31, 1965) for the period from the effective date of this provision through March 31, 1968. Senate amendment No. 22 provided that this temporary increase was not to apply to local residential telephone service, as defined in the amendment, and that the tax rates provided by existing law (3 percent for calendar year 1966, 2 percent for calendar year 1967, and 1 percent for calendar year 1968) were to continue to apply to this service.

The Senate recedes.

EFFECTIVE DATE OF INCREASE IN COMMUNICATIONS TAX

Amendment No. 26: Under the bill as passed by the House, the amendments made by section 202 of the bill (relating to communication services) were to take effect, under the rules prescribed by the bill, on the first day of the first month which begins more than 15 days after the date on which the bill is enacted. Under Senate amendment No. 26 the effective date is April 1, 1966.

The House recedes.

DISALLOWANCE OF DEDUCTIONS FOR CERTAIN INDIRECT CONTRIBUTIONS TO POLITICAL PARTIES

Amendment No. 33: This amendment adds a new section 276 to the code providing that no deduction otherwise allowable under chapter 1 of the code shall be allowed for any amount paid or incurred for—

(1) advertising in a convention program of a political party, or in any other publication if any part of the proceeds of such publication directly or indirectly inures (or is intended to inure) to or for the use of a political party or a political candidate.

(2) admission to any dinner or program, if any part of the proceeds of such dinner or program directly or indirectly inures (or is intended to inure) to or for the use of a political party or a political candidate, or

(3) admission to an inaugural ball, inaugural gala, inaugural parade, or inaugural concert, or to any similar event which is identified with political party or a political candidate.

The new section also defines the term "political party" and provides that proceeds are to be treated as inuring to or for the use of a political candidate only if (*a*) such proceeds may be used directly or indirectly for the purpose of furthering his candidacy for selection, nomination, or election to any elective public office, and (*b*) such proceeds are not received by such candidate in the ordinary course of a

trade or business (other than the trade or business of holding elective public office). The new section applies to taxable years beginning after December 31, 1965, but only with respect to amounts paid or incurred after the date of the enactment of the bill.

The House recedes.

INFORMATION RETURNS MADE BY THE DEPARTMENT OF AGRICULTURE

Amendment No. 34: Section 6041(a) of the code now requires information returns to be made by persons engaged in trade or business and by officers and employees of the United States with respect to certain payments of $600 or more in a taxable year. The return sets forth the amount of the payments and the name and address of the recipient. Senate amendment No. 34 added a new subsection (e) to section 6041 providing (1) that information returns which are required under section 6041(a) with respect to payments under programs administered by the Department of Agriculture are to be rendered by the Secretary of Agriculture or by one or more officers or employees of the Department of Agriculture designated by the Secretary of Agriculture to make such returns on his behalf, and (2) that the Secretary of Agriculture (or the officer or employee rendering the return) is to furnish to each person whose name is set forth in the return a written statement showing the aggregate amount of payments to the person as shown on the return.

The Senate recedes.

Although the conferees on the part of the House, because of problems of administering the amendment, did not agree to Senate amendment No. 34, it was recognized that there is a problem in correlating the different payments which may be made to a farmer during a year at different times or by different offices or agencies of the Department of Agriculture. It was thought that a means should be developed administratively to report with respect to any farmer a total of the payments made to him which should be reported for tax purposes. Also, a study should be made of the feasibility of reporting to the farmer amounts paid to him which are reported to the Internal Revenue Service. These studies should be made by the Department of Agriculture in cooperation with the Department of the Treasury and a report made to the House Committee on Ways and Means and the Senate Committee on Finance early in the next Congress.

SOCIAL SECURITY BENEFITS FOR CERTAIN AGED UNINSURED INDIVIDUALS

Amendment No. 35: This amendment adds a new section to the bill to provide monthly benefit payments under section 202 of the Social Security Act to individuals who meet the requirements of the new provisions. Under the Senate amendment, an individual would be entitled to the new benefits if he has filed application for the benefits and (*a*) has attained age 70, (*b*) either (i) is not and would not (upon filing application) be entitled to monthly benefits under existing section 202 for the month in which he attains age 70 or (if later) the month in which he files application for the new benefits, or (ii) is entitled to such benefits but the amount is less than the amount of the new benefits, and (*c*) is a resident of the United States (as defined in sec. 210(i) of the Social Security Act) and is a citizen of the United States or an alien lawfully admitted for permanent residence who has resided in the United States (as so defined) continuously during the 5 years immediately preceding the month in which he files application for the new benefits.

Under the Senate amendment, the amount of the new monthly benefit would (in effect) be $44, except that the amount would be $22 in the case of a married woman whose husband is entitled to the new benefits. Under the Senate amendment the new provisions would apply for months after September 1966, and section 227 of the Social Security Act (relating to transitional insured status) would be repealed as of the close of September 1966.

The Senate amendment authorized appropriations to be made from time to time to the Federal old-age and survivors insurance trust fund and to the Federal hospital insurance trust fund to place each trust fund in the same position in which it would have been but for the Senate amendment.

Under the conference agreement, the House recedes with an amendment in the nature of a substitute for the Senate amendment. Subsection (a) of section 302 of the bill as agreed to in conference adds a new section 228 to the Social

Security Act providing for benefits at age 72 for certain uninsured individuals.

Under subsection (a) of the new section 228 an individual is (subject to the limitations provided by sec. 228) to be entitled to benefits if he—

(1) has attained age 72;

(2) attained such age before 1968 or has not less than three quarters of coverage (whenever acquired) for each calendar year elapsing after 1966 and before the year in which he attained such age;

(3) is a resident of the United States (as defined in the second sentence of subsec. (e) of the new sec. 228), and is a citizen of the United States or an alien lawfully admitted for permanent residence who has resided in the United States (as defined in sec. 210(i) of the Social Security Act) continuously during the 5 years immediately preceding the month in which he files application under new section 228; and

(4) has filed application for benefits under new section 228.

Entitlement is to begin with the first month after September 1966 in which the individual becomes entitled to such benefits and is to end with the month preceding the month in which he dies.

Subsection (b) of the new section 228 provides that the benefit amount for any month is to be $35, except that if both husband and wife are entitled (or upon application would be entitled) to benefits under new section 228 for any month, the husband's benefit for such month is to be $35 and the wife's benefit is to be $17.50.

Subsection (c) of the new section 228 provides for the reduction of the benefits under this new provision on account of periodic benefits for which the individuals concerned are eligible under governmental pension systems (as defined in new subsec. (h)(2)).

Under paragraph (1) of the new subsection (c) the amount of the new benefit for any individual is first reduced by the periodic benefits under governmental pension systems for which such individual is eligible.

Paragraphs (2) and (3) relate to husbands and wives and in effect provide that the new benefit amount to which one spouse is entitled will be further reduced, in the manner specified, by a portion of the periodic benefits for which the other spouse is eligible under governmental pension systems.

Paragraph (4) of the new subsection (c) provides in effect that, in determining the eligibility of individuals for periodic benefits under governmental pension systems, applications for such benefits shall be deemed to have been filed and the individuals concerned shall be deemed to have retired.

Paragraph (5) of the new subsection (c) provides that where a periodic benefit is payable on a basis other than a calendar month, the Secretary of Health, Education, and Welfare is to allocate the amount of such benefit to the appropriate calendar months.

Paragraph (6) of the new subsection (c) provides that a monthly benefit amount under the new provision (determined before rounding under new subsec. (c)(7)) of less than $1 is to be reduced to zero. Where both husband and wife are entitled to benefits under the new provision for the month, their benefit amounts are to be reduced to zero only if, after such amounts are combined (but before rounding under new subsec. (c)(7)), they aggregate less than $1.

Paragraph (7) of the new subsection (c) provides that any benefit amount which is not a multiple of 10 cents is to be raised to the next higher multiple of 10 cents. In the case of a husband and wife, this rounding provision is to be applied separately to the benefit of each spouse.

Paragraph (8) of the new subsection (c) provides that, under regulations prescribed by the Secretary of Health, Education, and Welfare, where the amount otherwise payable under the new provision to an individual (or to a husband and wife) is less than $5, that amount may be accumulated. Where the amounts so accumulated equal or exceed $5, they will become immediately payable.

Subsection (d) of the new section 228 provides, in general, that the benefit to which any individual is entitled under section 228 for any month is not to be paid if he receives aid or assistance in the form of money payments in such month under a State plan approved under title I, IV, X, XIV, or XVI of the Social Security Act. Such benefit for any month is also not to be paid if such individual's spouse receives such aid or assistance in such month and the needs of such individual were taken into account in determining eligibility for (or the amount of) such aid or assistance.

Subsection (e) of the new section 228 provides that the benefit to which any individual is otherwise entitled under the new section 228 is not to be paid for any month during which the individual is not a resident of the United States. For this purpose, the term "United States" means the 50 States and the District of Columbia.

Subsection (f) of the new section 228 provides that monthly benefits under the new section are to be treated as monthly insurance benefits under section 202 of the Social Security Act for purposes of sections 202(t) (relating to suspension of benefits of aliens who are outside United States), 202(u) (relating to conviction for certain offenses), and 1840 (relating to payment of premiums for supplementary medical insurance benefits). It is to be noted that this treatment (as monthly benefits under sec. 202) does not apply, for example, with respect to section 226 of the Social Security Act (relating to entitlement to hospital insurance benefits) or to section 202(m) of such act (relating to minimum benefits.

Subsection (g) authorizes to be appropriated to the Federal old-age and survivors insurance trust fund for the fiscal year ending June 30, 1969, and for each fiscal year thereafter, such sums as the Secretary of Health, Education, and Welfare deems necessary on account of—

(1) benefit payments made under the new section 228 during the second preceding fiscal year (and all fiscal years prior thereto which begin after June 30, 1966) to individuals who had less than three quarters of coverage as of the beginning of the calendar year in which falls the month for which such benefit payments were made;

(2) the additional administrative expenses resulting from such benefit payments; and

(3) any loss in interest to such trust fund resulting from such benefit payments and administrative expenses;

in order to place such trust fund in the same position at the end of such fiscal year as it would have been in if such benefit payments had not been made.

Subsection (h) provides definitions for the new section 228.

Paragraph (1) provides that the term "quarter of coverage" includes a quarter of coverage as defined in section 5(1) of the Railroad Retirement Act of 1937.

Paragraph (2) defines the term "governmental pension system" to mean the insurance system established by title II of the Social Security Act or any other system or fund established by the United States, a State, any political subdivision of a State, or any wholly owned instrumentality of any one or more of the foregoing which provides for payment of (*a*) pensions, (*b*) retirement or retired pay, or (*c*) annuities or similar amounts payable on account of personal services performed by any individual (not including any payment under any workmen's compensation law or any payment by the Veterans' Administration as compensation for service-connected disability or death).

Paragraph (3) provides that the term "periodic benefit" includes a benefit payable in a lump sum if it is in commutation of, or a substitute for, periodic payments.

Paragraph (4) provides that the determination of whether an individual is a husband or wife for any month is to be made under the general rules of subsection (h) of section 216 without regard to the special rules in subsections (b) and (f) of such section.

The new subsection (b) of section 302 of the bill, as agreed to in conference, provides that, for purposes of paragraph (4) of the new section 228(a) of the Social Security Act (which requires the filing of an application as a condition of entitlement to the new benefits), applications filed before July of 1966 under section 103 of the Social Security Amendments of 1965 (which provides eligibility for hospital insurance benefits for certain uninsured individuals) shall be treated also as an application for benefits under the new section 228.

DUTY FREE TREATMENT OF GIFTS FROM SERVICEMEN IN COMBAT AREAS

Amendment No. 36: Under existing law (sec. 321(a) of the Tariff Act of 1930) bona fide gifts from abroad may be imported free of duty if the retail value in the country of shipment does not exceed $10. Senate amendment No. 36 adds a new item to the tariff schedules providing for the temporary duty free entry of articles constituting a bona fide gift from a member of the Armed Forces of the United States serving in a combat zone to the extent such articles

in any shipment do not exceed $50 in aggregate retail value in the country of shipment and with such limitations on the importation of alcoholic beverages and tobacco products as the Secretary of the Treasury may prescribe. The provision would apply only if the articles are purchased in or through authorized agencies of the Armed Forces of the United States or in accordance with regulations prescribed by the Secretary of Defense. For purposes of this provision the term "combat zone" is any area designated by the President by an Executive order [E.O. 11216, C.B. 1965–1, 62] under section 112(c) of the Internal Revenue Code of 1954 (relating to exclusion from gross income for certain combat pay of members of the Armed Forces). On April 24, 1965, the President designated Vietnam and adjacent waters as a combat zone.

The Senate amendment applies to articles entered after the date of the enactment of the bill and on or before December 31, 1967.

The House recedes with clerical amendments.

W. D. MILLS,
CECIL R. KING,
HALE BOGGS,
EUGENE J. KEOGH,
JOHN W. BYRNES,
JAMES B. UTT,
Managers on the Part of the House.

[H.R. 6319] [1]

TAX TREATMENT OF EXPROPRIATION LOSS RECOVERIES AND EXTENSION OF TIME FOR FILING MEDICARE SUPPLEMENTARY INSURANCE APPLICATIONS

[Senate Report No. 1091, Eighty-ninth Congress, Second Session]

[April 1, 1966]

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following report to accompany H.R. 6319.

The Committee on Finance, to which was referred the bill (H.R. 6319) to amend the Internal Revenue Code of 1954 to provide for treatment of the recovery of losses arising from expropriation, intervention, or confiscation of properties by governments of foreign countries, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

* * * * * * *

II. SUMMARY

Your committee has adopted the House-passed provisions of H.R. 6319, relating to the treatment of recoveries of foreign expropriation losses. It has, however, added an amendment which amends the Social Security Act, title XVIII, so as to extend through May 31, 1966, the initial enrollment period for coverage under the program of supplementary medical insurance benefits for the aged. This bill, in the case of recoveries of foreign expropriation losses, provides a new set of rules generally limiting the tax on the recovery to the benefit previously received in deducting the loss (but applying current tax rates), taking into account factors such as whether the loss offset income taxed at ordinary income tax rates or capital gains tax rates, and the effect, if any, of the loss on foreign tax credits, etc. In hardship situations the bill also makes provision for payment of the tax on recoveries in 10 equal annual installments bearing interest at 4 percent. A special rule in the case of life insurance companies provides that a recovery, for purposes of this foreign expropriation loss provision, is to include the release of a life insurance reserve (or other item referred to in sec. 810(c)) resulting from the release of liabilities. These provisions apply to recoveries on or after January 1, 1965.

The bill also makes provision for taxing recoveries with respect to foreign expropriation losses where a benefit from a tax deduction was received by one corporation holding securities in another whose property was expropriated. In

[1] Public Law 89-384, page 414, this Bulletin.

such a case the restoration in value of the securities is treated as a recovery and taxed to the corporation receiving the benefit from the loss deduction. This provision applies to taxable years beginning after December 31, 1965.

The Treasury Department has indicated that it has no objection to the House-passed provisions and the Department of Health, Education, and Welfare supports the social security amendment added by your committee.

III. REASONS FOR FOREIGN EXPORTATION PROVISIONS

Recoveries of foreign expropriation losses.—Present law provides an explicit rule in the case of the recovery of a "bad debt," "prior tax," or "delinquency amount." It, in effect, provides (in sec. 111) that the recovery in these cases is to be included in income subject to tax to the extent that the initial deduction offset income subject to tax. However, no account is taken of the fact that the prior deduction in effect offset income which otherwise was not subject to a full tax (e.g., offset a capital gain or income eligible for the Western Hemisphere trade corporation treatment) nor does this rule take into account the fact that the prior deduction may have offset income subject to tax but with respect to which no tax was payable because of the offset of credits against tax (e.g., the foreign tax credit and the investment credit). Although the statutory language under present law refers only to a bad debt, prior tax, or delinquency amount, the regulations also apply this rule with respect to all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years, including war losses, but not including deductions with respect to depreciation, depletion, amortization, or amortizable bond premiums.[2]

Thus, present law has been interpreted as providing that the recovery of losses sustained by reason of expropriation, intervention, seizure, or similar taking of property by a foreign government is to be included in the person's tax base to the extent the deduction for the loss initially taken was included in the tax base at the time of the taking of the property.[3] However, the amount included in income because of the recovery may result in a much greater tax than the tax saved by the original deduction.

Congress, in the Revenue Act of 1964, recognized the tax problems resulting from the numerous cases of expropriation by foreign governments of property of United States taxpayers since World War II, including the major expropriations made in Cuba, beginning in 1959, when substantially all investments in that country were expropriated. The Revenue Act of 1964 dealt with one aspect of the problem raised by these expropriatons; namely, the fact that a longer period than usual was needed to offset these major losses against income. For that reason the Revenue Act of 1964 provided a 10-year carryforward for expropriation losses rather than the generally available 5-year carryforward and 3-year carryback. However, there was not sufficient time when that legislation was considered to deal with the second phase of this problem; namely, the tax treatment to be accorded in the case of the recovery of any of these expropriations or similar takings of property. As a result, in the consideration of the Revenue Act of 1964 the Treasury Department and the congressional staff were requested to develop an appropriate suggestion as to the proper tax treatment of recoveries arising from expropriation, etc., losses. This provision grew out of this study. Your committee agrees with the House that it is important to act on this problem at the present time without regard to the possibility of the timing of any recovery in any specific instance, to assure taxpayers that in the event of a recovery of expropriated property they will be treated fairly under the U.S. tax laws.

The recovery provisions described more fully in "III. General Explanation of Foreign Expropriation Provisions" below are somewhat similar to the provisions of present law relating to a bad debt, prior tax, or delinquency amount (sec. 111). However, there are significant differences. Probably the most important is the fact that in determining the tax benefit of the prior deduction—and, therefore, the tax applicable with respect to the restored amount—tax credits, such as the foreign tax credit and investment credit, are taken into account. This, if because of such credits the deduction of the loss produced little or no actual tax benefit,

[2] Sec. 1.111–1(a) of the regulations.
[3] Separate rules are provided for the recovery of World War II losses.

little or no tax is to be imposed with respect to the recovery under the rules set forth below. Similar treatment is provided where the tax benefit in the year of the loss may have been reduced by lower rates, such as the capital gains rate and the rate applicable to Western Hemisphere trade corporations. The tax benefit, however, for purposes of the recovery will be measured by using the rates in effect in the year of the recovery rather than in the year of the loss.

Another important point of departure from the rule in present law, which is made available in the rules set forth below, relates to the time allowed for the payment of the tax on the recovery. Where certain conditions exist as to the recovery (e.g., the bulk of the recovery is in property rather than cash) up to 10 years is to be allowed for the payment of the tax on the recovered amount. However, these payments will be subject to interest at the rate of 4 percent on the declining balance. Frequently where there are recoveries it is necessary for the taxpayer to invest substantial additional amounts in placing the property in usable condition. Alternatively, the recovery may be made in the form of property which cannot readily be sold for a period of time. Because of these factors, the House-passed bill provides additional time for payment of the tax on these recovered amounts. The interest rate provided is the same as that available under present law for deferred payment of estate tax where it is determined that the full payment of the tax would constitute a hardship.

Decrease of liabilities for life insurance companies.—During the consideration of this bill life insurance companies presented a unique problem. Under the special provisions taxing life insurance companies (secs. 801–820 of the code), there is recognition of the fact that these companies, because of the long-term nature of their business, are entitled to deductions or exclusions for the addition to certain specified reserves (e.g., life insurance reserves). Likewise, when these reserves are no longer needed, they are "released" and become an item of income to the life insurance company. In general, these reserves must be required by State law (see secs. 801 (b) and (c)), which has been interpreted to mean either express statutory law or rules and regulations issued by a State insurance commissioner.

When the assets of a life insurance company are expropriated, a question immediately arises as to whether or not the company is still liable on its insurance policies arising in the country where the act of expropriation occurred. If the liability is no longer in existence, then the reserves behind these policies are no longer required and must be released. This release produces an item of income for a life insurance company under section 809(c)(2). Generally, it is understood that the insurance commissioners under State law do not require the companies to maintain reserves after the assets behind these reserves have been expropriated. In this case, no special problem is presented under the bill.

On the other hand, in some instances under State law the insurance commissioner requires the company to maintain the reserves even through the company's assets in a particular country have been expropriated. In cases where the company disagrees with this interpretation of State law, then the company may litigate its liability under these policies. If the company should be successful in the litigation, then the liability under the insurance contracts is eliminated and the reserves are no longer needed or required by the insurance commissioners under State law. Hence, they are released and become income to the company in the year when the litigation is successful. This will be years after the expropriation occurred and the assets were written off.

For a life insurance company, this release of its liability under its insurance contracts is, in essence, the same as a recovery of a part or all of the assets that had been expropriated. Your committee agrees with the House that a life insurance company should treat the release of reserves as a recovery of a foreign expropriation loss for purposes of this bill.

Restoration of value of securities after expropriation loss.—Present law (sec. 1334) contains a provision dealing with restoration of value of certain investments which were deducted as worthless investments under the World War II loss provisions. Under this provision, if stock in a corporation became worthless because the corporation's assets were seized by Germany during World War II and a deduction for the loss was taken with full tax benefit, then any restoration in value of the stock (by reason of recoveries made by the corporation) is required to be included in gross income in the year of such restoration in value of the stock, even though the stockholder at that time receives no money or other property.

The provision in present law deals only with World War II losses and existing law contains no comparable provision to deal with similar cases which can arise from other foreign expropriations. Your committee also agrees with the House that a comparable provision is needed for recoveries of more recent foreign expropriation losses. Such treatment is necessary if taxpayers in these cases are to be taxed on recoveries of amounts for which deductions previously were taken.

IV. GENERAL EXPLANATION OF FOREIGN EXPROPRIATION PROVISIONS

Recoveries of foreign expropriation losses.—The new provision of the House-passed bill, dealing with the treatment of recoveries by domestic corporations (subject to tax under sec. 11 or 802) of foreign expropriation losses, is elective at the option of the taxpayer, but once applied, is effective to all recoveries with respect to the same expropriation loss. This provision applies only if the corporation was subject to tax as a regular corporation (under sec. 11) or as a life insurance company (under sec. 802) both in the year the expropriation loss was taken and in the year of the recovery. Foreign expropriation losses for this purpose are defined in the same manner as in the case of the 10-year carryforward of losses. They are losses sustained by reason of expropriation, intervention, seizure, or similar taking of property by a foreign government. Included in this category is a debt which becomes worthless by reason of such an expropriation, etc.

The amount treated as recovered for purposes of the new provision is the amount of money and the current fair market value of other property received. For life insurance companies the amount of recovery includes the decrease of any item described in section 810(c) attributable to such foreign expropriation loss. This also is intended to cover the situation when the insurance commissioner under State law does not require the reserves to be maintained following an expropriation, but a subsequent court decision holds the company liable on the contracts. In that event, the company will be required by the insurance commissioner under State law to set up a reserve pending appeal to a higher court. If the ultimate judicial decision holds the company not liable under the insurance contracts, then the company has a decrease of liability which would qualify under the bill. The effect would be that the decrease of liability or release of reserve could be offset against the deduction taken in an earlier year. Of course, a foreign expropriation loss (as defined in sec. 1351(b)) does not include any interest element that may have been added or accrued with respect to the loss after the expropriation occurred. Thus, any such interest element is not subject to the treatment provided in new section 1351. For example, if a life insurance company had insurance reserves of $1,000 at the time the act of expropriation occurred and subsequently added $30 of required interest to the reserve before the recovery occurred, then the amount taken into account for purposes of section 1351(c) is $1,000. The balance, or $30, is an item of income for the year of recovery.

The bill divides the amount recovered into two portions: the amount with respect to which a deduction was taken on account of the loss; and any excess recovery of the amount over the deduction previously taken. The amount representing the deduction previously taken is excluded from gross income. In place of including this amount in income, a tax is computed with respect to this deduction under a "tax benefit" rule.

Any recovery in excess of the deduction previously taken is treated as gain on the involuntary conversion of property (as provided in sec. 1033). Thus, if cash in excess of the deduction previously taken is obtained on the recovery (or other property is obtained which is not of a like kind to that expropriated) and there is no reinvestment of this excess within the time specified under the present law in the case of involuntary conversions, gain is recognized with respect to this excess amount. However, if the property recovered is "similar or related in service or use" (or in the case of real estate of a like kind) or that expropriated or there is a reinvestment in such property to, that extent no gain is recognized at the time of the recovery on this portion of the amount received. Where this is true, the basis of the property is reduced to the extent of the gain which is not recognized because of treatment as an involuntary conversion.

Where both cash and similar, etc., property are received in a recovery and the amount of the recovery exceeds the deduction previously taken, then the cash is

to be first attributed to this deduction and the similar, etc., property, to the extent appropriate, attributed to the excess recovery over this deduction.

The tax computation under the "tax benefit rule," referred to above, is made by decreasing the loss in the year in which the expropriation occurred (or any year to which it was carried) by the amount of the recovery representing this prior reduction. A tax is then computed on this additional income (if any) and added to the tax liability for the year of recovery.

It should be noted that this additional tax is computed by in effect "restoring" the recovered amount back in the year or years in which the deduction was taken. However, for the purposes of this additional tax, the current year's tax rates (under sec. 11) rather than those applicable to the earlier year are to be used, although in other respects the law applicable in the earlier year or years will be applied. Thus, for example, the rules then applicable in the case of multiple surtax exemptions would govern, rather than those applicable in the year of the recovery.

For purposes of this computation of additional tax, if a series of recoveries has occurred, any recoveries made before the one in question are taken into account in determining income of the prior year or years for purposes of determining the additional tax in case of the current recovery. This includes recoveries whether or not this provision was elected (it includes, for example, those coming under sec. 111 of the code as well as the new sec. 1351(g)).

Adjustments are made for all credits against tax and also carryovers and carrybacks of losses or credits which would normally have resulted had the income in the prior year been greater by the amount now being added back. This gives effect, for example, to the foreign tax credit and the investment credit. It is important to note in this respect that where a foreign tax credit, for example, was not fully utilized in prior years because of a loss deduction, part of the deduction did not reduce the tax for those years. As a result a restoration of income where there was an unused foreign tax credit (except to the extent influenced by the foreign tax credit limitation) may not give rise to an additional tax on the recovery under this provision.

In making these recomputations with respect to prior years, the principles set forth in section 1314(a), relating to the correction of errors, are to apply. Thus, for example, there will be no recomputations of other income items or deductions with respect to such a year because of this provision, but limitations will be changed where they would normally have been different had the additional income been received in the prior year. Thus, for example, the 5-percent limitation on charitable contributions will permit a greater deduction where the actual contributions exceeded the amount previously deductible.

For purposes of this recomputation, taxpayers are also allowed a new choice as to whether they desire to deduct foreign taxes or take a foreign tax credit. Similarly, for this purpose, the taxpayer may make a new election between the "per country" and "overall" limitation in the case of the foreign tax credit. The new choice and election, in the case of foreign taxes, are only for purposes of the computation of the additional tax attributable to the recovery. For all other purposes any prior election or choice made is still binding to the same extent as if this provision were not applicable.

The tax benefit rule described above works in such a manner that where a partial recovery of property occurs, if no tax benefit was derived from a part of the prior deduction (e.g., where part of the deduction represented an unused net operating loss), the recovery is not to result in additional tax if the recovery does not exceed the part of the deduction which gave no tax reduction. This occurs since the loss previously taken is only reduced by the amount of the partial recovery and therefore the recomputation still gives rise to no tax.

The bill also provides that, for purposes of this provision, if an investment (such as a stock or bond) becomes worthless by reason of the expropriation of the assets of the corporation which issued the stock or bond, and thereafter there is a restoration in value of the stock or bond because of the recovery by the corporation of its expropriated property, then the value restored will be treated as a recovery.

The tax on the recovery cannot be reduced by foreign tax credits or investment credits available in the year of recovery.

The bill provides that the tax payable with respect to the recovery on a foreign expropriation loss—both that coming under the tax benefit rule attributable to the deduction previously taken and also any gain taxed on excess recovery—may under certain conditions be paid in 10 equal annual installments

bearing interest at 4 percent. As is generally true in the case of installment payments of taxes, if any installment is not paid on time, all of the remaining installments then become due.

The bill sets forth rules to permit the taxpayer to pay the tax attributable to the recovery of foreign expropriation losses over the 10-year period where a hardship situation is likely to exist. Thus, the taxpayer has this option where the money received is less than 25 percent of the recovery and is not larger than the tax attributable to the recovery. In addition, even though the cash payments exceed the 25-percent limit or the tax on the recovery, the Secretary of the Treasury may nevertheless permit the tax to be paid in up to 10 equal annual installments if he finds that the payment of the tax at the time of the recovery would result in undue hardship.

The bill provides that where the taxpayer has elected to pay the tax in 10 equal annual installments and property received on the recovery is sold for cash (or exchanged for other property sold for cash) the taxpayers' right to spread the tax payments over 10 years is modified. In such an event, to the extent the cash received exceeds the 25-percent limit or tax on the recovery if smaller, the remaining tax payments are to become due at the time of the due date for the next tax return. Money received in such a case is always attributed first to the payments with the shortest maturity. Money for purposes of this provision includes the dollar value of foreign currencies.

This provision applies to recoveries on or after January 1, 1965, with respect to foreign expropriation losses sustained after December 31, 1958.

Restoration of value of securities after expropriation loss.—The new provision (sec. 80) added by the House passed bill applies only to restoration in the value of securities (as defined in sec. 165(g)(2)). Without this provision there is no assurance that this restoration of value—for which a loss deduction was previously taken—will result in the imposition of any tax. If a stock or bond became worthless by reason of the expropriation after 1958 by a foreign government of the assets of the corporation which issued the stock or bond, and a deduction for the loss was allowed, and the value of the stock is restored in full or in part during any taxable year beginning after 1965 by reason of the recovery by the corporation of money or other property, under this provision the value restored will be included in gross income subject to two limitations. First, the amount included in gross income is not to exceed the amount of the original loss (the adjusted basis of the stock at the time it became worthless). Second, the amount includible in gross income is to be reduced by the amount, if any, by which the loss did not result in a tax benefit.

The following example will illustrate the application of the new provision. The taxpayer owns stock in a corporation having an adjusted basis of $10,000 and a fair market value of $30,000 at the time Cuba seized all the assets of the corporation. As a result of the expropriation the stock became worthless and the taxpayer deducted the $10,000 as a capital loss which was utilized in full against capital gains. In 1970 the Cuban Government returns property to the corporation with the result that there is a restoration in the value of the taxpayer's stock to $15,000. The first limitation referred to above requires the inclusion in 1970 in gross income of only $10,000 of the $15,000 restoration in value since the original loss was only $10,000. The second limitation referred to above would not apply since eliminating the original capital loss would have produced a tax on $10,000 of capital gains.

In the above example, if only $6,000 of the $10,000 capital loss had been utilized against capital gains, then the second limitation would apply so that the $10,000 restoration in value would be reduced by the $4,000 of the capital loss not utilized. If the restoration in value had been to $3,000 instead of $15,000, then the second limitation would apply so that the $3,000 would be reduced to zero since $4,000 of the original loss did not result in a tax benefit.

The amount included in gross income under this provision will be ordinary income unless the loss resulting from the expropriation was taken into account as a loss from the sale or exchange of a capital asset. In the latter case the restored value taken into gross income will be treated as a long-term capital gain.

This provision will not apply to a restoration in value if the taxpayer elects the application of section 1351 to the recovery or to any prior recovery with respect to the original loss. Section 1351 has its own rules with respect to restoration of value in case of expropriation losses.

The new provision applies to domestic corporations which are subject to the regular corporate tax (imposed by sec. 11) and to domestic life insurance companies (subject to the tax imposed by sec. 802). Thus, the new section will not apply to individuals, estates, or trusts. If a corporation is subject to the regular corporate tax, or the tax imposed on life insurance companies, it would not lose that status because its tax for the year is computed under the alternative tax in case of capital gains.

The new provision applies to restoration in value occurring in taxable years beginning after December 31, 1965, with respect to the specified types of expropriation losses sustained after December 31, 1958.

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[H.R. 9883][1]

SUBCHAPTERS S AND R OF CHAPTER 1 OF THE INTERNAL REVENUE CODE OF 1954

[Senate Report No. 1007, Eighty-ninth Congress, Second Session, Calendar No. 981]

[February 24, 1966]

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following report to accompany H.R. 9883.

The Committee on Finance, to which was referred the bill (H.R. 9883) to amend subchapter S of Chapter 1 of the Internal Revenue Code of 1954, and for other purposes, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

I. SUMMARY

Your committee has adopted the three House-passed provisions of H.R. 9883, relating to the option for corporations and their shareholders to be taxed in a manner similar to partnerships and partners, with only minor technical changes. It has, however, added an amendment relating to the option for unincorporated businesses to be taxed like corporations. This substantive amendment added by your committee repeals the provision of the code which provides a special option for partnerships and proprietorships to be taxed basically like corporations. It also provides for the tax-free incorporation of these businesses in certain cases.

In 1958 Congress enacted a series of provisions (secs. 1371–1377 of the code) designed to permit small business corporations and their shareholders to be taxed basically like partnerships and partners. Thus, corporations electing this status are not subject to tax but, instead, "pass through" to their shareholders the taxable consequences of their activities. This election was granted in order to minimize the effect of Federal income taxes on businessmen's choices of the form of organization which they conduct their business.

Since the enactment of these provisions in 1958, certain problems have arisen with the operation of this election. This bill deals with three such problems. It deals with two types of problems which resulted in unintended burdens and another which presents the possibility of tax manipulation which may lead to unintended benefits.

The first section of the bill provides that distributions of money made within 2½ months after the end of a year are to be considered as distributions of the undistributed taxable income of the corporation, which was taxed to the shareholders on the last day of the corporation's taxable year. As a result, these distributions made in this first 2½-month period will not again be taxed as dividends to the shareholders (as they are under present law where they are treated as distributions out of the earnings and profits of the corporation for the year in which distributed to the extent of those earnings and profits). The change described above applies with respect to distributions made after the date of enactment of this bill. However, for periods back to the adoption of this "passthrough" provision in 1958 this new rule will apply to open years, but on an elective basis and with respect to distributions made in the first 3½ months after the end of the year in question. It is also to apply on an elective basis

[1] Public Law 89-389, page 419, this Bulletin.

to refunds for certain "closed" years where there is a close correlation between the distributions made in such a 3½-month period and the undistributed earnings of the corporation at the end of the prior year.

The second section of the bill amends the "passthrough" election to prevent its use as a device to avoid a capital gains tax. Thus, except where a small business corporation has elected the "passthrough" treatment for the 3 prior years (or from the time of its existence, if shorter), under certain conditions capital gains are to be taxed to the corporation as well as to the shareholders. Capital gains in such cases will be taxed to the corporation (as well as the shareholder) if they are greater than the corporation's ordinary income, but only to the extent they exceed $25,000 (also, only if the corporation's taxable income exceeds $25,000). This provision applies to taxable years of these corporations beginning after the date of enactment of this bill.

The third section of the bill is designed to eliminate the hardship of an unexpected termination of the "passthrough" election where a corporation in its initial period of operation derives more than 20 percent of its income from passive investment sources. This may well occur as a result of it not commencing business operations as soon as anticipated. The bill suspends this 20-percent requirement in the first 2 years of a corporation's active conduct of business where the passive investment income for any year involved is less than $3,000. This provision applies to taxable years of corporations ending after the date of enactment of this bill. It also applies on an elective basis with respect to taxable years beginning after December 31, 1962.

The fourth section of the bill, added by your committee, repeals the provision of the code (sec. 1361) which presently permits proprietorships and certain partnerships to elect to be taxed basically like corporations. This provision, which is substantially the reverse of the "passthrough" treatment described above, preceded the "passthrough" treatment in adoption, having been enacted in 1954. The repeal of this provision will become effective January 1, 1969. In the meanwhile, a partnership or proprietorship which had previously made this election is permitted to become an actual corporation in a tax-free reorganization. After the date of enactment of this bill, no partnership or proprietorship which is not already under the election will be permitted to elect the corporate tax treatment.

The Treasury Department has indicated that it has no objection to the House-passed provisions and favors the adoption of the amendments made by your committee.

II. GENERAL EXPLANATION

A. DISTRIBUTIONS AFTER THE END OF THE YEAR (SEC. 1 OF THE BILL)

While the tax treatment accorded the small business corporations and their shareholders is similar to the Federal income tax treatment accorded partnerships and their partners, certain differences continue as a result of the corporate form of these organizations. For example, one of these small business corporations may have previously been taxed as a regular corporation with the result that when these earnings and profits previously earned are treated as distributed, they represent an ordinary dividend from a corporation.

The present small business corporation provision treats distributions of money made during the corporation's year as being made first out of the corporation's earnings and profits of that year. If the corporation's income for the year exceeds these actual distributions made during the year, then this remaining income is treated as if it were distributed to the shareholders on the last day of the corporation's year and taxed to the shareholders as if received by them at that time. On the other hand, if the small business corporation actually distributes more money than its income for the year, this excess amount would generally be considered as the income of the prior year or years. If the corporation had elected this "passthrough" option in the prior year, this excess amount would not be taxable to the shareholders but only if this amount had already been taken into the shareholders' income in a year prior to that in which they received the distribution.

While in most respects the rules described above as to the order of distributions have worked well, nevertheless, they have presented problems where distributions have been made shortly after the end of a year. As a practical matter, corporate officers frequently do not know the amount of the corporation's income until after its year has ended. Consequently, it is difficult to distribute the entire amount of the corporation's income within the year. (This problem

has been met elsewhere in the internal revenue laws by allowing amounts distributed for a limited period after the end of a year to be treated as a distribution made during a year.) In addition, taxpayers who think of small business corporations as being taxed like partnerships fail to recognize the significance of the timing of a distribution by the corporation. In the case of a partnership, the income of the partnership is taxed to the partners, whether or not distributed, and the timing of the distribution of the partnership earnings as such makes little or no difference for tax purposes.

The effect of postponing a distribution until after the end of the year in the case of a small business corporation in some cases has little tax consequences, while in other cases it can work substantial hardships on the shareholders.

One type of situation where hardship may exist in the case of such a distribution made shortly after the end of a year arises where the shareholder is on a taxable year ending 1 month or more after that of the corporation. This can be illustrated by a corporation with the taxable year ending on November 30 and a shareholder with a taxable year ending on December 31. In such a case, if the corporation has made no distribution by November 30, each shareholder is taxed on his proportionate share of the taxable income of the corporation for that year. If the corporation then distributes this income to the shareholders during December, the shareholder will be faced with a double inclusion of the corporation's earnings in 1 year since such a shareholder first is taxed on his share of the undistributed earnings as of November 30; then, when the actual distribution is made in the following December, it is treated as a distribution out of the earnings and profits of the corporation for that following year. Thus, this distribution, too, is taxable to the shareholder.

It is, of course, true that in the shareholder's next year he will not be taxed on the corporate earnings for that year (assuming the profits for the year do not exceed the distribution). However, because of the progressive structure of the individual income tax rates, such a shareholder may suffer a substantial detriment by having two inclusions made in 1 year with respect to what was intended to be the same corporate earnings even though he is not taxed on these corporate earnings in the following year.

Another problem has arisen because a distribution is treated as being paid out of the prior year's undistributed taxable income only when this income already has been taxed to the shareholders at the time of the actual distribution. The problem arises when the year of a shareholder, to which the undistributed taxable income is attributed for tax purposes, extends beyond that of the corporation and has not closed prior to the time of the actual distribution. (See regulations, secs. 1.1375–4(d) and 1.1375–4(g), example No. 2.) In such cases if there is no undistributed taxable income in prior years, the distribution may be treated as being paid out of earnings and profits of the corporation for years before it elected the "passthrough" treatment and therefore be treated as an ordinary dividend to the shareholder.

Problems have also arisen, whether or not the corporation and shareholders are on different years, where for one reason or another the "passthrough" election is terminated in the year in which the actual distribution is made. The problems become particularly severe where the corporation does not intend to distribute its profits of this second year. In such a case, despite this intent, the actual distribution made (which the corporation intended to be out of the earnings of the prior year) nevertheless, is treated as a dividend in the actual year of distribution. As a result, the shareholder is taxed on these amounts at this time and also is taxed on the earnings of the prior year which were undistributed at the end of that year. A number of problems of this type have occurred since 1958 in the operation of these provisions, working unintended hardships on shareholders.

Section 1 of this bill deals with this problem for the future and also provides a mechanism for the relief of those taxpayers who were misled in their understanding of the "passthrough" election in the past.

The bill provides, in the case of an electing small business corporation, that distributions of money to shareholders within 2½ months after the close of a taxable year are to be treated as distributions of the corporation's undistributed taxable income for the year just ended, to the extent that these distributions do not exceed this undistributed taxable income. This treatment is similar to that provided in the case of accumulated earnings tax and in the case of personal holding companies. This rule is expected to afford corporations a reasonable time after the end of a year to determine how much their profit was and to dis-

tribute it to their shareholders. Yet, the period within which these distributions must be made is sufficiently short so that the shareholders can, in effect, elect to treat distributions (by waiting 2½ months) as having been made out of the current year's income without unduly delaying the distribution in order to achieve that result.

Present law (sec. 1375(e)) already permits distributions of the proceeds of a sale of capital assets to be treated as having been made on the last day of the taxable year within which the sale occurred, if the distributions are made within 2½ months after the end of that taxable year and were made pursuant to a resolution of the board of directors adopted before the end of the year in question. This treatment is available only if each shareholder owns the same proportion of the corporation's stock on the distribution date as he did on the last days of the corporation's last taxable year.

In view of the significant overlap between this existing subsection and the new subsection added by this bill, your committee agrees with the House that the retention of the existing subsection (sec. 1375(e)) is unnecessary and therefore this bill repeals this subsection. However, because corporations already may have entered into transactions intending to use this subsection, the repeal is to affect only distributions made after the close of taxable years beginning after the date of enactment of this bill. Thereafter, corporations should be able to qualify such transactions to a substantial degree under the new provision.

As has been indicated, it appears that numerous persons have misunderstood the distribution rules under existing law, assuming that the profits of an electing small business corporation could be distributed after the end of the year without tax effect in the same way as the profits of a partnership. Because of this apparently widely held misunderstanding, the bill applies the new provision described above, on an elective basis, to distributions made under similar circumstances before the enactment of this bill. Because any such application of this provision might affect adversely the tax liabilities of some shareholders, and (depending upon the circumstances of the individual case) might affect the corporation's accumulated earnings and profits, the bill requires this election to be consented to by all persons who were shareholders at any time on or after the date of the first applicable distribution, unless the Treasury Department determines that the nonconsenting shareholder's potential, and actual, tax liabilities could not be affected by the election.

Your committee also agrees with the House that it was appropriate in these cases to allow up to the ordinary time for filing individual income tax returns after the end of the year in these cases—namely, 3½, rather than 2½, months after the end of the year for these past distributions—since some such distributions apparently were not made until needed to make income tax payments for shareholders.

Elections regarding these past distributions must be made within 1 year after final regulations are published in the Federal Register.

Interest on deficiencies or overpayments resulting from elections regarding past distributions is not to be required or allowed for any period prior to 2 years after the publication of final regulations.

The bill provides that an election regarding past distributions may normally be made only as to a year that is still open. However, a credit or refund may be made for a closed year where the qualifying distributions (or the first few qualifying distributions) substantially equaled the undistributed taxable income of the corporation for its prior year. In addition a closed year may be opened for refunds if the taxpayer can show to the satisfaction of the Secretary of the Treasury or his delegate that the distributions were intended to be made out of the undistributed taxable income. Pertinent information might, for example, include a showing that the shareholders treated the distributions on their personal income tax returns as having been made out of the electing small business corporation's prior year's undistributed taxable income, a showing that the distributions approximated the shareholders' taxes on the prior year's income from the corporation, or a showing that on the corporation's tax return (as a part of the information required on the return by sec. 6037 of the code) it had treated such distributions as being made out of the prior year's undistributed taxable income.

Although it is expected that an election will not be made to apply the new provision to past distributions unless a refund will be available for the year designated in the election, other changes caused by the election might result in deficiencies for some stockholders for some of the intervening years which

also may have been "closed." In order to avoid manipulation of open overpayment years against closed deficiency years, the bill provides that the statute of limitations for deficiencies for any years involved is not to expire for 1 year after the last date for filing an election under this provision.[2]

If the deficiency year would otherwise have been closed, then the deficiency may not exceed the amount attributable to an election under this provision.

If a claim for refund would not have been barred on the date of enactment of this bill but the statute of limitations would normally expire before 2 years after the final regulations on this point are published, then the years would remain open for the refund until the end of the 2 years. In this situation the refund may not exceed the overpayment attributable to an election under the proposed new provision.

B. AVOIDANCE OF CAPITAL GAINS TAX AT CORPORATE LEVEL (SEC. 2 OF THE BILL)

It has come to your committee's attention that the "passthrough" election has on occasion been used by corporations as a device for the avoidance of capital gains tax: A corporation in such a case arranges to have a large amount of capital gains realized in 1 year, elects the "passthrough" treatment for that year, distributes these realized capital gains, and then deliberately causes its "passthrough" status to be terminated. This avoids a capital gains tax at the corporate level and substitutes capital gains tax for an ordinary (dividend) income tax at the shareholder level. Normally, this could be done where a corporation sold its assets and completely liquidated within a 12-month period (under the provisions of sec. 337). However, by using the "passthrough" treatment the shareholders can obtain the same results without liquidating the business.

Such use of the "passthrough" treatment is contrary to the intent of Congress when it enacted this provision. It was basically intended for an operating business which for business reasons desired the corporate structure yet preferred tax treatment similar to that accorded a partnership. It was intended for an organization desiring this tax treatment at least for a number of years and certainly not for a single year as a device to avoid capital gains tax to the corporation.

This bill provides for the problem described above by adding a new provision (sec. 1378) to the tax laws imposing a tax upon the capital gains of a corporation which has elected the "passthrough" treatment under certain limited conditions. This tax is imposed only when the electing corporation has an excess of net long-term capital gain over any net short-term capital loss which exceeds its other taxable income and also exceeds $25,000.[3] In addition, where the corporation would have a loss for the year but for the excess of capital gain referred to above, the tax will apply only if the taxable income (taking into account this capital gain) is over $25,000.

Since this provision is intended to apply only in those situations where the "passthrough" treatment was elected to avoid taxes on capital gains, the tax is not to be applied in the case of corporations which have been under a "passthrough" election for at least the 3 immediately prior years. Alternatively the tax will not apply in the case of new corporations which have been in existence for less than the 3 prior years but have made the "passthrough" election for the entire period of their existence.

Where the conditions set forth above exist, a tax is to be imposed upon the electing corporation, equal to 25 percent of the excess of the net long-term capital gain over net short-term capital loss, but only to the extent this exceeds $25,000. However, the tax in no event is to exceed the tax which would have been imposed if the corporation had not elected the "passthrough."[4]

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[2] A deficiency assessment is not to be barred by the statute of limitations under these circumstances even if the statute has already run by the time the election is made and even if an assessment would normally be barred on account of a court decision as to the taxpayers' income tax liability for that year or because a binding closing agreement had been entered into for that year between the taxpayer and the Internal Revenue Service. Of course, the usual limitations in sec. 6213(a) on the Government's right to assess a deficiency will continue to apply and the running of the extended period of limitation will be suspended where sec. 6503 applies.

[3] Taxable income for this purpose is computed in the same manner as for corporations generally except that no deduction is allowed for a net operating loss carryover, for dividends received or for other deductions specified in secs. 241 to 247 of the code, inclusive.

[4] For this purpose the tax is computed on taxable income as defined in footnote No. 3.

The tax imposed on an electing corporation by this provision will reduce the undistributed taxable income of the corporation and will therefore reduce the amount of income taxable to the shareholders by a like amount. As a result, the shareholders will not be required to pay a tax upon an amount which the corporation in fact paid out as its own tax. The income taxable to the shareholders, however, retains its character as capital gain.

The new provision (in sec. 1378(b)) which sets forth the tax rates, provides that credits generally are not to be allowed against the new capital gains tax imposed at the corporate level. This rule as to credits is designed to insure that the new provision will not extend to these "passthrough" corporations credits for which they would not be eligible in the absence of the special capital gains tax. This is consistent with the rule under present law, that if a corporation which has elected "passthrough" treatment would otherwise be entitled to an investment credit carryback or carryover from a year when the corporation was not subject to this "passthrough" treatment, then neither the corporation nor the stockholders are permitted to receive this credit in a year when the corporation is subject to such treatment. The amount of the carryback or carryover available to be used in the next year would not be changed under present law. However, since a carryback or carryforward generally is reduced by a portion of the corporation's tax liability, and since the new provision added here would impose such a liability upon a "passthrough" corporation for the first time, it may be that the investment credit carryback or carryover would be reduced (in the absence of a provision to the contrary) by a portion of the special capital gains tax even though neither the corporation nor the shareholders are permitted to use the credit. To avoid this result, your committee has added a technical amendment to provide that this tax is not to be treated as a tax for purposes of determining the amount by which the investment credit carryover or carryback is reduced.

The requirement previously described, to the effect that a corporation will be subject to this special 25-percent capital gains tax unless it has elected the "passthrough" treatment for the 3 prior years, could be avoided (were no limitation to be imposed) by having an existing corporation participate in a reorganization and having a new corporation which comes out of the reorganization elect the "passthrough" treatment immediately upon its creation, or by transferring property in a tax-free transaction to a corporation which previously has made this election. In order to prevent these results, the bill provides that the tax is to apply to gains and losses from the disposition of property by an electing corporation if (1) the property was acquired in the year in question or within the 3 prior years; (2) the property was acquired from a corporation which was not itself an electing corporation during any of this period up to the time of the acquisition; and (3) the property has a substituted basis in the hands of the electing corporation. Thus, the special 25-percent tax will apply in those cases where the property in question was acquired in a tax-free transaction (such as the various types of corporate reorganizations) and the corporation from which the property was acquired had not used the "passthrough" election during any of this period up to the time of the acquisition. Where that corporation had itself acquired the property in a tax-free transaction, then this test would apply to the corporation from which that corporation had acquired the property.

This provision would apply to corporate taxable years beginning after the date of enactment of the bill.

C. PASSIVE INVESTMENT TEST IN THE CASE OF NEW BUSINESS (SEC. 3 OF THE BILL)

When the "passthrough" type of tax treatment was provided for corporations, Congress decided to limit the availability of this treatment to small businesses actively engaged in trades or businesses. Therefore, it denied this treatment to corporations with large amounts of passive income. Accordingly, present law (sec. 1372(e)(5)) provides that a "passthrough" election is to determine automatically where more than 20 percent of a corporation's gross receipts are derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities. To prevent a corporation from electing in and out of the "passthrough" status, present law (sec. 1372(f)) also provides that generally where a corporation terminates its "passthrough" election, it may not again elect this status until after the lapse of a 5-year period.

Attention has been called to a type of instance, which may well occur with some frequency, where the provisions described above work unintended hard-

ships. New corporations, electing the "passthrough" treatment and intending to commence the operation of businesses, frequently have to improve real property and acquire tangible personal property before they can actually begin operations. Because of construction delays, or delays in obtaining the tangible personal property, the corporations may not produce the anticipated operating receipts in their first or second year of operation. Meanwhile, funds accumulated to pay the cost of construction (or the purchase price for the tangible personal assets) normally remain in interest-bearing accounts awaiting the subsequently required payments. The interest thus produced may well amount to more than 20 percent of a corporation's gross receipts particularly since its operating income may not yet have really begun to come in. Where this happens a corporation's "passthrough" status may automatically terminate. This status then cannot generally be renewed for 5 years.[5]

To meet this type of problem, the bill provides that a corporation is not to lose its "passthrough" status merely because its passive investment income exceeds 20 percent of its gross receipts during the first 2 taxable years in which it carried on the active conduct of a trade or business if its passive investment income for the year in question is less than $3,000.

This provision is to apply to corporate taxable years ending after the date of the bill's enactment. It is also to apply to earlier years beginning after December 31, 1962, at the election of the corporation if all persons who were shareholders at any time during those years consent to the application of this provision.

D. REPEAL OF PROVISIONS PERMITTING UNINCORPORATED BUSINESSES TO BE TAXED AS CORPORATIONS; TAX-FREE INCORPORATIONS OF SUCH BUSINESSES (SEC. 4 OF THE BILL)

1. Repeal of provision

In 1954 the Congress enacted a provision (sec. 1361) to permit proprietorships and partnerships to elect to be taxed basically like corporations.

The latest available Internal Revenue Service statistics indicate that there are probably fewer than 1,000 business entities which have elected this corporate tax option. Your committee has concluded that a provision of this complexity which has proved to be of such limited usefulness should not be continued.

Accordingly your committee's amendment repeals this provision. However, to permit businesses subject to this provision to plan their affairs in light of this repeal, your committee's amendment makes this repeal effective January 1, 1969. In the meanwhile, no new elections under this provision are to be permitted, but (as further explained below) entities presently subject to this provision will be permitted to incorporate in a tax-free reorganization. They may also liquidate in this period without incorporation.

Under present law (sec. 1361(f)) where there is a change of 20 percent or more in profits or capital interests of a business which has made this election, a new election must be made. Under your committee's amendment, such an election to continue the corporate tax treatment will be permitted until December 31, 1968, despite the general prohibition referred to above with respect to new elections.

2. Tax-free reorganizations

One of the major problems with this election for corporate tax treatment has been that where this election has been made and then subsequently the owners want to actually incorporate the business, this cannot be done in many cases without payment of substantial taxes. This occurs because it has been held that the incorporation of such a business must be treated first as a taxable liquidation of the business subject to the election and only then as the incorporation of the business. Two Tax Court decisions have agreed with the regulations (Regulations, sec. 1.1361–5(b)) in this respect.[6] This has proved to be a

[5] Under present law (sec. 1372(f)) a new election may be made in the 5-year period if the Commissioner of Internal Revenue gives his consent. However, in cases of this type the shareholders may not be aware of the fact that their election has been terminated until a revenue agent audits the corporation's return, some years later. Since a new election can have almost no retroactive effect (sec. 1372 (c)(1) and (d)), the shareholders in such cases usually cannot undo much of the effects of the termination.

[6] One decision was affirmed per curiam by the Court of Appeals for the Third Circuit and the other has been on appeal to the Court of Appeals for the Fifth Circuit for 17 months.

trap for the unwary and may well account for a substantial proportion of the less than 1,000 businesses under this option. They may not have been aware of this treatment initially and now cannot change their status without payment of heavy taxes. Action on situations of this type becomes especially important because repeal of this option would otherwise result in taxable liquidations, for Federal income tax purposes, of all of these businesses.

In view of the considerations set forth above your committee's amendment repeals the portions of this option resulting in this "liquidation-incorporation" concept in the regulations effective with the enactment of this act. Thus an incorporation of the business is to be treated under the provisions of present law relating to corporate organizations, reorganizations, etc. (pts. III and IV of subch. C of ch. 1 of the code). This in such cases generally will result in the tax-free incorporation of one of these businesses. However, to the extent that money or other property is withdrawn from the business and does not go over to the corporation, tax will apply in the same way as in the case of "boot" in any other corporate reorganization which otherwise is tax-free.

3. Revocation of elections

In view of your committee's amendment repealing this provision effective January 1, 1969, your committee sees no reason why an unincorporated business which has made an election to be taxed like a corporation should be required to remain in that status until that date, whether or not the owners of the business desire to form an actual corporation to continue the business. Accordingly, your committee has included an amendment to permit an election to be revoked on or before December 31, 1968. If an election is not revoked on or before this date, it will terminate on January 1, 1969. The revocation or termination of an election (without any transfer to an actual corporation) under your committee's amendment will be treated, for Federal income tax purposes, as a complete liquidation of a corporation.

III. TECHNICAL EXPLANATION

SECTION 1. DISTRIBUTIONS OF SUBCHAPTER S CORPORATIONS AFTER CLOSE OF TAXABLE YEAR

(*a*) *Distributions within 2½-month period after close of taxable year.*—Under existing law, distributions of money by an electing small business corporation to its shareholders (other than distributions with respect to which an election is made under sec. 1375(e) of the code) are dividends out of earnings and profits of the taxable year in which the distributions are made to the extent of such earnings and profits. Further, under section 1375(d), such distributions in excess of earnings and profits of the year of distribution may be nondividend distributions of previously taxed income to a shareholder of such corporation only to the extent of amounts which have been included in his gross income under section 1373(b) for his taxable years ending before such distributions. Also, under existing law if an election under section 1372(a) is terminated under section 1372(e), the corporation may not, during the first taxable year to which the termination applies or during any subsequent taxable year, make nondividend distributions of previously taxed income of taxable years prior to the termination.

Distributions of undistributed taxable income

Subsection (a)(1) of the first section of the bill amends subchapter S of chapter 1 of the code by adding a subsection (f) to section 1375. Paragraph (1) of new section 1375(f) provides that any distribution of money made by a corporation which was an electing small business corporation for the taxable year immediately preceding the year of distribution (including a corporation with respect to which an election was terminated under sec. 1372(e) for the year in which the distribution is made) shall be treated as a distribution of the corporation's undistributed taxable income for such immediately preceding year—

(1) if it is made after the close of such immediately preceding year and on or before the 15th day of the 3d month following the close of such year;

(2) if it is made to a person who was a shareholder of such corporation at the close of such year; but

(3) only to the extent that such distribution (when added to the sum of all prior distributions of money made to such person by such corporation following the close of such year) does not exceed such person's share of the corporation's undistributed taxable income for such year.

Any distribution so treated shall, for purposes of chapter 1 of the code, be considered a distribution which is not a dividend, and the earnings and profits of the corporation are not to be reduced by reason of such distribution.

Share of undistributed taxable income

Paragraph (2) of new section 1375(f) provides that, for purposes of paragraph (1), a person's share of a corporation's undistributed taxable income for a taxable year is the amount required to be included in his gross income under section 1373(b) as a shareholder of such corporation for his taxable year in which or with which the taxable year of the corporation ends.

Thus, the treatment of distributions provided in new section 1375(f) is applicable only to distributions of money made to persons who were shareholders of the corporation on the last day of the corporation's taxable year immediately preceding the corporation's taxable year in which the distributions are made. Such treatment is applicable to the amount each such shareholder receives only to the extent of the amount required to be included in his gross income under section 1373(b) as a shareholder of the corporation on the last day of such immediately preceding year.

Election under section 1375(e)

Paragraph (3) of new section 1375(f) provides that paragraph (1) shall not apply to any distribution with respect to which an election under section 1375(e) applies. Thus, if a corporation makes an election under section 1375(e) with respect to a distribution of money, the treatment provided by new section 1375(f) does not apply to such distribution.

Repeal of section 1375(e).—Subsection (a)(2) of the first section of the bill repeals section 1375(e) of the code effective with respect to distributions made after the close of any taxable year beginning after the date of enactment of the bill. Thus, an election under section 1375(e) may be made only with respect to proceeds of sales which are made by an electing small business corporation before the close of its first taxable year ending after the date of enactment of the bill.

(*b*) *Technical amendment.*—Subsection (b) of the first section of the bill amends section 1375(d)(2)(B)(ii) of the code to provide that a shareholder's net share of undistributed taxable income for purposes of section 1375(d) (relating to distributions of undistributed taxable income previously taxed to shareholders) is reduced by distributions treated under new section 1375(f) as nondividend distributions.

The provisions of new section 1375(f) of the code are illustrated by the following examples:

Example (1).—*X* corporation, an electing small business corporation which uses the fiscal year ending March 31 as its taxable year, has two shareholders, *A* and *B*, calendar year taxpayers each owning 50 percent of its outstanding stock. For its year ending March 31, 1967, *X* has made no distributions to its shareholders and has undistributed taxable income (as defined in sec. 1373(c)) of $50,000. On May 1, 1967, *X* distributes $25,000 in money to *A* and $25,000 in money to *B*. *X* makes no further distributions to *A* and *B* during the calendar year 1967, even though it has earnings and profits of $60,000 for its taxable year ending on March 31, 1968.

Under existing law, *A* and *B* would each include $50,000 in gross income for the calendar year 1967; $25,000 of this would be includible under section 1373(b) and the other $25,000 would be includible by reason of the May 1, 1967, distribution. Pursuant to new section 1375(f), however, the May 1, 1967, distribution is treated as a distribution of *X*'s undistributed taxable income for its year ending March 31, 1967, and will not increase *A*'s and *B*'s gross incomes.

Example (2).—*Y* corporation, an electing small business corporation which uses the calendar year as its taxable year, has two shareholders, *C* and *D*, calendar year taxpayers each owning 50 percent of its outstanding stock. For its taxable year 1966, *Y* has $20,000 of undistributed taxable income (as defined in sec. 1373(c)). At the beginning of 1967, *C* and *D* each have $25,000 as their respective net shares of previously taxed income, including the $10,000 which was required to be included in the gross income of *C* and *D* for 1966 as their respective

shares of *Y*'s undistributed taxable income for 1966. On February 1, 1967, *Y* distributes $15,000 in money to *C* and $15,000 in money to *D*. *Y* makes no other distributions during 1967 and has $40,000 of taxable income for such year. Of the $15,000 distributions made to *C* and *D* on February 1, 1967, $10,000 of each such distribution is treated as a distribution of *Y*'s undistributed taxable income for 1966, pursuant to new section 1375(f), and is not a dividend to each shareholder. Pursuant to section 1375(d)(2)(B)(ii) of the code, as amended by subsection (b) of the first section of the bill, however, *C*'s and *D*'s net shares of previously taxed income are reduced by the amounts so treated to $15,000 each. The balance of each $15,000 distribution, $5,000, is a dividend to *C* and *D* out of *Y*'s earnings and profits for 1967. At the end of 1967, *Y* has $30,000 of undistributed taxable income, allocated one-half to *C* and one-half to *D* as their respective shares to be included in their gross incomes for 1967.

Example (3).—*Z* corporation, which uses the calendar year as its taxable year, has two shareholders, *E* and *F*, calendar year taxpayers each owning 50 percent of its outstanding stock. *Z* has $10,000 of undistributed taxable income for 1966, a year for which it was an electing small business corporation. On February 15, 1967, *F* sells all of his stock in *Z* to *G*, who does not consent to the election of *Z* to be an electing small business corporation. Thus, the election is terminated effective for 1967 and all succeeding taxable years of *Z*. On March 1, 1967, *Z* distributes $5,000 in money to *E* and $5,000 in money to *G*. Under new section 1375(f), the distribution to *E* is treated as a distribution of *Z*'s undistributed taxable income for 1966 because *E* was a shartholder of *Z* on the last day of 1966 and his share of such undistributed taxable income was $5,000. However, the distribution to *G*, who was not a shareholder of *Z* on the last day of 1966, is a distribution under section 301 of the code, and thus a dividend to the extent provided in section 316 of the code.

(*c*) *Effective date.*—Subsection (c) of the first section of the bill provides that the amendments made by subsections (a)(1) and (b) shall apply only with respect to distributions made after the date of enactment of the bill, except as provided in subsection (d) of the first section of the bill which is discussed below.

(*d*) *Distributions made before date of enactment.*—Subsection (d) of the first section of the bill provides rules for the application of new section 1375(f) (and the amendment of sec. 1375(d)(2)(B)(ii)) of the code to distributions of money made on or before the enactment of the bill. However, new section 1375(f) is not to apply to any such distribution with respect to which an election under section 1375(e) of the code applies.

Election and consents

Subsection (d)(1) of the first section of the bill provides that new section 1375(f) will apply to distributions of money made during any taxable year designated by a corporation, if it elects to have new section 1375(f) apply to all such distributions during such year and to all such distributions during subsequent years. Thus, when a corporation makes an election to have new section 1375(f) apply to distributions of money made on or before the date of enactment of the bill, it must designate a taxable year. New section 1375(f) will then apply to all such distributions made during the prescribed periods following the close of the taxable year immediately preceding the year designated, and each subsequent taxable year. For example, if a corporation designates the taxable year 1959, and it makes an effective election, new section 1375(f) will apply to all distributions of money made by the corporation during the prescribed periods following the taxable year 1958 and all subsequent years of the corporation.

In order for such an election by a corporation to be effective, except as otherwise provided by subsection (d) of the first section of the bill, all persons (or their personal representatives) who were shareholders of the corporation at any time on or after the date of the first distribution with respect to which the election applies, and before the date on which the corporation files the election with the Secretary of the Treasury or his delegate, must consent to such election and to the application of the provisions of subsection (d) of the first section of the bill. The persons who must consent under these provisions include persons who are not shareholders of the corporation at the time of the election but who were shareholders at any time during the period described above. For example, if the taxable year 1959 is the year designated by a calendar year corporation in its election filed on February 15, 1967, and the corporation made its first distribution in 1959 on January 15, 1959, all persons who were shareholders of the corporation at any time on or after January 15, 1959, and before February 15, 1967, including

those who were no longer shareholders on February 15, 1967, must consent in order to have an effective election.

Subsection (d)(2) of the first section of the bill provides that an election by a corporation under such subsection, and the consent thereto by persons who are or were shareholders of such corporation, shall be made in such manner and within such time as the Secretary of the Treasury or his delegate prescribes by regulations. However, the period for making such election is not to expire before 1 year after the date on which the regulations prescribed under subsection (d) are published in the Federal Register.

Consents not required

Subsection (d)(3) provides that the consent of a person to an election by a corporation under subsection (d) (1) and (2) of section 1 of the bill shall not be required if, under regulations prescribed under subsection (d), it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the liability for Federal income tax of such person cannot be affected by the election of the corporation of which he is or was a shareholder. It is possible that a person's liability for Federal income tax may be affected even though he was not a shareholder on the date of the distribution with respect to which new section 1375(f) applies. For example, a reduction in the corporation's earnings and profits made under existing law may be restored under the last sentence of section 1375(f)(1). This restoration could affect the amount of subsequent distributions to a shareholder which are considered dividends out of earnings and profits. In any such case, the consent of such shareholder would therefore be required.

Three and one-half month period

Subsection (d)(4) provides that if a corporation elects to have new section 1375(f) apply with respect to distributions made on or before the date of enactment of the bill, such distributions made on or before the 15th day of the 4th month following the close of a taxable year are treated as distributions of the corporation's undistributed taxable income for such year to the extent otherwise provided in new section 1375(f).

Deficiency assessment

Subsection (d)(5) provides that the statutory period for the assessment of any deficiency for any taxable year, to the extent it is attributable to an election under subsection (d), against the corporation filing the election or any person consenting thereto, shall not expire before the last day of the 2-year period beginning on the date on which the regulations prescribed under subsection (d) are published in the Federal Register. Thus, even though such assessment may otherwise be prevented by any law or rule of law, it may nevertheless be assessed against an electing corporation and the persons consenting thereto until the last day of such 2-year period.

Credit or refund of overpayment

Subsection (d)(6) extends the period within which credit or refund may be allowed or made of certain amounts with respect to which credit or refund is not prevented on the date of the enactment of the bill. If—

(A) credit or refund of the amount of any overpayment for any taxable year attributable to an election under subsection (d) is not prevented, on the date of enactment, by the operation of any law or rule of law, and

(B) credit or refund of the amount of such overpayment is prevented, by the operation of any law or rule of law (other than ch. 74 of the Internal Revenue Code of 1954, relating to closing agreements and compromises), at any time on or before the expiration of the 2-year period beginning on the date on which the regulations prescribed under subsection (d) are published in the Federal Register,

credit or refund of such overpayment may, nevertheless, be made, to the extent such overpayment is attributable to such election, if claim therefor is filed before the expiration of such 2-year period. Thus, subsection (d)(6) applies only to the extent of the amount with respect to which credit or refund is not prevented on the date of enactment of the bill, even though such amount may be less than the amount of any overpayment attributable to the election.

Subsection (d)(7) provides for the allowance of credit or refund of the amount of any overpayment attributable to an election under subsection (d) for any taxable year in which certain distributions were received, even though credit or refund of such overpayment is otherwise prevented on the date of enactment of

the bill by the operation of any law or rule of law (other than ch. 74 of the code, relating to closing agreements and compromises). In such case, credit or refund may be allowed or made if claim therefor is filed before the expiration of the 2-year period beginning on the date on which the regulations prescribed under subsection (d) are published in the Federal Register.

These provisions apply to distributions of money which were, or were part of, one or more consecutive distributions made by a corporation after the close of a taxable year for which it was an electing small business corporation and on or before the 15th day of the 4th month following the close of such taxable year, if the total amount of such distributions was substantially the same in amount as the undistributed taxable income (as defined in sec. 1373(c) of the code) of such corporation for such year. In determining the consecutive distributions, the first distribution of money made after the close of such year must be included.

These provisions also apply to distributions of money made by a corporation after the close of a taxable year for which it was an electing small business corporation and on or before the 15th day of the 4th month following the close of such year, if it is established to the satisfaction of the Secretary of the Treasury or his delegate that such distributions were intended to be distributions of the undistributed taxable income of such corporation for such year.

No interest on deficiencies or overpayments

Subsection (d)(8) of the first section of the bill provides that no interest shall be assessed or collected on any deficiency, or allowed or paid on any overpayment, attributable to an election under subsection (d), for any period before the expiration of the 2-year period beginning on the date on which the regulations prescribed under subsection (d) are published in the Federal Register. These provisions do not prevent the assessment, collection, payment, or allowance of interest which would otherwise be lawful in respect of adjustments which are not attributable to an election under subsection (d), even though such adjustments are for the same taxable year with respect to which there is a deficiency or overpayment attributable to an election under subsection (d). For example, if for a taxable year for which the statutory period for the assessment of a deficiency has not expired, a taxpayer has a deficiency which is attributable, in part, to an election under subsection (d), and if he also has an additional amount of deficiency for such year attributable to an unrelated item, interest may be assessed and collected on the portion of the deficiency attributable to such unrelated item for the period prior to the expiration of such 2-year period.

SECTION 2. TAX IMPOSED ON CERTAIN CAPITAL GAINS OF SUBCHAPTER S CORPORATIONS

(a) *General rule.*—Under existing law, corporations which make an election under section 1372(a) of the code are not subject to the taxes imposed by chapter 1 of the code with respect to the taxable years of the corporation for which such election is in effect. Subsection (a) of section 2 of the bill amends subchapter S of chapter 1 of the code by adding a section 1378, which imposes a tax on such corporations under certain circumstances.

Income requirements

A tax is imposed on an electing small business corporation for a taxable year for which subsection (a) of new section 1378 applies if—

(1) the excess of the net long-term capital gain over the net short-term capital loss of such corporation exceeds $25,000, and exceeds 50 percent of its taxable income (computed as provided in sec. 1373(d) of the code) for such year, and

(2) such taxable income for such year exceeds $25,000.

Amount of tax

Subsection (b) of new section 1378 provides that the amount of the tax imposed by subsection (a) shall be the lower of (1) an amount equal to 25 percent of the amount by which the excess of the net long-term capital gain over the net short-term capital loss of the corporation for the taxable year exceeds $25,000, or (2) an amount equal to the tax which would be imposed by section 11 of the code on the taxable income (computed as provided in sec. 1373(d) of the code) of the corporation for the taxable year if the corporation was not an electing small business corporation.

No credit shall be allowable under part IV of subchapter A of chapter 1 of the code (other than under sec. 39, relating to certain uses of gasoline and lubricating oil) against the tax imposed by new section 1378(a).

The provisions of subsections (a) and (b) of new section 1378 of the code are illustrated by the following examples:

Example (1).—*X* corporation is an electing small business corporation with respect to which section 1378(a) applies for its taxable year 1967. *X* has an excess of net long-term capital gain over net short-term capital loss in the amount of $30,000 for 1967. However, due to an excess of deductions over other income, *X*'s taxable income (computed as provided in sec. 1373(d) of the code) is only $15,000. Thus, although such excess of the net long-term capital gain over the net short-term capital loss ($30,000) exceeds $25,000, and exceeds 50 percent of *X*'s taxable income ($7,500), a tax is not imposed by new section 1378 (a) because *X*'s taxable income does not exceed $25,000.

Example (2).—Assume that *X* in example (1) has taxable income of $40,000. (This amount includes the excess of net long-term capital gain over net short-term capital loss because such gains and losses are included in the computation of taxable income under sec. 1373(d) of the code.) In such case there is a tax imposed by new section 1378(a) of the code. The excess of the net long-term capital gain over the net short-term capital loss ($30,000) exceeds $25,000, and exceeds 50 percent of the taxable income ($20,000); and taxable income exceeds $25,000. The amount of the tax, computed under new section 1378(b)(1) of the code, is 25 percent of $5,000 or $1,250. This is lower than the amount computed under new section 1378(b)(2) of the code which is 22 percent of $40,000 plus 26 percent of $15,000, or $12,700.

Example (3).—Assume that *X* in example (1) has an excess of net long-term capital gain over net short-term capital loss of $125,000 and taxable income of $60,000. In such case there is a tax imposed by new section 1378(a) of the code. The amount of the tax, computed under new section 1378(b)(2) of the code, is 22 percent of $60,000 plus 26 percent of $35,000, or $22,300. This is lower than the amount computed under new section 1378(b)(1) of the code which is 25 percent of $100,000 or $25,000.

Exceptions

Subsection (c) of new section 1378 of the code provides that new section 1378 (a), and thus the tax imposed by such section, shall not apply to certain electing small business corporations

Paragraph (1) of new section 1378(c) provides that new section 1378(a) shall not apply to an electing small business corporation for any taxable year if it was an electing small business corporation for the 3 immediately preceding taxable years. Thus, if an election under section 1372(a) was in effect with respect to a corporation for its taxable years 1964, 1965, 1966, and 1967, new section 1378 (a) does not apply to such corporation for its taxable year 1967 (except to the extent new sec. 1378(c)(3) may apply).

Paragraph (2) of new section 1378(c) provides that new section 1378(a) shall not apply to an electing small business corporation for a taxable year if, at the end of such year (A) it has been in existence for less than 4 taxable years, and (B) it has been an electing small business corporation for each of its taxable years. Thus, new section 1378(a) does not apply to such corporation (except to the extent new sec. 1378(c)(3) may apply) even though it does not meet the tests of new section 1378(c)(1).

Paragraph (3) of new section 1378(c) provides that if the provisions of paragraph (1) or (2) would preclude the application of new section 1378(a) for a taxable year, new section 1378(a) will nevertheless apply for such year under certain circumstances. Under the provisions of paragraph (3), new section 1378(c) will apply for a taxable year if—

(A) there is any long-term capital gain of the electing small business corporation for such year which is attributable to property acquired by it during the period beginning 36 months before the first day of such year and ending on the last day of such year;

(B) such property has a basis in the hands of such corporation determined in whole or in part by reference to the basis of any property in the hands of another corporation; and

(C) such other corporation was not an electing small business corporation throughout that part of the period beginning 36 months before the first day of the taxable year and ending on the day of the transfer during which such other corporation was in existence.

"Transfer," as used in the preceding sentence, means a transfer by such other corporation of the property the basis of which is referred to for purposes of determining the basis of the property to which such long-term capital gain is attributable. The basis of property in the hands of an electing small business corporation may, for purposes of these provisions, be determined by reference to the basis of property in the hands of another corporation whether or not such other corporation transferred such property directly to the electing small business corporation. For example, if corporation *X* merges into corporation *Y*, an electing small business corporation, pursuant to a transaction in which the basis of an asset in the hands of *Y* after the merger is determined by reference to the basis of such asset in the hands of *X* before the merger, then the basis of such asset, or any other asset for which it may be exchanged in a transaction in which gain or loss is not recognized, would be determined, for purposes of paragraph (3) of the new section 1378(c), by reference to the basis of property in the hands of *X*.

If new section 1378(a) would not be applicable to an electing small business corporation for a taxable year but for the provisions of paragraph (3) of new section 1378(c), then the amount of the tax imposed by new section 1378(a), shall be the lower of—

(1) The amount determined under new section 1378(b), or

(2) 25 percent of the excess of the net long-term capital gain over the net short-term capital loss attributable to property acquired as provided in subparagraph (B) and having a basis described in subparagraph (C) of new section 1378(c)(3).

The provisions of subsection (c) of new section 1378 of the code are illustrated by the following example:

Example.—Corporation *X*, which uses the calendar year for its taxable year, has been an electing small business corporation continuously since its taxable year 1958. For 1967, *X* has an excess of $100,000 of net long-term capital gain over its net short-term capital loss, and its taxable income is $150,000. During 1967 *X* recognized $10,000 of long-term capital gain from the sale of property which it acquired from corporation *Y* on March 31, 1964, pursuant to a statutory merger of corporation *Y* into *X* on that date. Such property had a basis in the hands of *X* determined by reference to its basis in the hands of *Y*. Thus, although *X* meets the requirements of paragraph (1) of new section 1378(c), the tax imposed by new section 1378(a) will apply to *X* for 1967 unless *Y* was an electing small business corporation throughout the period January 1, 1964, through March 31, 1964, during which *Y* was in existence. If *Y* was not an electing small business corporation throughout such period, and if *X* had no capital losses for 1967 attributable to property acquired as provided in subparagraph (B) and having a basis described in subparagraph (C) of new section 1378(c)(3), the amount of tax imposed on the income of *X* for 1967 by new section 1378(a) is equal to 25 percent of $10,000, or $2,500, because such amount is lower than the amount determined under new section 1378(b).

(*b*) *Related amendments.*—Paragraph (1) of section 2(b) of the bill amends the table of sections for subchapter S of chapter 1 of the code.

Paragraph (2) of section 2(b) of the bill amends section 1372(b)(1) of the code to provide an exception, for purposes of new section 1378(a), to the rule that electing small business corporations shall not be subject to the taxes imposed by chapter 1 of the code.

Paragraph (3) of section 2(b) of the bill amends section 1373(c) of the code to provide for the subtraction of the amount of the tax imposed by section 1378(a) from taxable income in determining the corporation's undistributed taxable income for a taxable year.

Paragraph (4) of section 2(b) of the bill amends section 1375(a) of the code by adding a new paragraph (3) which provides for the reduction, for purposes of such section, of the amount of the excess of an electing small business corporation's net long-term capital gain over its net short-term capital loss for a taxable year by the amount of the tax imposed by section 1378(a) for such year.

Paragraph (5) of section 2(b) of the bill amends section 46(a)(3) of the code to provide that the tax imposed by section 1378(a) for a taxable year shall not be considered in determining liability for tax for purposes of the credit for investment in certain depreciable property.

(*c*) *Effective date.*—Subsection (c) of section 2 of the bill provides that the amendments made by section 2 of the bill shall apply with respect to taxable

years of electing small business corporations beginning after the date of enactment of the bill.

SECTION 3. EXCEPTIONS TO TERMINATION OF SUBCHAPTER S ELECTION FOR CERTAIN PASSIVE INVESTMENT INCOME

(a) *General rule.*—Under section 1372(e)(5) of existing law, an election under section 1372(a) of the code is terminated if, for any taxable year of the corporation for which the election is in effect, such corporation has gross receipts more than 20 percent of which is derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (gross receipts from such sales or exchanges being taken into account for purposes of par. (5) only to the extent of gains therefrom).

Subsection (a) of section 3 of the bill amends section 1372(e)(5) of the code by changing the heading of paragraph (5) to "passive investment income" and by dividing the paragraph into new subparagraphs (A), (B), and (C).

New subparagraphs (A) and (C) of section 1372(e)(5) contain the same general rule as existing law. However, new subparagraph (B) contains an exception to the application of such general rule. Subparagraph (C) defines the term "passive investment income" to mean the same gross receipts as are taken into account under existing law.

New subparagraph (B) of section 1372(e)(5) provides that new subparagraph (A) shall not apply to a taxable year, and thus an election under section 1372(a) of the code shall not terminate for such year by reason of section 1372(e)(5)(A) if (i) such year is the first taxable year in which the corporation commenced the active conduct of any trade or business or the next succeeding taxable year, and (ii) the amount of passive investment income for such year is less than $3,000. The taxable year in which a corporation commences the active conduct of a new trade or business is not necessarily the first year in which a corporation commences the active conduct of any trade or business. Thus, if a corporation was engaged in the active conduct of one trade or business in any prior taxable year, the taxable year in which such corporation commences the active conduct of a second or new trade or business is not the first taxable year in which such corporation commences the active conduct of any trade or business. Further, the first taxable year in which a corporation commences the active conduct of any trade or business is not necessarily the same year in which a corporation comes into existence.

(b) *Effective dates.*—Subsection (b) of section 3 of the bill provides that the amendment made by subsection (a) shall apply to taxable years of electing small business corporations ending after the date of enactment of the bill. Further, such amendment shall also apply with respect to taxable years beginning after December 31, 1962, and ending on or before such date of enactment, if (1) the corporation elects to have such amendment so apply, and (2) all persons (or their personal representatives) who were shareholders of such corporation at any time during any taxable year beginning after December 31, 1962, and ending on or before the date of enactment of the bill consent to such election and to the application of the amendment made by subsection (a) of section 3 of the bill. Such persons who must consent include persons who are not shareholders on the date of enactment of the bill if they were shareholders during the prescribed period. The effect of an election under these provisions is that a corporation may be an electing small business corporation whose election would, but for these provisions, have terminated under section 1372(e)(5) of the code. If such a corporation has shareholders or former shareholders whose consent is necessary to prevent a termination under section 1372(e)(1), such shareholders may consent to such election under section 1372(a) of the code at such time as the Secretary of the Treasury or his delegate shall prescribe by regulations. Further, the election by the corporation under subsection (b) of section 3 of the bill and the consents thereto shall be made at such time and in such manner as the Secretary of the Treasury or his delegate prescribes by regulations.

SECTION 4. REPEAL OF SUBCHAPTER R

This is a new section added to the bill by your committee. Under existing law (sec. 1361 of the code) unincorporated business enterprises may elect to be taxed as domestic corporations. Once an election has been made, it may not be revoked and the unincorporated business enterprise is thereafter subject to tax as a domestic corporation and the owners are treated as its shareholders, unless the

election is terminated under section 1361(f) of the code by reason of a change of ownership. However, under existing law, parts III and IV of subchapter C of chapter 1 of the code are generally not applicable to unincorporated business enterprises which have made an election.

(*a*) *Status pending repeal—New elections.*—Paragraph (1) of section 4(a) of the bill amends section 1361(a) of the code to provide that no new elections under section 1361(a) may be made after the date of enactment of the bill. However, elections may be made after such date of enactment by unincorporated business enterprises which have a valid election in effect on the date of enactment but which, because of the subsequent application of the provisions of section 1361(f) (relating to change of ownership), would no longer be considered a domestic corporation but for another election under section 1361(a).

Transfer to an actual corporation

Paragraph (2) of section 4(a) of the bill amends section 1361(c) of the code by deleting a reference to section 1361(m); and paragraph (4) of section 4(a) of the bill deletes the provisions of section 1361(m). Section 4(c) of the bill provides that these amendments shall apply with respect to transactions occurring after the date of the enactment of the bill.

The effect of these amendments is to make all of the provisions of parts III and IV of subchapter C of chapter 1 of the code (relating to corporate organizations, and reorganizations, and insolvency reorganizations) applicable to a "section 1361 corporation" and its owners, in the same manner as these provisions are applicable to any true corporation and its shareholders. Thus, for example, if after the date of enactment and before January 1, 1969, the partners of an enterprise, which has a valid election in effect under section 1361(a) transfer all of the assets of such enterprise to an actual corporation and receive stock in proportion to their interests there will be no tax on the transfer of property and on the issuance of stock, under sections 368(a)(1) and 354 of the code. On the other hand, if the partners retain money or property of the enterprise, this may be treated as "boot" for purposes of section 356 of the code.

Revocation and termination of elections

Paragraph (3) of section 4(a) of the bill amends section 1361(e) of the code (relating to irrevocability of elections under section 1361(a)) to provide a reference to new section 1361(n) of the code; paragraph (5) of section 4(a) of the bill adds section 1361(n).

Paragraph (1) of new section 1361(n) provides that an election under section 1361(a) with respect to an unincorporated business enterprise may be revoked after the date of the enactment of the bill by the proprietor of such enterprise or by all of the partners owning an interest in such enterprise on the date on which the revocation is made. The revocation shall be made in such manner as the Secretary of the Treasury or his delegate may prescribe by regulations. The revocation will be effective on the date on which it is made unless the revocation specifies a later effective date and such enterprise shall not be considered a domestic corporation for any period on or after the effective date of the revocation. The section 1361 corporation and its owners shall be treated as if the corporation had distributed its assets in a complete liquidation on the effective date of the revocation, unless such treatment is inappropriate because of the applicability of provisions of the code relating to corporate organizations and reorganizations. Such applicability can result, for example, from a subsequent transfer of assets to an actual corporation.

Paragraph (2) of new section 1361(n) provides that if a revocation under paragraph (1) of an election under section 1361(a) with respect to any unincorporated business enterprise is not effective on or before December 31, 1968, such election shall terminate on January 1, 1969, and such enterprise shall not be considered a domestic corporation for any period on or after January 1, 1969. Of course, if an election with respect to an enterprise terminates on or before December 31, 1968, as a result of the provisions of section 1361(f), and another election under section 1361(a) with respect to such enterprise is not made on or before such date, section 1361(n) is not applicable to such enterprise. If an election is terminated under the provisions of paragraph (2) of new section 1361(n), the section 1361 corporation and its owners shall be treated in the same manner as if a revocation had been made under paragraph (1) of section 1361(n), effective on January 1, 1969.

(*b*) *Repeal of subchapter R.*—Section 4(b) of the bill repeals subchapter R of chapter 1 of the code, and all references thereto contained in the code, effective January 1, 1969.

TAX PROTOCOLS WITH BELGIUM AND GERMANY

[Senate Executive Report No. 7, Eighty-ninth Congress, First Session]

[October 19, 1965]

Mr. FULBRIGHT, from the Committee on Foreign Relations, submitted the following report to accompany Ex. G, 89th Cong., 1st sess., and Ex. I, 89th Cong., 1st sess.

The Committee on Foreign Relations, to which was referred the protocol signed at Brussels on May 21, 1965, modifying and supplementing the convention of October 28, 1948, between the United States and Belgium for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, as amended by supplementary conventions of September 9, 1952, and August 22, 1957, and the protocol between the United States of America and the Federal Republic of Germany, signed at Bonn on September 17, 1965,[1] modifying the convention of July 22, 1954, for the avoidance of double taxation with respect to taxes on income, having considered the same, reports favorably thereon without reservation and recommends that the Senate give its advice and consent to ratification thereof.

GENERAL PURPOSE OF PROTOCOLS

1. Protocol with Belgium[2]

The main purpose of the supplementary income tax protocol with Belgium (Ex. G, 89th Cong., 1st sess.) is to modify the provisions of the basic convention of 1948, as amended, in order to adjust them to the provisions of the new Belgian income tax law of November 20, 1962. According to the Treasury Department, the changes in internal Belgian law required: (1) redesignation of the Belgian taxes to which the convention applies; (2) revision of the provisions concerning the Belgian tax on dividends paid by Belgian corporations to residents, corporations, or other entities of the United States; (3) the addition of new language relating to dividends and interest; and (4) revision of present language regarding the Belgian commitment to provide tax relief for its residents or corporations deriving income from sources within the United States upon which U.S. income tax is levied. In addition, the protocol makes certain technical amendments to the 1948 convention, as amended.

Article II of the supplementary protocol provides that it shall enter into force on the date of the exchange of instruments of ratification and remain in effect with respect to income of calendar or taxable years beginning before January 1, 1968, or with respect to payments made before that date where withholding taxes are involved. It is understood that the modifications contained in the protocol deal with the most urgent questions arising from the new Belgian tax law and that the two countries agreed to consider revision of the entire convention at some future date. Accordingly, in order to insure such consideration, the supplementary protocol may be continued in effect after January 1, 1968, only if an extension of time is agreed to by the two countries through an exchange of diplomatic notes. In no circumstances, however, may the protocol be extended beyond December 31, 1970.

2. Protocol with Germany

This protocol is the outgrowth of discussions over a period of several years between representatives of the United States and the Federal Republic of Germany. It is designed primarily to deal with problems which have arisen as a result of experience in the application of the basic 1954 convention since it became effective and changes that have since been made in the tax laws of the two countries.

The protocol with Germany contains 18 articles, the first 15 of which would effect substantive modifications in the 1954 convention. For example, the protocol

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[1] Page 360, this Bulletin.
[2] Has not been ratified by Belgium.

contains new provisions, unilateral in application, which would exempt U.S. residents and companies from German capital taxes with respect to certain forms of property. In addition, American nonprofit institutions would be accorded exemption from German tax comparable with that accorded German nonprofit institutions under U.S. law.

The protocol also makes various other amendments or would insert in the convention new provisions covering a broad range of subjects, including the taxation of industrial and commercial profits, dividends, interest, rents, royalties, and capital gains, as well as a redefinition of the concept of "permanent establishment," and the granting of relief from double taxation by the country of the taxpayer's residence. Moreover, the protocol contains a new provision empowering the competent authorities of the two countries to make adjustments in tax liability, including refunds, and determinations as to the source of particular items of income, in order to avoid double taxation in appropriate cases.

Article 17 of the protocol provides that it shall come into force on the date of the exchange of instruments of ratification and that the articles thereof, with certain exceptions, shall have effect for taxable years beginning on or after the first day of January in the year in which such exchange takes place.

A detailed explanation of the provisions of the tax protocols with Belgium and Germany is contained in the technical memorandum on each protocol which was prepared by the Treasury Department. These have been incorporated in the printed hearings which were held before the Subcommittee on Tax Conventions of the Committee on Foreign Relations on October 13, 1965.

COMMITTEE ACTION

The supplementary income tax protocol with Belgium was signed on May 21, 1965, and transmitted to the Senate on August 5, 1965. The tax protocol with the Federal Republic of Germany was signed on September 17, 1965, and transmitted to the Senate on September 29, 1965. The Subcommittee on Tax Conventions under the chairmanship of Senator Gore held a public hearing on October 13, 1965, at which time testimony in support of the protocols was received from Mr. Stanley S. Surrey, Assistant Secretary of the Treasury, and Mr. George V. Allen, president of the Tobacco Institute, who testified for the Chamber of Commerce of the United States. In addition, statements recommending favorable and early action on the protocols were received from the Department of State and the National Foreign Trade Council. No witness testified against the protocols and the committee has not received any communications opposing either of them.

The Committee on Foreign Relations considered the tax protocols with Belgium and Germany in executive session on October 19, 1965. At that time additional testimony was received from Mr. Stanley S. Surrey and Mr. L. N. Woodworth, chief of staff, Joint Committee on Internal Revenue Taxation, and the committee ordered the protocols reported favorably with the recommendation that the Senate give its advice and consent to their ratification.

ANALYSIS OF PROTOCOLS

Set forth below are two memorandums relating to the tax protocols with Belgium and Germany which were prepared by the staff of the Joint Committee on Internal Revenue Taxation.

LETTER OF TRANSMITTAL

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, October 14, 1965.

Hon. ALBERT GORE,
Chairman, Subcommittee on Tax Conventions, Foreign Relations Committee, U.S. Senate, Washington, D.C.

DEAR SENATOR GORE: At your request the staff of the Joint Committee on Internal Revenue Taxation has reviewed the provisions of the Supplementary Income Tax Protocol With Belgium (Ex. G, 89th Cong., 1st sess.) and the Tax Protocol With the Federal Republic of Germany (Ex. I, 89th Cong., 1st sess.).

The memoranda prepared by the joint committee staff summarizing the principal provisions of each of these protocols are enclosed.

Sincerely yours,

LAURENCE N. WOODWORTH,
Chief of Staff.

PROPOSED PROTOCOL AMENDING INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND BELGIUM

(Memorandum from the staff of the Joint Committee on Internal Revenue Taxation)

The pending protocol is a modification of the existing income tax convention between the United States and Belgium. The modifications proposed by the protocol are necessary in order to conform the existing convention to the provisions of the new Belgian income tax law of November 20, 1962. The modifications suggested by the protocol are temporary in nature and will not be effective beyond January 1, 1971.

The major substantive changes provided by the protocol which affect U.S. persons are the limitation tax on dividends received by U.S. persons from Belgian sources, in most cases to 15 percent, and limitation Belgian tax on U.S. citizens who are residents of Belgium to 15 percent on their U.S. source investment income after allowance of the Belgian lump sum foreign tax credit. There follows a summary of the provisions of the protocol.

ARTICLE I

TAXES AND AREAS COVERED

Belgian taxes

The protocol contains an amendment modifying the Belgian taxes which are to be subject to the convention. Presently, the convention specifies that the Belgian income taxes, the national crisis tax, and the personal complementary tax, including all additions to these taxes, are subject to the convention. The amendment proposed by the protocol would substitute a specific list of the recently enacted Belgian taxes. The taxes listed include the four types of direct income taxes: (1) the individual income tax; (2) the corporate tax; (3) the income tax on legal entities; and (4) the income tax on nonresidents, as well as the prepayments and additional prepayments which relate to the four types of direct income taxes and the proportional taxes supplementing the direct income taxes. As indicated, the substitution of this list of new Belgian taxes is necessary to conform the convention to the substantial amendments made to the Belgian tax system in 1962.

Areas

Reference to Alaska and Hawaii as U.S. territories is deleted since these former territories are now States.

DIVIDENDS

The existing convention contains a provision that the rate of U.S. tax on dividends derived from sources within the United States by a resident or corporation of Belgium, not having a permanent establishment within the United States, is not to exceed 15 percent. It also provides that Belgium is not to impose any tax on dividends derived from sources within Belgium by a resident or corporation of the United States not having a permanent establishment within Belgium if the tax is (*a*) in the nature of a personal complementary tax or surtax, or (*b*) any tax similar to that withheld at the source on dividends under U.S. law in the case of nonresident aliens or foreign corporations.

However, the new Belgian income tax law subjects dividends received by nonresidents to the "précompte mobilier." This is a "prepayment" or withholding tax levied on income from personal property received by both residents and nonresidents. It is levied in two parts: the standard personal property prepayment and the additional personal property prepayment. The standard prepayment is withheld at the source at the rate of 15 percent on 121.4 percent (the base is grossed up to, in effect, restore the Belgian creditable portion of the corporate tax to the base) of the amount distributed (effective rate on net distribution: 18.2 percent).

The additional prepayment is also a 15-percent tax, but it is only levied on the amount of income distributed less the standard prepayment. However, if adequate information about the recipient is supplied to the tax authorities, the additional prepayment is not due and the total tax withheld is only the standard prepayment tax of 18.2 percent.

It is our understanding that the Belgian tax authorities have taken the position that the standard prepayment may be imposed on the dividend income received by nonresident U.S. persons notwithstanding the above-mentioned treaty provisions. They are of the opinion that this prepayment does not constitute a tax similar to that withheld at source on dividends under U.S. law in the case of nonresident aliens or foreign corporations.

The proposed protocol does not alter the provisions of the existing convention relating to the U.S. tax (15 percent) on Belgian-source dividend income. However, as a result of the modifications of Belgian law with respect to the recent changes in the Belgian taxation of dividends received by U.S. persons who do not have permanent establishments in Belgium, substantial changes are provided in the proposed protocol as to Belgian taxation of dividends.

It provides that the tax on a U.S. resident corporation which does not have a permanent establishment in Belgium is not to exceed 15 percent on dividends received from Belgian sources as determined by existing Belgian law (i.e., the standard prepayment tax). Under Belgian law, the effective rate of this tax is 15 percent, computed on a grossed-up base or 18.2 percent on a net basis. However, the gross-up does not apply if the shares giving rise to the dividends are registered and have been held for more than 12 months. Therefore, the effective, as well as the stated maximum rate of tax on dividend income, if the shares are held in registered form, will be 15 percent.

Apparently, the 18.2-percent effective treaty rate of tax on bearer shares as opposed to the 15 percent on registered shares, is designed to avoid administrative problems in Belgium. Generally, holdings of parents in Belgian subsidiaries are in registered form. It is expected that this higher rate of tax on bearer shares will be eliminated by the end of the period of this protocol and that in a subsequent protocol the same effective rates will apply to all dividends received from Belgian sources.

The protocol also provides a specific exemption from the Belgium additional personal property prepayment with respect to dividends and interest paid to a resident, corporation, or entity of the United States not having a permanent establishment in Belgium. Also, each country agrees to exempt from tax dividends and interest paid by a corporation of the other country to a person other than its own citizen, resident, corporation, or other entity.

RELIEF FROM DOUBLE TAXATION

U.S. credit provision

The existing convention provides that the United States is to allow U.S. taxpayers a credit against their U.S. tax for Belgian taxes paid on Belgian source income as provided by section 131 of the Internal Revenue Code of 1939. Since the Internal Revenue Code has undergone many changes since the effectuation of the existing convention and may, in the future, undergo further changes, the substitute language of the proposed protocol, in general terms, grants a credit to U.S. taxpayers for the taxes covered by the convention which are paid to Belgium. Such a provision, while continuing to grant a credit, allows the credit to be computed on the basis of U.S. law in existence at the time the income is received. It should be noted that under the proposed protocol, the credit is limited to that portion of the U.S. taxes which net income from sources within Belgium bears to the taxpayer's total net income. This concept is normally referred to as the "per country" limitation. However, it should be noted that the convention already contains a general clause which allows the U.S. taxpayer to avail himself of the existing code provisions (secs. 901–905) [Internal Revenue Code of 1954] if more favorable. Therefore, where it is to his advantage the "overall" limitation can be utilized. This alternative rule is not modified by the protocol.

Belgian relief provision

The protocol contains a substitute provision for granting relief from double taxation to Belgian residents or corporations. The protocol contains a number of provisions whereby Belgium will grant exemptions, credits, or deductions to reduce the Belgian tax which its residents must pay on U.S. source income that has been taxed by the United States pursuant to the treaty.

The exemption provided for U.S. source dividend income received by Belgian corporations with no permanent establishment in the United States, is an intercorporate dividend exemption of 85 percent in the case of financial corporations and 95 percent in the case of industrial corporations. This is the same as the exemption made available by Belgium for dividends from a domestic corporation. A procedure is also provided under which U.S. source dividends received by a Belgian corporation may be exempt from the Belgian standard personal property prepayment. With respect to Belgian residents (individuals), the Belgian tax on U.S. source dividend income is to be credited by an amount equal to 15 percent. In the case of U.S. interest income both Belgian corporations and residents receive a 15-percent credit against their Belgian tax.

This provision also contains a special rule for taxing U.S. source income from dividends, interests, pensions, annuities, or royalties of U.S. citizens who are residents of Belgium. It provides that the Belgian tax on this income is not to exceed 15 percent of the income after allowance of the 15-percent lump sum credit. In other words, the U.S. citizen first computes the lump sum credit, and then the Belgian tax on the remaining income is to be computed at a maximum rate of 15 percent.

The business or investment income of a Belgian resident or corporation with a permanent establishment in the United States which has been taxed by the United States is to be exempt from Belgian tax. However, the proposed protocol provides that in order to compute the amount of the taxpayer's tax on the remainder of its income, Belgium may apply the rate of its tax which would have applied if this income had not been exempt. Also, the proportionate amount of such income exempted from Belgian tax is to be reduced by the amount of any net-operating loss deducted for U.S. tax purposes. In other words, the amount of any net operatng loss deducted is added back to the Belgian tax base.

ARTICLE II

EFFECTIVE DATES

The protocol is to come into force on the date of the exchange of instruments of ratification. In general, its provisions are to be applicable to income received in taxable years beginning after December 31, 1962, which date corresponds to the effective date of the amendments to the relative Belgian law.

In the case of dividend income, if a U.S. person, because of his taxable status (i.e., exempt organization), cannot utilize the tax credit provision of the protocol, provided for the avoidance of double taxation, then the new dividend provision is to apply only to dividends paid on or after January 1, 1965.

The final provision of the protocol provides that it is to remain in effect at least through 1967, or, if the contracting countries so agree to some later date, not beyond January 1, 1971.

PROPOSED PROTOCOL AMENDING THE INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND THE FEDERAL REPUBLIC OF GERMANY

(Memorandum from the staff of the Joint Committee on Internal Revenue Taxation)

The pending protocol is a modification of the existing income tax convention between the United States and the Federal Republic of Germany. These modifications are deemed necessary because of changes in the internal tax laws of the contracting parties and to eliminate interpretative problems which have arisen in the intervening years since the signing of the original treaty as well as to make the convention more nearly comparable to other treaties recently entered into by the United States.

The term "permanent establishment" was redefined by substantially adopting the language of the model OECD Convention, but no major substantive changes resulted. The term "industrial and commercial profits" was amended to specifically include personal service income of an enterprise. Also, the so-called "force of attraction" doctrine was abandoned both with respect to industrial and commercial profits and for dividends, interest, royalties, and capital gains. The protocol substitutes a concept based on a determination as to whether the item of income is "effectively connected" with a permanent establishment in the

country of source; i.e., whether the income is essentially a part of or closely related to the activities of the permanent establishment.

The taxation of dividends received by U.S. corporations from German corporations (10-percent U.S. owned), is changed by the protocol to reduce the rate of tax on part of his dividends and to discourage U.S. corporations from taking advantage of the German split-rate corporate dividend tax. The definition of "royalties" is amended to include "know-how" payments so that these payments are exempted from tax in the country of source. In addition, the protocol contains a new provision granting the Governments of the two countries the authority to make adjustments in tax liabilities, including refunds, in order to avoid double taxation in appropriate cases notwithstanding impediments, such as the statute of limitations, which might exist under internal law. None of our existing treaties contains such a provision. An analysis of the protocol follows.

TAXES COVERED

The proposed protocol amends the existing treaty by eliminating reference to one German tax and including within the taxes covered, two additional German taxes. Included are the German trade tax (Gewerbesteuer) and the German capital tax (Vermogensteuer), while the Berlin emergency contribution tax, which is no longer imposed, is eliminated. With respect to the German trade tax, the protocol specifically covers all of the tax. (The provision of the present treaty which provides that the convention is also to apply to any other tax of a substantially similar character which may be subsequently imposed by one of the contracting states is left unchanged.)

BUSINESS PROFITS

Permanent establishment

The protocol redefines the term "permanent establishment" by adopting, for all material purposes, the language of article 5 of the model OECD Convention. However, no major substantive changes from the present convention are made. Added to the list of activities which constitute a permanent establishment are "a place of management" and "store or other sales outlet." Due to this latter addition, the reference to the "sales office" in the present treaty is dropped. The memorandum of understanding which supplements the protocol reaffirms that a place temporarily occupied (e.g., hotel room) does not constitute a place of management. It is also understood that the term "management" does not include decisions which are solely of a technical or scientific nature.

The protocol also provides that a concern can maintain as many of the listed activities, which do not constitute a permanent establishment, within the other country as it wishes without this giving rise to a permanent establishment within the meaning of the treaty.

Industrial or commercial profits

The existing treaty subjects industrial or commercial profits of an enterprise of one country to tax in the other country only if the enterprise is engaged in a trade or business in the other country through a permanent establishment. If so engaged, the present treaty allows the other country to impose its tax upon the entire income of the enterprise from sources within that state whether or not the income is attributable to the activities or assets of the permanent establishment. This is the so-called "force of attraction" doctrine.

The proposed protocol limits the existing treaty by allowing the other country to tax only those industrial or commercial profits which are (1) attributable to a permanent establishment, (2) derived from sales of goods or merchandise of the same kind as those sold through such permanent establishment, or (3) derived from other business transactions of the same kind as those affected through such permanent establishment. Therefore, unless the income is essentially a part of, or closely related to, the permanent establishment it will not be taxed by the source country. The "arm's-length" allocation rule of the present treaty which divides the business property between the concern's home office and its permanent establishment is left unchanged by the protocol.

The present treaty provides that in determining the industrial or commercial profits, deductions are to be allowed if reasonably connected with the permanent establishment's profits. The protocol merely adds a clarifying phrase which indicates that the deductions so connected are to be allowed without regard to the country in which the expenses are incurred.

The protocol defines the term "commercial or industrial profits" to include

income derived by an enterprise from the active conduct of a trade or business and excludes income, such as that received from dividends, interest, royalties, and capital gain which is specifically dealt with in other articles of the convention. An important aspect of this definitional provision is that it specifically provides that the term "industrial or commercial profits" includes "income derived by an enterprise, from the furnishing of services of employees or other personnel." Therefore, income derived from the performance of such services by an enterprise which does not have a permanent establishment in the source country will not be subject to tax in that country. Previously, it was not clear whether income derived from such services constituted "industrial or commercial profits" or personal services which are dealt with in a subsequent provision of the convention.

INVESTMENT INCOME

Dividends

Under the present convention, the maximum tax which can be imposed by the country of source on dividends paid is 15 percent provided the receiving company did not have a permanent establishment in the source country and that the receiving company owns at least 10 percent of the voting stock of the corporation paying such dividends. The proposed protocol continues the applicable rate of tax at 15 percent and extends this treaty provision to dividends paid to individual shareholders and less than 10 percent corporate shareholders.

Germany applies different tax rates with respect to distributed and undistributed profits (15 and 51 percent, respectively), and although it imposes a 36 percent supplementary tax on intercorporate dividends received and accumulated by parent companies, this does not apply in the case of foreign corporations (instead, the treaty rate applies). Thus, the present convention may encourage U.S. corporations to maximize distributions from their German subsidiaries and then reinvest the amount of the distributions in the subsidiaries.

To eliminate this incentive, the proposed protocol provides a special rule for dividends which are reinvested. It provides that reinvested dividends paid on or after January 1, 1965, by a German company to a U.S. corporation may be taxed by Germany at a rate in excess of the 15 percent rate, but at not more than the statutory withholding tax rate of 25 percent. However, this higher rate is to be applicable only if the U.S. corporation owns directly at least 10 percent of the German company paying the dividend. The German tax system continues to treat distributed profits substantially more favorably than undistributed profits, and the rate of reinvestment by the U.S. company is 7.5 percent or more of the dividends received. If the higher rate becomes applicable due to subsequent reinvestment, the protocol provides that the tax benefit derived from the application of the standard treaty rate (15 percent) rather than the higher 25 percent rate may be recovered.

A principal modification resulting from the proposed protocol is the substitution of the "effectively connected" concept for the "force of attraction" doctrine. The protocol provides that the reduced rate of tax on dividends is broadened in that it will be available unless the recipient of the dividend has both a permanent establishment in the source country and the stock giving rise to the dividend is "effectively connected" with the permanent establishment. Thus, the proposed protocol provides that the treaty withholding rates on dividends will apply to dividend income if not "effectively connected" with a permanent establishment in the country of source. This new rule makes it unnecessary for a taxpayer of one country to isolate his business activities in a separate subsidiary solely to prevent taxation of his investment income from sources within the country wherein he has a permanent establishment.

The memorandum of understanding provides that the term "effectively connected" is to be so construed that items of income will be considered to be "effectively connected" with a permanent establishment if these items of income accrue to the recipient of the dividend by virtue of assets held by the permanent establishment or held by a recipient of the dividend specifically to promote the business activities of the permanent establishment. Also, the income will be considered to be "effectively connected" if the activities of the permanent establishment are a material factor in realizing such income.

Under the present treaty, a number of interpretative problems have arisen with respect to the scope of the term "dividend" as it applies to distributions by German corporations. Accordingly, the proposed protocol contains a definition of the term "dividends" which, in essence, is a listing of the types of distributions which would be considered to be dividends under U.S. tax law.

Interest

The present treaty exempts from taxation by the source country interest on bonds, notes, debentures, securities or other forms of indebtedness if the recipient of the interest does not have a permanent establishment in the source country. However, this exemption is not applicable to debts secured by mortgages or other encumbrances on real property.

In the case of the tax treatment of interest, two significant changes are made. First, the "effectively connected" rule described above in the case of dividends was also substituted for the "force of attraction" doctrine in the case of interest. Second, the general interest exemption was extended to interest on debts secured by mortgages or other encumbrances of real property.

Royalties

The existing treaty exempts royalties from taxation in the source country and defines the term "royalties" to mean any royalties, rentals, or other amounts paid as consideration for the use of, or the right to use, copyrights, artistic or scientific works, patents, etc. The protocol expands this definition of royalties to include amounts which are paid as consideration for knowledge, experience, or skill ("know-how").

Under the protocol, the new royalty provision will apply to royalty payments made on or after January 1, 1963. However, correspondence with the German Government specifies that the exemption from German tax for "know-how" payments also will apply to such payments made prior to January 1, 1963, where the German authorities have held that such remuneration was exempt from tax. The memorandum of understanding accompanying the protocol contains the agreement that the "know-how" amendment is not to influence the interpretation to be given to the existing royalty provision of the convention. Thus, the German tax authorities may not make use of the fact that such payments were later specifically included under this protocol as royalties for purposes of concluding that earlier payments were not covered by the exemption provided for royalties in the existing convention.

The protocol also provides that the term "royalties" is to include gains derived from the alienation of any right or property giving rise to those royalty payments. For U.S. tax purposes, this exemption shall apply both to gains derived from the outright assignment of property or rights, and from arrangements for the licensing of such property or rights which are deemed to constitute transactions which produce capital gain income.

This provision further provides for the abandonment of the "force of attraction" doctrine in the case of royalty income. Gains derived from the sale of any right or property giving rise to royalties will be exempt from tax in the source country if the resident of the other country maintains a permanent establishment in the source country and the royalty income is "effectively connected" with the permanent establishment. This is the same rule as has been described above for interest and dividends.

Real property income and natural resource royalties

The existing treaty provides to the source country the right to tax income from real property, and royalties with respect to the operation of mines, quarries, or other natural resources, located in that country. It also provides that a resident or corporation of the other country may elect, for any taxable year, to be taxed on such income on a net basis at rates that would apply to a resident or company of the source country. Therefore, the expenses incurred in connection with the production of such income will be deductible.

The proposed protocol amends this provision to reflect the changes discussed under the interest provision which proposes to treat income from debts secured by mortgages or other encumbrances on real property as interest income.

Capital gains

This provision of the proposed protocol adds a new article to the convention which generally has the effect of providing a reciprocal exemption from tax by the country of source of capital gains except those derived from the sale of real property, dealt with in a separate provision. This provision contains unilateral limitations, however, which are designed to deny the exemption to German residents who are in this country for an extended period. Specifically, the exemption does not apply if the German resident is present in the United States for a period equal to, or exceeding, an aggregate of 183 days during the taxable

year, and the asset sold was held by such person for 6 months or less. A similar provision is contained in the internal German law and, therefore, it was not necessary that this provision be made bilateral in order for U.S. citizens to be taxed on the same basis on their German gains of the same nature.

The exemption from capital gains tax described above is unavailable where the person realizing the gain has a permanent establishment in the source country with which the asset sold is "effectively connected." The memorandum of understanding provides that the term "effectively connected" is to be construed for purposes of this provision so that gain will be considered to be effectively connected if derived from the sale of property either held by the permanent establishment or held by the recipient of the capital gain specifically to promote the permanent establishment's business activities. For purposes of this provision, gain on the sale of capital assets is not considered "effectively connected" to a permanent establishment merely because the activities of the permanent establishment were a material factor in realizing such gain. This omission distinguishes the rule with respect to this provision from that provided in the case of dividends, interest, and royalties.

INDIVIDUAL COMPENSATION

Personal service compensation

The proposed protocol provides specific exemption from the tax of one country of compensation for labor or personal services performed outside that country by an individual resident of the other country. This is the rule promulgated in the German regulations under the existing treaty. Therefore, the insertion of this provision in the treaty provides a basis for the present German treaty regulations as well as providing a bilateral rule in the treaty.

The proposed protocol largely conforms to the present provisions with respect to the taxation of income for services performed in one country by an individual resident of the other country. Compensation for labor or personal services performed in the source country by a resident of the other country is to be exempt from tax in the source country if the following three conditions are met:

1. If present in the source country for a period or periods not exceeding a total of 183 days during the taxable year.
2. Such labor or personal services are performed as an employee of, or under contract with, a resident of the other country or a company of the country, and such compensation is borne by such resident or company.
3. Such compensation is not borne by a permanent establishment which such resident or company has in the source country (this requirement is not in the original treaty).

Government pensions and salaries and private pensions and annuities

Language is added to the present treaty provisions which would exempt from U.S. tax amounts paid by juridical persons organized under the public laws of Germany as compensation for an injury or damage sustained as a result of hostilities or political persecution.

TAXES ON CAPITAL

This provision of the proposed protocol adds a new article which relates to the imposition of the German trade and capital taxes. As mentioned above, the proposed protocol brings these taxes within the ambit of the treaty. In general, this provision provides unilateral relief from the German capital tax and from the portion of the trade tax computed on the basis of the capital of a resident, corporation, or other entity of the United States.

The proposed provision contains two major exceptions. It provides that capital represented by real property or natural resources may be taxed in the country where this property is situated. Additionally, capital represented by assets which are "effectively connected" with a permanent establishment of an enterprise of one country may be taxed in the country where the permanent establishment is situated. However, this latter rule does not apply to ships and aircraft of an enterprise of one country and assets (other than certain real property) pertaining to the operation of such ships and aircraft. It should be noted that no foreign tax credit is available with respect to either the German capital tax or the trade tax computed on the basis of capital.

RELIEF FROM DOUBLE TAXATION

This article of the proposed protocol contains the provisions which provide the mitigation permitted by each contracting country to its residents, citizens, and corporations with respect to taxes paid to the other country.

U.S. credit provision

Under the existing treaty the United States grants relief under its statutory foreign tax credit provisions subject to the traditional savings clause. The proposed protocol does not depart from the existing convention in any material respect. This provision of the protocol makes it clear that the amendments to U.S. law concerning the foreign tax credit made after the effective date of this protocol are to be taken into account in determining the allowable credit. Also, although the principles of the per country limitation of the U.S. tax law have been incorporated in the convention, this inclusion will not affect the right presently enjoyed by U.S. taxpayers of electing the overall limitation provision as a substitute.

German relief provision

Under the protocol, Germany will use both an exemption method and a credit provision. In the case of dividend income, the exemption applies only to dividends subject to U.S. tax which are paid to German companies owning 25 percent or more of the paying U.S. company. In all other cases the protocol provides a credit for U.S. taxes imposed with respect to dividends received by Germans from sources within the United States. A credit is also granted for the U.S. tax paid on wages, salaries, pensions, and similar compensation paid by the United States or by its States, territories, or political subdivisions to a German citizen since this latter type of income is not exempt under the provisions of the proposed protocol.

The proposed protocol also contains a specific provision that provides the rules to be applied by Germany in granting relief from double taxation to those German residents who are also citizens or residents of the United States, and, as a result, are subject to taxation in both countries on their worldwide income. In general, such an individual is, for purposes of German taxes, to be taxed in the same manner as an individual resident of Germany who is not a U.S. citizen or resident but will be allowed a special credit for U.S. taxes paid on his U.S. source income.

MISCELLANEOUS PROVISIONS

Charitable organizations

The proposed protocol adds a new article relating to the taxation of certain nonprofit organizations. The new article provides that organizations of one country which are operated exclusively for religious, charitable, scientific, educational, or public purposes are to be exempt from tax in the other country if and to the extent that such organization would be exempt from tax in the other country if it were organized, and carried on all its activities, in that other country.

Exchange of information

The language of the present exchange of information provision, if literally construed, could result in the complete loss of this provision's utility by denying the right to disclose the information received pursuant to this provision to courts or administrative bodies. The proposed protocol clarifies this situation by making specific reference to a court or administrative body as competent authority to receive such information. Also, it adds language permitting such information to be disclosed to persons concerned with "enforcement or prosecution" of such taxes.

Application to West Berlin

This article of the proposed protocol provides that it is to apply to West Berlin unless Germany delivers a contrary declaration to the Government of the United States within 3 months from the date of entry into force of this protocol.

Taxpayer claims and consultation

Although this article of the proposed protocol deletes the existing provision of the convention which deals with taxpayer claims and consultation between

the contracting parties, no major substantive change results from the substituted language. The language relating to taxpayer claims is identical to that in the existing treaty. The consultation provisions have been modified in some respects to more accurately express the intent of the contracting parties. The proposed protocol does contain a new provision which authorizes the two treaty countries to endeavor to agree on the—

(1) attribution of industrial or commercial profits between an enterprise's home office and permanent establishment;
(2) allocation of profits between related enterprises; and
(3) source of particular items of income.

In addition, this provision provides that in the event the competent authorities reach an agreement, the taxes of each country are to be imposed on the income as reattributed, reallocated, or differently sourced and an appropriate refund of taxes shall be allowed by the country to carry out the agreement, even if such refund would otherwise be barred by the statute of limitations. None of the existing income tax conventions to which the United States is a party contains procedures permitting the countries to make the resulting appropriate accommodation of tax liability resulting from such a reallocation. This provision will apply in the case of any discussions conducted by the competent authorities of the two cases after the treaty goes into effect even if such discussions concern taxable years prior thereto.

The memorandum of understanding which supplements the proposed protocol provides for consultation between the contracting countries for determining whether it is necessary to amend the convention with respect to the taxation of dividends if either country's income tax applicable to corporations is substantially changed or if experience evinces that the effect of the new article is not in accordance with the underlying purposes.

EFFECTIVE DATE

The protocol comes into force on the date of exchange of instruments of ratification and all the articles, other than those pertaining to the taxation of dividends and royalties, will be effective for taxable years beginning on or after January 1 of the year in which the exchange of instruments of ratification takes place. The new dividend article of the convention (art. VI), will have effect with respect to dividends paid on or after January 1, 1965, and this new article will apply to reinvestments made on or after that date. The new royalty article of the convention (art. VIII), will have effect with respect to any payment made on or after January 1, 1963.

INTEGRATION INTO ORIGINAL TREATY

This provision provides that the proposed protocol will form an integral part of the original convention of July 22, 1954, and that it will continue in force as long as that convention remains effective. Since the initial 5-year period of the existing convention has elapsed and no additional 5-year period was provided for, the convention, as amended by the proposed protocol, may be terminated by either country at any time by the prescribed notice of termination.

PART V

ADMINISTRATIVE, PROCEDURAL, AND MISCELLANEOUS MATTERS

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PART V

ADMINISTRATIVE, PROCEDURAL, AND MISCELLANEOUS MATTERS

TREASURY DEPARTMENT ORDER NO. 175-3

Transfer of Special Enrollment Examination Function

By virtue of the authority vested in me by Reorganization Plan No. 26 of 1950, it is hereby ordered that the function of administering the Special Enrollment Examination for practice by agents before the Internal Revenue Service is transferred from the Office of the Director of Practice in the Office of the General Counsel to the Internal Revenue Service.

Such personnel, funds, records and equipment as are determined by the General Counsel and the Commissioner of Internal Revenue to be necessary to perform the function relating to the Special Enrollment Examination shall be transferred to the Internal Revenue Service as of the date of this order.

Dated: April 28, 1966.

[SEAL]

JOSEPH W. BARR,
Acting Secretary.

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TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER H, PART 601.—STATEMENT OF PROCEDURAL RULES [1]

Miscellaneous amendments

This part as filed with the Federal Register on June 29, 1955 [C.B. 1955-2, 921], was last amended on March 14, 1964 [C.B. 1964-1 (Part 1), 608]. The further amendments made herein do not reflect the changes made by Public Law 89-332, approved on November 8, 1965 [C.B. 1965-2, 640], which provides for the right of persons to be represented in matters before Federal agencies. Subpart E of this part, relating to conference and practice requirements, will be amended in the near future to reflect the changes required by Public Law 89-332 [C.B. 1965-2, 640]. The amended provisions read as follows:

[1] 31 F.R. 2818.

PARAGRAPH 1. Section 601.101 is amended by revising paragraphs (a) and (b). These amended provisions read as follows:

§ 601.101 INTRODUCTION.

(a) *General.*—The Internal Revenue Service is a branch of the Treasury Department under the immediate direction of the Commissioner of Internal Revenue. The Commissioner has general superintendence of the assessment and collection of all taxes imposed by any law providing internal revenue and also of other functions relating to the administration and enforcement of laws applicable to alcohol and certain firearms which are in addition to those related to taxes. The Internal Revenue Service is the agency by which these functions are performed. Within an internal revenue district the internal revenue laws are administered by a district director of internal revenue. The Director of International Operations administers the internal revenue laws applicable to taxpayers residing or doing business abroad, foreign taxpayers deriving income from sources within the United States, and taxpayers who are required to withhold tax on certain payments to nonresident aliens and foreign corporations. For purposes of these procedural rules any reference to a district director or a district office includes the Director of International Operations or the Office of International Operations, if appropriate. Generally, the procedural rules of the Service are based on the Internal Revenue Code of 1939 and the Internal Revenue Code of 1954, and the procedural rules in this part apply to the taxes imposed by both Codes except to the extent specifically stated or where the procedure under one Code is incompatible with the procedure under the other Code. Reference to sections of the Code are references to the Internal Revenue Code of 1954, unless otherwise expressly indicated.

(b) *Scope.*—This part sets forth the procedural rules of the Internal Revenue Service respecting all taxes administered by the Service, and supersedes the previously published statement (26 CFR (1949 ed., Part 300–End) Parts 600 and 601) with respect to such procedural rules. Subpart A provides a descriptive statement of the general course and method by which the Service's functions are channeled and determined, insofar as such functions relate generally to the assessment and collection of internal revenue taxes. Certain provisions special to particular taxes are separately described in Subpart D of this part. Conference and practice requirements of the Internal Revenue Service are contained in Subpart E of this part. Specific matters not generally involved in the assessment and collection functions are separately described in Subpart B of this part. A description of the rulemaking functions of the Treasury Department with respect to internal revenue tax matters is contained in Subpart F. The procedural rules of the Service with respect to distilled spirits, wines, beer, cigars, cigarettes, and cigarette papers and tubes, and certain firearms are described in Subpart C of this part. Subpart G of this part relates to matters of official record in the Internal Revenue Service and the extent to which records and documents are subject to publication or open to public inspection. This part does not contain a detailed discussion of the substantive provisions pertaining to any particular tax or the procedures relating thereto, and for such information it is necessary that reference be made to the applicable provisions of law and the regulations promulgated thereunder. The regulations relating to the taxes administered by the Service are contained in Titles 26 and 27 of the Code of Federal Regulations.

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PAR. 2. Section 601.103 is amended by revising paragraphs (a), (b), and subparagraph (1) of paragraph (c). These amended provisions read as follows:

§ 601.103 SUMMARY OF GENERAL TAX PROCEDURE.

(a) *Collection procedure.*—The Federal tax system is basically one of self-assessment. In general each taxpayer (or person required to collect and pay over the tax) is required to file a prescribed form of return which shows the facts upon which tax liability may be determined and assessed. Generally, the taxpayer must compute the tax due on the return and make payment thereof on or before the due date for filing the return. If the taxpayer fails to pay the tax when due, the district director of internal revenue or the director of the regional service center after assessment issues a notice and demands payment

within 10 days from the date of the notice. In the case of wage earners and nonresident aliens, the income tax is collected in large part through withholding at the source. Another means of collecting the income tax is through payments on declarations of estimated tax which are required by law to be filed by certain individual and corporate taxpayers. Neither withholding nor a declaration of estimated tax relieves a taxpayer from the duty of filing a return otherwise required. Certain excise taxes are collected by the sale of internal revenue stamps.

(b) *Examination and determination of tax liability.*—After the returns are filed in the office of the district director of internal revenue or in the office of the director of a regional service center, they are sorted, classified, and processed. Many of these returns are selected for examination. If adjustments are proposed with which the taxpayer does not agree, he is ordinarily afforded certain appeal rights, including an opportunity to discuss the proposed adjustments (except mathematical errors) in a conference in the district director's office. If this conference results in agreement on the proposed adjustments, the taxpayer is requested to execute an agreement form. If the tax involved is an income, profits, estate, or gift tax, and if the taxpayer waives restrictions on the assessment and collection of the tax (see § 601.105(b)), the deficiency will be immediately assessed.

(c) *Disputed liability.*—(1) *General.*—If the conference on the proposed adjustments does not result in agreement, the taxpayer is given an opportunity to request that his case be considered by the regional Appellate Division, provided that Division has jurisdiction (see § 601.106(a)(3)). If the taxpayer requests such consideration, the case will be referred to the regional Appellate Division where the taxpayer may have another conference. The determination of tax liability by the Appellate Division is final insofar as the taxpayer's appellate rights within the Service are concerned. Upon protest of cases under the jurisdiction of the Director of International Operations exclusive settlement authority is vested in the regional Appellate Division having jurisdiction of the place where the taxpayer requests the Appellate Division conference. If the taxpayer does not specify a location for the conference, or if the location specified is outside the territorial limits of the regional Appellate Divisions, the Washington, D.C., branch office of the Appellate Division for the Mid-Atlantic region assumes jurisdiction. The fact that conferences were held by the Office of International Operations either before or after the receipt of a protest does not foreclose a taxpayer from having the Appellate Division consider his case.

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PAR. 3. Section 601.104 is amended by revising subparagraphs (1), (3), and (5) of paragraph (a) and paragraph (c). These amended provisions read as follows:

§ 601.104 COLLECTION FUNCTIONS.

(a) *Collection methods.*—(1) *Returns.*—Generally, an internal revenue tax assessment is based upon a return required by law or regulations to be filed by the taxpayer upon which he himself computes the tax in the manner indicated by the return. If a taxpayer fails to make a return it may be made for him by a district director or other duly authorized officer or employee. See section 6020 of the Code and the regulations thereunder. Returns must be made on the forms prescribed by the Internal Revenue Service. Forms are obtainable at the principal and branch offices of district directors of internal revenue. Forms are generally mailed to persons whom the Service has reason to believe may be required to file returns, but failure to receive a form does not excuse failure to comply with the law or regulations requiring a return. Returns, supplementary returns, statements or schedules, and the time for filing them, may sometimes be prescribed by regulations issued under authority of law by the Commissioner with the approval of the Secretary of the Treasury or his delegate. In the case of certain individual income taxpayers having gross income from specified sources of less than $10,000, a special form (Form 1040A) is prescribed upon which the taxpayer may set forth the information necessary to a determination of his tax liability. A taxpayer filing a return on Form 1040A shall compute the tax and transmit with the return any unpaid balance of tax, except that if his income was less than $5,000 he may elect to have the Internal Revenue Service compute the tax and mail him a notice stating the amount of tax due. A husband

and wife may make a single income tax return jointly. Certain affiliated groups of corporations may file consolidated income tax returns. See section 1501 of the Code and the regulations thereunder.

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(3) *Declarations of estimated tax.*—Any individual who may reasonably expect to receive gross income for the taxable year from wages or from sources other than wages, in excess of amounts specified by law, or who can reasonably expect his estimated tax to be $40 or more, is required to file a declaration of estimated income tax. Payments of estimated tax are applied in payment of the tax for the taxable year. A husband and wife may make a single declaration jointly, and the amount of the estimated tax paid on the declaration may be applied in payment of the income tax liability of either spouse in any proportion they may specify. For taxable years ending on or after December 31, 1955, the law requires a declaration of estimated tax by certain corporations. See section 6016 of the Code.

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(5) *Collection of tax by another person.*—Certain miscellaneous excise taxes are imposed on the person making the payment for telephone service, air transportation, and other facilities or services. Such taxes are required to be collected by the telephone company, airline, or other person receiving the payment. All taxes collected in this manner are held by the collecting agent in trust for the United States until paid over to the district director of internal revenue. 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 the facts to the district director of internal revenue, and the tax will then be collected by direct assessment against the person failing or refusing to pay the tax to the collecting agent. For special provisions applicable to excise taxes collected by another person, see § 601.403.

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(c) *Enforcement procedure.*—(1) *General.*—Taxes shown to be due on returns, deficiencies in taxes, additional or delinquent taxes to be assessed, and penalties, interest, and additions to taxes, are recorded by the district director or the director of the regional service center as "assessments". Under the law an assessment is prima facie correct for all purposes. Generally, the taxpayer bears the burden of disproving the correctness of an assessment. Upon assessment, the district director is required to effect collection of any amounts which remain due and unpaid. Generally, payment within 10 days from the date of the notice and demand for payment is requested; however, payment may be required in a shorter period if collection of the tax is considered to be in jeopardy.

(2) *Levy.*—If a taxpayer neglects or refuses to pay any tax within the period provided for its payment, it is lawful for the district director to make collection by levy on the taxpayer's property. See section 6331 of the Code. No suit for the purpose of restraining the assessment or collection of an internal revenue tax may be maintained in any court, except to restrain the assessment or collection of income, estate, or gift taxes during the period within which the assessment or collection of deficiencies in such taxes is prohibited. See section 7421 of the Code. Property taken under authority of any revenue law of the United States is irrepleviable. 28 U.S.C. 2463.

(3) *Liens.*—The United States' claim for taxes is a lien on the taxpayer's property at the time of assessment. Such lien is not valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice has been filed by the district director. Despite such filing, the lien is not valid with respect to certain securities as against any mortgagee, pledgee, or purchaser of such securities, for adequate and full consideration in money or money's worth, who is without notice or knowledge of the existence of such lien. Certain motor vehicle purchasers are similarly protected. A valid lien generally continues until the liability is satisfied or becomes unenforceable by reason of lapse of time. A certificate of release of lien may be issued upon the taxpayer's furnishing proper bond in lieu of the lien, or when the liability is satisfied or becomes unenforceable by reason of lapse of time. The Code also contains additional provisions with respect to liens in the case of estate and gift taxes. For the specific rules with respect to liens, see subchapter C of chapter 64 of the Code and the regulations thereunder.

(4) *Penalties.*—In the case of failure to file a return within the prescribed time, a certain percentage of the amount of tax is, pursuant to statute, added to the tax unless the failure to file the return within the prescribed time is shown to the satisfaction of the district director or the director of the regional service center to be due to reasonable cause and not neglect. Civil penalties are also imposed for fraudulent returns; in the case of income and gift taxes, for intentional disregard of rules and regulations or negligence; and additions to the tax are imposed for the failure to comply with the requirements of law with respect to the estimated income tax. See chapter 68 of the Code. Civil penalties may also be imposed for failure to pay the tax on liquors, cigars, cigarettes, and cigarette papers and tubes within the time prescribed. See chapters 51 and 52 of the Code. Criminal penalties are imposed for willful failure to make returns, keep records, supply information, etc. See chapter 75 of the Code.

(5) *Informants' rewards.*—Payments to informers are authorized for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws. See section 7623 of the Code and the regulations thereunder. Claims for rewards should be made on Form 211. Relevant facts should be stated on the form, which after execution should be forwarded to the district director of internal revenue for the district in which the informer resides, or to the Commissioner of Internal Revenue, Washington, D.C., 20224.

PAR. 4. Section 601.105 is amended by revising paragraph (a), subparagraphs (1), (2), (4), and subdivisions (iii)(*a*), (vi)(*b*), and (vi)(*e*) of subparagraph (5) of paragraph (b), paragraph (c), subparagraphs (1) and (2)(i) of paragraph (d), subparagraphs (1) and (2) of paragraph (e), and paragraph (i). These amended provisions read as follows:

§ 601.105 EXAMINATION OF RETURNS AND CLAIMS FOR REFUND, CREDIT OR ABATEMENT; DETERMINATION OF CORRECT TAX LIABILITY.

(a) *Processing of returns.*—When the returns are filed in the office of the district director of internal revenue or the office of the director of a regional service center, they are checked first for form, execution, and mathematical accuracy. Mathematical errors are corrected and a correction notice of any such error is sent to the taxpayer. Notice and demand is made for the payment of any additional tax so resulting, or refund is made of any overpayment. All returns are then sorted according to such classifications and subclassifications as are prescribed by the uniform management directive of the Commissioner. The purpose of these classifications is to facilitate prompt processing of returns showing refunds due and returns received with insufficient or no remittance, the selection of refunds for audit, and the compilation of income and other statistics.

(b) *Examination of returns.*—(1) *General.*—The original examination of income, profits, estate, gift, excise, and employment tax returns is a primary function of internal revenue agents in the Audit Division of the office of each district director of internal revenue. Such internal revenue agents are organized in groups, each of which is under the immediate supervision of a group supervisor designated by the district director. In the international enforcement program, which provides comprehensive audit coverage of the returns of domestic taxpayers engaged in substantial international activities, these agents are assisted by specialists from the Office of International Operations. These specialists assist in developing the facts bearing on international activity and in determining whether any change in reported taxable income should be recommended as a result of the inquiry. Revenue agents (and such other officers or employees of the Internal Revenue Service as may be designated for this purpose by the Commissioner) are authorized to examine any books, papers, records, or memoranda bearing upon matters required to be included in Federal tax returns and to take testimony relative thereto and to administer oaths. See section 7602 of the Code and the regulations thereunder. There are two general types of audit. These are commonly called "office audit" and "field audit". During the audit of a return a taxpayer may be represented before the examining officer by an attorney, certified public accountant, or other representative. See Subpart E for conference and practice requirements.

(2) *Office audit.*—Certain returns are examined by office audit. These are returns susceptible to office audit techniques and include certain business returns

in addition to the full range of nonbusiness individual income tax returns. Office audits are conducted either by correspondence or by office interview. The method employed normally depends upon the complexity of the items questioned. When an examination can be conducted by either method, the convenience of the taxpayer generally will be the principal consideration. In a correspondence audit, the taxpayer is asked to supply explanations or supporting evidence by mail. In an office interview audit the taxpayer is asked to come to the district director's office for a personal interview and to bring certain records with him in support of his return. During the audit the taxpayer has the right, of course, to bring to the attention of the examining officer any amounts included in his return which are not taxable or any deductions which he failed to claim on his return. If it develops that a field audit is necessary, an appropriate transfer will be made.

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(4) *Conclusion of audit.*—At the conclusion of an office or field audit, the taxpayer is given an opportunity to agree with the findings of the examining officer. If the taxpayer does not agree, the examining officer will inform the taxpayer of his appeal rights. See paragraph (c) of this section for district conference procedure. If the taxpayer does agree with the proposed changes, the examining officer will invite him to execute either Form 870 or another appropriate agreement form. When the taxpayer agrees with the proposed changes but does not offer to pay any deficiency or additional tax which may be due, the examining officer will also invite payment (by check or money order), together with any applicable interest or penalty. If the agreed case involves income, profits, estate, or gift taxes, the agreement is evidenced by a waiver by the taxpayer of restrictions on assessment and collection of the deficiency, or an acceptance of a proposed overassessment. If the agreed case involves excise or employment taxes, the agreement is evidenced by a waiver by the taxpayer of his right to file a claim for abatement after assessment of the additional tax, or by acceptance of a proposed overassessment. Even though the taxpayer signs an acceptance of a proposed overassessment the district director or the director of the regional service center remains free to assess a deficiency. On the other hand, the taxpayer who has given a waiver may still claim a refund of any part of the deficiency assessed against him and paid by him, or any part of the tax originally assessed and paid by him. The taxpayer's acceptance of an agreed overassessment does not prevent his filing a claim and bringing a suit for an additional sum, nor does it preclude the Government from maintaining suit to recover an erroneous refund. As a matter of practice, however, waivers or acceptances ordinarily result in the closing of a case insofar as the Government is concerned.

(5) *Technical advice from the National Office.* * * *

(iii) *Requesting technical advice.*—(*a*) It is the responsibility of the district office to determine whether technical advice is to be requested on any issue before that office. However, during the course of an examination or a conference in a district office, a taxpayer or his representative may request that an issue be referred to the National Office for technical advice on the grounds that a lack of uniformity exists as to the disposition of the issue, or that the issue is so unusual or complex as to warrant consideration by the National Office. If, in the opinion of the examining officer or conferee, the circumstances do not warrant such referral, he will so advise the taxpayer.

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(vi) (*a*) *Conference in the National Office.* * * *

(*b*) A taxpayer is entitled, as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in (*a*) through (*c*) of this subdivision exists. This conference will usually be held at the branch level in the appropriate division in the office of the Assistant Commissioner (Technical) and will usually be attended by a person who has authority to act for the branch chief. (See § 601.201(a)(2) for the divisions involved.) If more than one subject is discussed at the conference, the discussion constitutes a conference with respect to each subject. At the request of the taxpayer or his representative, the conference may be held at an earlier stage in the consideration of the case than the service would ordinarily designate. A taxpayer has no "right" of appeal from an action of a branch to the director of a division or to any other National Office official.

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(e) A taxpayer or his representative desiring to obtain information as to the status of his case may do so by contacting the appropriate division in the office of the Assistant Commissioner (Technical). (See § 601.201(a)(2) for the divisions involved.)

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(c) *District conference procedure.*—(1) *Office audit.*—(i) In a correspondence audit the taxpayer is informed of the examining officer's proposed findings by a form letter. He is asked to sign and return an agreement if he accepts the findings. The letter also informs the taxpayer of several courses of appeal available to him, including a district conference and consideration of his case by the regional Appellate Division. A conference in the district director's office will be granted the taxpayer upon request without submission of a written protest. If no agreement is reached at the conference, the taxpayer will be furnished a report of the findings and a 30-day letter describing his further appeal rights.

(ii) In an office interview audit the taxpayer will usually be informed of the examining officer's findings at the interview. If no agreement is reached at the conference, the taxpayer is given an opportunity to request a district conference at the end of the interview or is invited in a 15-day letter to arrange for such a conference. The balance of the procedure in a correspondence audit is also applicable in an office interview audit.

(2) *Field audit.*—(i) If, at the conclusion of an examination, the taxpayer does not agree with the adjustments proposed by the examining officer, a complete examination report will be prepared fully explaining all proposed adjustments. Before the report or any invitation to a district Audit Division conference is sent to the taxpayer, the case file will be submitted to the district Review Staff for a thorough technical and procedural review. Following such review, the taxpayer will receive a copy of the examination report under cover of a transmittal letter (30-day letter) providing him with a detailed explanation of the available appeal procedure and requesting the taxpayer to inform the district director of his choice of action.

(ii) If the total amount of proposed additional tax, proposed overassessment, or claimed refund does not exceed $1,000 for any taxable year, the taxpayer will be granted a district Audit Division conference on request. A written protest is not required.

(iii) If the amount of proposed additional tax, proposed overassessment, or claimed refund exceeds $1,000 for any taxable year, the taxpayer, on request, will be granted a district Audit Division conference, provided a written protest is filed setting forth the facts, law, and arguments upon which the taxpayer relies.

(iv) If the issues involved are such that there appears to be little possibility of disposing of them in a district Audit Division conference, the taxpayer will be encouraged to bypass the district conference in favor of prompt consideration of his case by the regional Appellate Division. In such a case, unless the taxpayer expressly requests a district conference, the taxpayer's protest and case file, after preliminary screening by the Chief, Conference Staff, will be forwarded to the regional Appellate Division.

(v) Ordinarily, the examining officer will not attend the district Audit Division conference.

(vi) Changes made by the Conference Staff in the proposals set forth in the examining officer's examination report will be reflected in a Conference Audit Statement which will be forwarded to the taxpayer to inform him of changes made and to serve as a supplement to the examination report.

(vii) The determination of the Conference Staff will not be submitted to the district Review Staff for review.

(3) *Scope of district conference procedure.*—The conference procedure described in this paragraph is applicable in the determination of any liability in respect of income, profits, estate, gift, excise, or employment taxes. 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. The procedure described in this paragraph does not apply in any case where criminal prosecution is under consideration, or in any case in which, in the discretion of the district director of internal revenue, the Government's interest would be prejudiced thereby. Nor does this procedure preclude the

taking of appropriate action where the assessment or collection of the tax is in jeopardy. See paragraph (h) of this section.

(4) *Rules governing district conferences.*—The objective of the district conference procedure is to give taxpayers a greater opportunity to reach an early agreement with respect to disputed items arising from office and field audits. If the taxpayer is represented at a district conference, see the conference and practice requirements of Subpart E. In conduct of conferences, it is the duty of the conferee (i) to conduct the conference in accordance with the objectives of the conference procedure, (ii) to provide the taxpayer a fair and courteous hearing at which the taxpayer may discuss the issues, (iii) to make certain that all pertinent facts are included in the record and are considered in arriving at the proposed recommendation, (iv) to make certain that the pertinent provisions of the Internal Revenue Code are applied in arriving at the proposed recommendation and that the proposed recommendation is in accord with the interpretations of the Internal Revenue Service as expressed in regulations and rulings, and (v) to explain fully to the taxpayer the conclusions reached and the reasons therefor. If an agreement with the taxpayer is reached at the conference, the taxpayer will be requested to execute Form 870 or another appropriate agreement form. Any deficiency in tax or additional tax proposed will then be assessed, or any overpayment will be credited or refunded.

(5) *Settlement authority.*—The authority of the Chief, Conference Staff, may be extended to include the settlement of selected issues on a basis reflecting an evaluation of litigating hazards, provided a substantially identical issue has been previously so disposed of by a regional Appellate Division. This procedure applies only if the total amount of proposed additional tax, proposed overassessment, or claimed refund does not exceed $1,000 for any year.

(d) *Thirty-day letters and protests.*—(1) *General.*—The report of the examining officer, 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) Denial of a claim for refund, credit, or abatement which has been filed and is found wholly lacking in merit.

In an unagreed case, the district director sends to the taxpayer a preliminary or "30-day letter" if any one of the last three determinations is made (except a full allowance of a claim in respect of any tax). The 30-day letter is a form letter which states the determination proposed to be made. It is accompanied by a copy of the examining officer'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 a waiver or acceptance. The preliminary letter also informs the taxpayer of his appeal rights if he disagrees with the proposed determination. If the taxpayer does not respond to the letter within 30 days, a statutory notice of deficiency will be issued or other appropriate action taken, such as the issuance of a notice of adjustment, the denial of a claim in income, profits, estate, and gift tax cases, or an appropriate adjustment of the tax liability or denial of a claim in excise and employment tax cases.

(2) *Protests.*—(i) No written protest is required to obtain a district Audit Division conference in an office audit case. However, in a field audit case a written protest is required to obtain a district conference if the total amount of proposed additional tax, proposed overassessment or claimed refund exceeds $1,000 for any taxable year. A written protest is required in every case in which the taxpayer requests Appellate Division consideration. Instructions for the preparation of protests are sent with the preliminary letter.

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(e) *Claims for refund or credit.*—(1) After payment of the tax a taxpayer may (unless he has executed an agreement to the contrary) contest the assessment by filing a claim for refund or credit for all or any part of the amount paid, except as provided in section 6512 of the Code with respect to certain taxes determined by the Tax Court, the decision of which has become final. A claim for refund or credit is made on Form 843, which is obtainable from the district director. Generally, the claim, together with the appropriate supporting evidence, must be filed in the office of the district director for the district in which the tax was paid. A claim for refund or credit must be filed

within the applicable statutory period of limitation. In the case of individuals a properly executed income tax return may, if the taxpayer elects, operate as a claim for refund or credit of the amount of the overpayment disclosed by such return. If an individual income taxpayer files Form 1040A as a return and properly elects to have the tax computed by the district director or the director of the regional service center, such return operates automatically as a claim for refund for the amount of any overpayment disclosed by such computation.

(2) Generally, claims for refund or credit are investigated and considered by the Audit Division of the district director's office. The procedure applicable to the determination of correct tax liability upon the basis of a claim for refund or credit filed by the taxpayer is substantially the same as the procedure applicable to the original determination of tax liability upon the basis of a return filed by a taxpayer. See § 601.108 for procedure for review of proposed overpayment exceeding $100,000 of income, estate, and gift taxes.

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(i) *Regional post review of examined cases.*—Regional commissioners review samples of the examined cases closely in their district offices to assure uniformity throughout their districts in the application of the provisions of the Code, regulations, and rulings, as well as the general policies of the Service. The Audit Division of the National Office in a similar manner reviews samples of the examined cases closed in the Office of International Operations. In certain circumstances, such as where substantial errors are found or where there is evidence of fraud or collusion, the regional commissioner has authority to reopen the case. When a re-examination of books and records is necessary, Form 2756, Notice of Re-examination, will be delivered to the taxpayer at the time the re-examination is begun.

PAR. 5. Section 601.106 is amended by revising paragraphs (a)(1), (b), and (c), by adding a new subdivision (iii) to paragraph (d)(2), and by revising subparagraphs (3), (5), and (9) of paragraph (f). These amended and added provisions read as follows:

§ 601.106 APPELLATE FUNCTIONS.

(a) *General.*—(1) There is provided in each region an Appellate Division with office facilities within the region. Unless they otherwise specify, taxpayers residing outside the territorial limits of the regional Appellate Divisions use the facilities of the Washington, D.C., branch office of the Appellate Division of the Mid-Atlantic Region. Subject to the limitations set forth in subparagraphs (2) and (3) of this paragraph, the Commissioner has delegated to certain officers of the Appellate Division of each region authority to represent the regional commissioner in his exclusive and final authority for the determination of Federal income, profits, estate, or gift tax liability (whether before or after the issuance of a statutory notice of deficiency), and for the determination of employment or certain Federal excise tax liability in any case originating in the office of any district director situated in the region, or in any case in which jurisdiction has been transferred to the region, in which the taxpayer has protested the determination of liability made by that officer and no agreement has been reached. The Appellate Division has complete jurisdiction of every income, profits, estate, or gift tax case after the issuance of the statutory notice of deficiency, subject to the limitations provided in subparagraph (2) of this paragraph. After the filing of a petition in the Tax Court the Appellate Division continues to have exclusive jurisdiction of the case, subject to the provisions of subparagraph (2) of this paragraph. Subject to the exceptions and limitations set forth in subparagraph (2) of this paragraph, there is also vested in the Appellate Division of the region authority to represent the regional commissioner in his exclusive authority to settle (i) all cases docketed in the Tax Court of the United States and designated for trial at any place within the territory comprising the region and (ii) all docketed cases originating in the office of any district director situated within the region or in which jurisdiction has been transferred to the region, which are designated for trial at Washington, D.C., unless the petitioner resides in and his books and records are located (or can be made available) in the region which includes Washington, D.C.

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(b) *Initiation of proceedings before the Appellate Division.*—In any case in which the district director has issued a preliminary or "30-day letter" and the taxpayer files a written protest (see paragraph (c) (1) of § 601.103 and § 601.509) 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 regional office of the Appellate Division. Organizations such as labor unions and trade associations which have been examined by the district director to determine the amounts expended by the organization for purposes of lobbying, promotion or defeat of legislation, political campaigns, or propaganda related to those purposes are treated as "taxpayers" for the purpose of this right of administrative appeal. Thus, upon filing a protest to the district director's findings that a portion of member dues is to be disallowed as a deduction to each member because expended for such purposes, the organization will be afforded full rights of administrative appeal to the Appellate Division of the region similar to those rights afforded to taxpayers generally. After review of any protest by the district director, the case and its administrative record are referred to the Appellate Division. No taxpayer is required to submit his case to the Appellate Division for consideration. Appeal is at the option of the taxpayer. A request for administrative appeal to the Appellate Division will not be denied because no district conference was held in the district director's office. After the issuance by the district director of a statutory notice of deficiency, upon the taxpayer's request, the Appellate Division may take up the case for settlement and may grant the taxpayer a conference thereon. Except in unusual circumstances, however, no conference will be granted prior to the filing of a petition in the Tax Court for a redetermination of the deficiency proposed in the statutory notice.

(c) *Nature of proceedings before the Appellate Division.*—Proceedings before the Appellate Division are informal. Testimony under oath is not taken, although matters alleged as facts may be required to be submitted in the form of affidavits, or declared to be true under the penalties of perjury. Taxpayers may appear in person or by or with a representative. See Subpart E for conference and practice requirements. At any conference granted by the Appellate Division on a nondocketed case, the district director will be represented if he and the Appellate Division official having settlement authority deem it advisable. At any such conference on a case involving the ad valorem fraud penalty, the regional counsel will be represented if he so desires.

(d) *Disposition and settlement of cases before the Appellate Division.* * * *

(2) *Cases docketed in the Tax Court.* * * *

(iii) If the deficiency notice in a case docketed in the Tax Court was not issued by the Appellate Division and no recommendation for criminal prosecution is pending, the case will be referred by the regional counsel to the Appellate Division for settlement as soon as it is at issue in the Tax Court. The settlement procedure shall be governed by the following rules:

(*a*) The Appellate Division will arrange a conference for settlement purposes promptly after receipt of the file. Except in unusual circumstances, the regional counsel will be represented at the conference and will actively participate in it.

(*b*) If a settlement is agreed upon by the Appellate Division and the regional counsel as a result of a conference with the taxpayer, the stipulation of settlement will be prepared and filed with the Tax Court without delay.

(*c*) If no settlement is reached at a conference with the taxpayer, the file will be returned promptly to the regional counsel for preparation for trial and the taxpayer will be so advised by appropriate letter by the Appellate Division.

(*d*) In the event of disagreement between the Appellate Division and the regional counsel as to the settlement of the case, any issue in the case, or with respect to the amount of a counter offer which should be made, efforts will be made to resolve the matter quickly. If agreement cannot be reached the case will promptly be referred in writing to the Chief Counsel for decision.

(*e*) During the period between receipt of the Tax Court's "Trial Status Order" (usually issued from 60 to 90 days in advance of the issuance of the trial calendars and the receipt of the trial calendar (usually issued about 90 days in advance of the opening date of the trial calendar) the Appellate Division will conclude settlement negotiations on any case not previously settled or referred to the regional counsel.

(*f*) In order to enable the regional counsel to prepare the case for trial and stipulate the undisputed facts in any case on the trial calendar which has not

been settled, the Appellate Division will ordinarily, upon receipt of the trial calendar, return to the regional counsel any file still in its possession in any case on the calendar. Concurrent with any such return of the file, the Appellate Division will advise the taxpayer by letter that, since settlement negotiations have not been productive, the case is being referred to the regional counsel for preparation for trial.

(*g*) Upon receipt of the trial calendar, the regional counsel will address an appropriate letter to the taxpayer in each case on the calendar which has not been settled, or where the file has been retained by the Appellate Division, or in which the parties are not then negotiating a stipulation of facts. This letter will arrange or suggest a conference at an early date for the purpose of stipulating facts, as required by Rule 31(b) of the Tax Court, to clarify and, if possible, limit the issues.

(*h*) Any request for conferences received after receipt of the trial calendar will be referred to the regional counsel.

* * * * * * *

(f) *Conference and practice requirements.* * * *

(3) *Rule III.*—Where the Appellate Division conferee recommends acceptance of the taxpayer's proposal of settlement, or, in the absence of a proposal, recommends action favorable to the taxpayer, and said recommendation is disapproved in whole or in part by a reviewing officer in the Appellate Division, the taxpayer shall be so advised and upon written request shall be accorded a conference with such reviewing officer. The Appellate Division may disregard this rule where the interest of the Government would be injured by delay, as for example, in a case involving the imminent expiration of the statute of limitations or the dissipation of assets.

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(5) *Rule V.*—In order to bring before the Appellate Division an unagreed income, estate, or gift tax case in prestatutory notice status, an unagreed employment or excise tax case, or an offer in compromise, the taxpayer or his representative must first file with the district director a written protest setting forth specifically the reasons for his refusal to accept the district director's findings. If the protest includes a statement of facts upon which the taxpayer relies, such statement must be declared to be true under the penalties of perjury (see paragraph (c)(1) of § 601.103 and § 601.509). The protest and any new facts, law, or arguments presented therewith will be reviewed by the district director for the purpose of deciding whether further development or action is required prior to referring the case to the Appellate Division. Where the Appellate Division has an issue under consideration as a result of the filing of a protest or Tax Court petition, it may, with the concurrence of the taxpayer, assume jurisdiction in a related case without the necessity of an additional protest, after the district director has completed any necessary action. The Director, Appellate Division, may authorize the regional Appellate Division to accept jurisdiction (after any necessary action by the district director) in specified classes of cases without a written protest, provided a written request for Appellate Division consideration is submitted by or on behalf of each taxpayer.

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(9) *Rule IX.*—Prior to the opening date of the session of the Tax Court at which the case is on the calendar for trial (or the opening date of any pre-trial hearing or report session) a taxpayer may request the reopening or resumption of settlement conferences in a docketed case, before the Chief, Associate Chief, or the Assistant Chief, in charge of an Appellate Division branch office, and whenever such request is granted the Appellate conferee who originally considered the case shall ordinarily be present and participate in any conference.

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PAR. 6. Paragraph (a)(2) of section 601.107 is amended to read as follows:

§ 601.107 EXCESS PROFITS TAX COUNCIL; APPELLATE FUNCTIONS AND PROCEDURES UNDER SECTION 722 OF THE INTERNAL REVENUE CODE OF 1939.

(a) *General.* * * *

(2) The rules bearing upon the procedure applicable with respect to section 722 of the 1939 Code are found in Regulations 109 (26 CFR, 1938 Ed. and Supps., Part 30) and Regulations 112 (26 CFR, 1938 Ed. and Supps., Part 35). There has

also been published "Bulletin on Section 722 of the Internal Revenue Code", copies of which may be obtained from the Superintendent of Documents, Government Printing Office, Washington, D.C., 20402. Practice and conference procedure before the Council is also governed by the requirements of Subpart E.

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PAR. 7. Section 601.108 is amended to read as follows:

§ 601.108 REVIEW OF OVERPAYMENTS EXCEEDING $100,000.

(a) *General.*—Section 6405(a) of the Code provides that no refund or credit of income, profits, estate, or gift taxes in excess of $100,000 may be made until 30 days after a report has been made to the Joint Committee on Internal Revenue Taxation. Taxpayers in cases requiring review by the Joint Committee are afforded the same district conference and appeal rights as other taxpayers. In general, these cases follow regular procedures, except for preparation of reports to and review by the Joint Committee.

(b) *Reports to Joint Committee.*—In any case in which no protest is made to the Appellate Division and no petition docketed in the Tax Court, the report to the Joint Committee is prepared by a Joint Committee Coordinator, who is an Audit Division regional specialist. In cases in which such a protest has been made or such a petition docketed, the report to the Joint Committee is prepared by an Appellate Division conferee.

(c) *Procedure after report to Joint Committee.*—After compliance with section 6405 of the Code, the case is processed for issuance of a certificate of overassessment, and payment or credit of any overpayment. 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 certified or registered mail to the taxpayer, except where the taxpayer has filed a written waiver of such notice of disallowance.

PAR. 8. Section 601.109 is amended by revising subparagraphs (1) and (3) of paragraph (b). These amended provisions read as follows:

§ 601.109 BANKRUPTCY AND RECEIVERSHIP CASES.

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(b) *Procedure in office of district director.*—(1) While the district director is required by section 6871 of the Code to make immediate assessment of any deficiency in income, estate, or gift taxes, such assessment is not made as a jeopardy assessment (see paragraph (h) of § 601.105), and the provisions of section 6861 of the Code do not apply to any assessment made under section 6871. Therefore, the notice of deficiency provided for in section 6861(b) will not be mailed to the taxpayer. Nevertheless, a letter (Form 7900) will be prepared and addressed in the name of the taxpayer, immediately followed by the name of the trustee, receiver, debtor in possession, or other person designated to be in control of the assets or affairs of the debtor by the court in which the bankruptcy or receivership proceeding is pending. Such letter will state how the deficiency was computed, advise that within 30 days a written protest under penalties of perjury may be filed with the district director showing wherein the deficiency is claimed to be incorrect, and advise that upon request a district conference will be granted with respect to such deficiency. If, after protest is filed and a district conference is held, adjustment appears necessary in the deficiency, appropriate action will be taken. Except where the interests of the Government require otherwise, Form 7900 letters are issued by the office of the district director. If at the time of the adjudication of bankruptcy in a liquidating proceeding, the approval of a petition in any other proceeding under the Bankruptcy Act, or appointment of a receiver, a case was pending before the Tax Court, the prescribed Form 7900 letter will not advise the addressee of any right to request a conference in the office of the district director. Protests must be filed in triplicate. The district conference procedures described in paragraph (c) of § 601.105 are generally applicable to a district conference held after the issuance of a Form 7900 letter.

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(3) If after such assessment a claim for abatement is filed and such claim is accompanied by a request in writing for a conference, a district conference in the office of the district director of internal revenue will be granted. Ordinarily,

only one conference will be held, unless it develops that additional information can be furnished which has a material bearing upon the tax liability, in which event the conference will be continued to a later date.

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PAR. 9. Section 601.201 is amended by revising subparagraphs (1), (2), and (6) of paragraph (a), paragraph (c)(4), subparagraphs (2), (6), (7), and (9) of paragraph (e), paragraph (f)(2), subparagraphs (1), (7), and (8) of paragraph (l), paragraph (m), and subparagraphs (2) and (11) (i) and (ii) of paragraph (n). These amended provisions read as follows:

§ 601.201 RULINGS AND DETERMINATION LETTERS.

(a) *General practice and definitions.*—(1) It is the practice of the Internal Revenue Service to answer inquiries of individuals and organizations, whenever appropriate in the interest of sound tax administration, as to their status for tax purposes and as to the tax effects of their acts or transactions. One of the functions of the National Office of the Internal Revenue Service is to issue rulings in such matters. District directors apply the statutes, regulations, Revenue Rulings, and other precedents published in the Internal Revenue Bulletin in the determination of tax liability, the collection of taxes, and the issuance of determination letters in answer to taxpayers' inquiries or requests. For purposes of this section any reference to district director or district office also includes, where appropriate, the office of the Director, Office of International Operations.

(2) A "ruling" is a written statement issued to a taxpayer or his authorized representative by the National Office which interprets and applies the tax laws to a specific set of facts. Rulings are issued only by the National Office. The issuance of rulings is under the general supervision of the Assistant Commissioner (Technical) and has been largely redelegated to the Directors of three divisions: Director, Income Tax Division; Director, Exempt Organization and Pension Trust Division; and Director, Miscellaneous Tax Division.

* * * * * * *

(6) A "closing agreement", as the term is used in this section, is an agreement between the Commissioner of Internal Revenue or his delegate and a taxpayer with respect to a specific issue or issues entered into pursuant to the authority contained in section 7121 of the Code. Such a closing agreement is based on a ruling which has been signed by the Commissioner or his delegate and in which the Commissioner or his delegate indicates that he will enter into a closing agreement on the basis of the holding of the ruling letter. Closing agreements are final and conclusive except upon a showing of fraud, malfeasance, or misrepresentation of a material fact. They may be entered into where it is advantageous to have the matter permanently and conclusively closed, or where a taxpayer can show good and sufficient reasons for an agreement and the Government will sustain no disadvantage by its consummation.

* * * * * * *

(c) *Determination letters issued by district directors of internal revenue.* * * *

(4) Notwithstanding the provisions of subparagraphs (1), (2), (3), (5), and (6) of this paragraph, a district director may not issue a determination letter in response to an inquiry, although the inquiry presents a question covered specifically by statute, regulations, rulings, etc., published in the Internal Revenue Bulletin, where (i) it appears that the taxpayer has directed a similar inquiry to the National Office, (ii) the identical issue is pending in a case before the Appellate Division, (iii) the determination letter is requested by an industry, trade association, or similar group, or (iv) the request involves an industry-wide problem. Under no circumstances will a district director issue a determination letter unless it is clearly indicated that the inquiry is with regard to a taxpayer or taxpayers who have filed or are required to file returns in the district under his supervision. Notwithstanding the provision of subparagraph (3) of this paragraph, a district director may not issue a determination letter on an employment tax question when the specific question involved has been or is being considered by the National Office of the Social Security Administration. Nor may district directors issue determination letters on excise tax questions if the request is for a determination of fair market

price under section 4216(b) or 4218 of the Code. However the National Office will issue rulings in this area. See paragraph (d)(3) of this section.

* * * * * * *

(e) *Instructions to taxpayers.* * * *

(2) Each request for a determination letter or a ruling must contain a complete statement of facts relating to the transaction. This includes, but is not necessarily limited to, the names, addresses, and taxpayer account numbers of all interested parties; the district office where each files or will file its return or report; a full and precise statement of the business reasons for the transactions; and true copies of all contracts, wills, deeds, agreements, or other documents involved in the transaction. The request must contain a statement whether, to the best of the knowledge of the taxpayer or his representative, the identical issue is being considered by any field office of the Service in connection with an active examination or audit of a tax return already filed. Such statement will enable the Service to rule with full knowledge of the consequences of the ruling. Where the request pertains to only one step of a larger integrated transaction, the facts, circumstances, etc., must be submitted with respect to the entire transaction. (The term "all interested parties" is not to be construed as requiring a list of all shareholders of a widely held corporation requesting a ruling relating to a reorganization, or a list of employees where a large number may be involved in a plan.) As documents and exhibits become a part of the Internal Revenue Service file and cannot be returned, the original documents should not be submitted. When documents and exhibits are submitted, they must be accompanied by an analysis of their bearing on the issue or issues, specifying the pertinent provisions. If the request is with respect to a corporate distribution, reorganization, or other similar or related transaction, the corporate balance sheet nearest the date of the transaction should be submitted. (If the request relates to a prospective transaction, the most recent balance sheet should be submitted.)

* * * * * * *

(6) A request for a ruling by the National Office should be addressed to the Commissioner of Internal Revenue, Washington, D.C., 20224. A request for a determination letter should be addressed to the district director of internal revenue for the district with which the tax return of the taxpayer has been filed or is required to be filed. See also paragraphs (n) and (o) of this section.

(7) Any request for a ruling or a determination letter which does not comply with all the provisions of this section will be acknowledged, pointing out the requirements which have not been met. See Subpart E for power of attorney requirements.

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(9) It is the practice of the Service to process requests for rulings or determination letters in regular order and as expeditiously as possible. Compliance with a request for consideration of a particular matter ahead of its regular order, or by a specified time, tends to delay the disposition of other matters. Requests for processing ahead of the regular order, made in writing and showing clear need for such treatment, will be given consideration as the particular circumstances warrant. However, no assurance can be given that any ruling or determination letter will be processed by the time requested. Requests by telegram will be treated in the same manner as requests by letter. Rulings and determination letters ordinarily will not be issued by telegram. A taxpayer or his representative desiring to obtain information as to the status of his case may do so by contacting the appropriate division in the office of the Assistant Commissioner (Technical).

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(f) *Conferences in the National Office.* * * *

(2) A taxpayer is entitled as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in this paragraph exists. This conference will usually be held at the branch level of the appropriate division in the office of the Assistant Commissioner (Technical) and will usually be attended by a person who has authority to act for the branch chief. (See § 601.201(a)(2) for the divisions involved.) If more than one subject is to be discussed at the conference, the discussion will constitute a conference with respect to each subject. At the request of the taxpayer or his representative

the conference may be held at an earlier stage in the consideration of the case than the Service would ordinarily designate. No taxpayer has a "right" to appeal the action of a branch to a Division Director or to any other official of the Service.

* * * * * * *

(l) *Effect of rulings.*—(1) A ruling, except to the extent incorporated in a closing agreement, may be revoked or modified at any time in the wise administration of the taxing statutes. See paragraph (a)(6) of this section for the effect of a closing agreement. If a ruling is revoked or modified, the revocation or modification applies to all open years under the statutes, unless the Assistant Commissioner (Compliance) or the Assistant Commissioner (Technical) exercises the discretionary powers delegated to him under section 7805(b) of the Code to limit the retroactive effect of the ruling. The Assistant Commissioner (Compliance) exercises such powers with respect to rulings concerning alcohol, tobacco and firearms taxes other than the manufacturers excise tax on firearms arising from the application of sections 4181 and 4182 of the Code. The Assistant Commissioner (Technical) exercises such powers with respect to rulings issued by or pursuant to authorization from him relating to the internal revenue laws concerning taxes other than those for which the Assistant Commissioner (Compliance) has responsibility. The manner in which such Assistant Commissioners generally will exercise this power is set forth in this paragraph. With reference to rulings relating to the sale or lease of articles subject to the manufacturers excise tax and the retailers excise tax, see specifically subparagraph (8) of this paragraph.

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(7) If a ruling is issued covering a continuing action or a series of actions and it is determined that the ruling was in error or no longer in accord with the position of the Service, the appropriate Assistant Commissioner ordinarily will limit the retroactivity of the revocation or modification to a date not earlier than that on which the original ruling was modified or revoked. To illustrate, if a taxpayer rendered service or provided a facility which is subject to the excise tax on services or facilities, and in reliance on a ruling issued to the same taxpayer did not pass the tax on to the user of the service or the facility, the appropriate Assistant Commissioner ordinarily will restrict the retroactive application to the revocation or modification of the ruling.

(8) A ruling holding that the sale or lease of a particular article is subject to the manufacturers excise tax may not revoke or modify retroactively a prior ruling holding the sale or lease of such article was not taxable, if the taxpayer to whom the ruling was issued, in reliance upon such prior ruling, parted with possession or ownership of the article without passing the tax on to his customer. Section 1108(b), Revenue Act of 1926.

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(m) *Effect of determination letters.*—A determination letter issued by a district director, in accordance with this section, shall be given the same effect upon examination of the return of the taxpayer to whom the determination letter was issued as is described in paragraph (l) of this section, in the case of a ruling issued to a taxpayer, except that reference to the National Office is not necessary where, upon the examination of the return, it is the opinion of the district director that a conclusion contrary to that expressed in the determination letter is indicated. A district director may not limit the modification or revocation of a determination letter, but may refer the matter to the National Office for exercise by the Assistant Commissioner (Technical) of his authority to limit the modification or revocation.

(n) *Organization claiming exemption under section 501 or 521 of the Code.* * * *

(2) Requests other than in the form of an application for exemption, involving the provisions of section 502 of the Code relating to feeder corporations, section 503 relating to prohibited transactions, section 504 relating to accumulation of income, or sections 511 through 515 relating to unrelated business income, should be forwarded to the Commissioner of Internal Revenue, Washington, D.C., 20224. In this connection see subparagraph (7) of this paragraph and paragraphs (a) through (m) of this section.

* * * * * * *

(11) (i) If a district director concludes, in the course of examining an information return, or from any other source, that a ruling or a determination letter holding an organization to be exempt should be revoked or modified, the organization will be advised in writing of the proposed action and the reasons therefor. The district office will also advise the organization of its rights to protest the proposed action by submitting a statement of facts, law, and arguments in support of its continued exemption, and of its rights to a conference in the district office.

(ii) If the organization agrees with the proposed action, either before or after a district conference, or if no protest is filed, the district director will advise the organization in writing of the revocation or modification of the exemption status.

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PAR. 10. Section 601.202 is amended by revising paragraphs (b), (c), and (d). These amended provisions read as follows:

§ 601.202 CLOSING AGREEMENTS.

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(b) *Use of prescribed forms.*—In cases in which it is proposed to close conclusively the total tax liability for a taxable period ending prior to the date of the agreement, Form 866, Agreement as to Final Determination of Tax Liability, will be used. In cases in which agreement has been reached as to the disposition of one or more issues and a closing agreement is considered necessary to insure consistent treatment of such issues in any other taxable period Form 906, Closing Agreement as to Final Determination Covering Specific Matters, generally will be used. A request for a closing agreement which determines tax liability may be submitted at any time before the determination of such liability becomes a matter within the province of a court of competent jurisdiction. The request should be submitted to the district director of internal revenue with whom the return for the period involved was filed. However, if the matter to which the request relates is pending before an office of the Appellate Division, the request should be submitted to that office. A request for a closing agreement which relates only to a subsequent period should be submitted to the Commissioner of Internal Revenue, Washington, D.C., 20224.

(c) *Review and approval.*—All closing agreements initiated in the field offices are reviewed in the Appellate Division of the National Office. After review in the Appellate Division these closing agreements are referred to the Office of the Assistant Commissioner (Compliance) as authorized in Delegation Order 97 (Rev. 1), I.R.B. 1965–40, 23 [C.B. 1965–2, 862]. After approval of a closing agreement affecting or relating to tax liability for a period ending subsequent to the date of the agreement, the appropriate regional commissioner or district director is fully advised as to the basis of the agreement in order that, by the maintenance of proper controls, the Government may be insured against loss through the failure to give effect to all terms thereof in the determination of taxes for periods ending subsequent to the date of the agreement.

(d) *Applicability of ruling requirements.*—The requirements relating to requests for rulings (see § 601.201) shall be applicable with respect to requests for closing agreements pertaining to future periods only (see paragraph (b) of § 601.202).

PAR. 11. Section 601.203 is amended by revising paragraph (a)(1), subdivisions (iii) and (iv) of subparagraph (1) and subparagraphs (3) and (4) of paragraph (c), and paragraph (d). These amended provisions read as follows:

§ 601.203 OFFERS IN COMPROMISE.

(a) *General.*—(1) The Commissioner may compromise, in accordance with the provisions of section 7122 of the Code, any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense. Certain functions of the Commissioner with respect to compromise of civil cases involving liability under $100,000, and of certain specific penalties involving only the regulatory provisions of the Code and related statutes, have been delegated to district directors. In civil cases involving liability of $500 or over and in criminal cases the functions of the General Counsel are performed by the Chief Counsel for the Internal Revenue Service.

In certain cases these functions are performed in the National Office and in other cases by Regional Counsel. (See also paragraph (c) of this section.)

* * * * * * *

(c) *Consideration of offer.*—(1) * * *

(iii) Accept the offer if it involves a civil liability of $500 or more, but less than $100,000, or involves a specific penalty (including in the case of narcotics, smoking opium, and marihuana taxes only those specific penalties which involve delinquency in registration or delinquency in payment), and the Regional Counsel concurs in the acceptance of the offer, or

(iv) Recommend to the National Office the acceptance of the offer if it involves a civil liability of $100,000 or over.

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(3) The district directors are authorized to reject any offer in compromise referred for their consideration. Unacceptable offers considered by the Chief Counsel, regional counsel, or the Appellate Division are also rejected by district directors. If an offer is not acceptable, the taxpayer is promptly notified of the rejection of that offer. If an offer is rejected, the sum submitted with the offer is returned by the district director to the proponent, unless the taxpayer, in submitting the offer, authorized the district director to retain the sum submitted with the offer. A selective post review of offers rejected by a district director involving liabilities totaling $5,000 or more is made by each regional commissioner. A selected post review of offers rejected by the Director of International Operations involving liabilities totaling $5,000 or more is made by the Audit Division of the National Office.

(4) If an offer involving unpaid liability of $100,000 or more is considered acceptable by the office having jurisdiction over the offer, a recommendation for acceptance is forwarded to the Audit Division in the National Office for review. If the Audit Division approves the recommendation for acceptance, the offer is forwarded to the Office of the Chief Counsel for approval. After approval by the Office of the Chief Counsel, it is forwarded to the Commissioner for acceptance. The taxpayer is notified of the acceptance of the offer in accordance with its terms. 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.

(d) *Conferences.*—Before filing a formal offer in compromise, a taxpayer may request a conference in the office which would have jurisdiction of the offer filed by him for the purpose of exploring the possibilities of compromising the unpaid tax liability. A conference may also be requested by the taxpayer in the office which has jurisdiction of the offer filed by him after all investigations have been made for the purpose of determining the amount which may be accepted as a compromise. 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, accompanied by a protest, for a district conference. If the controversial issues cannot be resolved at the district conference level, the taxpayer may appeal the case to the appropriate Appellate branch office for a conference provided the required protest has been filed. The procedure outlined in the preceding sentence will not be followed if the offer relates to a tax over which the Appellate Division has no authority (see paragraph (a)(3) of § 601.106). Taxpayers and their representatives are required to fulfill and comply with the applicable conference and practice requirements. See Subpart E.

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PAR. 12. Section 601.204 is amended to read as follows:

§ 601.204 CHANGES IN ACCOUNTING PERIODS AND IN METHODS OF ACCOUNTING.

(a) *Accounting periods.*—A taxpayer who changes his accounting period shall, before using the new period for income tax purposes, comply with the provisions of the income tax regulations relating to changes in accounting periods. In cases where the regulations require the taxpayer to secure the consent of the Commissioner to the change, the application for permission to change the accounting period shall be made on Form 1128 and shall be submitted to the Commissioner of Internal Revenue, Washington, D.C., 20224, within the period

of time prescribed in such regulations. See section 442 and the regulations thereunder (under the 1939 Code, § 39.46–1 of Regulations 118) (26 CFR Rev. 1953, Parts 1–79, 39.46–1). If the change is approved by the Commissioner, the taxpayer shall thereafter make his returns and compute his net income upon the basis of the new accounting period. A request for permission to change the accounting period will be considered by the Income Tax Division.

(b) *Methods of accounting.*—A taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such method for purposes of income taxation, comply with the provisions of the income tax regulations relating to changes in accounting methods. The regulations require that, in the ordinary case, the taxpayer secure the consent of the Commissioner to the change. See section 446 of the Code and the regulations thereunder. Application for permission to change the method of accounting employed shall be made on Form 3115 and shall be submitted to the Commissioner of Internal Revenue, Washington, D.C., 20224, within 90 days after the beginning of the taxable year in which it is desired to make the change. Permission to change the method of accounting will not be granted unless the taxpayer and the Commissioner agree to the terms and conditions under which the change will be effected. The request will be considered by the Income Tax Division.

(c) *Verification of changes.*—Written permission to a taxpayer by the National Office consenting to a change in his annual accounting period or to a change in his accounting method is a "ruling". Therefore, in the examination of returns involving changes of annual accounting periods and methods of accounting, district directors must determine whether the representations upon which the permission was granted reflect an accurate statement of the material facts, and whether the agreed terms, conditions, and adjustments have been substantially carried out as proposed.

PAR. 13. Section 601.205 is amended to read as follows:

§ 601.205 TORT CLAIMS.

Claims for property loss or damage, personal injury, or death caused by the negligent or wrongful act or omission of any employee of the Service, acting within the scope of his office or employment, filed under the Federal Tort Claims Act, as amended, must be prepared and filed in accordance with Treasury Department regulations entitled "Central Office Procedures" and "Claims Regulations" (31 CFR Parts 1 and 3). Such regulations contain the procedural and substantive requirements relative to such claims, and set forth the manner in which they are handled. The claims should be filed with the Commissioner of Internal Revenue, Washington, D.C., 20224, and must be filed within two years after the accident or incident occurred.

PAR. 14. The heading for subpart C of part 601 is amended to read as follows:

SUBPART C.—PROVISIONS RELATING TO DISTILLED SPIRITS, WINES, BEER, CIGARS, CIGARETTES, and CIGARETTE PAPERS and TUBES, and CERTAIN FIREARMS

PAR. 15. Section 601.301 is amended by revising the introductory language of paragraph (c), by deleting subdivision (vi) of subparagraph (2) of paragraph (c), by redesignating subdivisions (ii), (iii), (iv), and (v) of subparagraph (2) of paragraph (c) as subdivisions (iii), (iv), (v), and (vi), respectively, by adding a new subdivision (ii) to subparagraph (2) of paragraph (c), and by revising subparagraphs (4), (12), (16), (18), (21), and (28) of paragraph (c). These amended and added provisions read as follows:

§ 601.301 IMPOSITION OF TAXES, QUALIFICATION REQUIREMENTS, AND REGULATIONS.

* * * * * * *

(c) *Regulations.*—The procedural requirements with respect to matters relating to distilled spirits, wines, and beer which are within the jurisdiction of the Alcohol and Tobacco Tax Division are published in the regulations described in this paragraph. These regulations contain full information as to the general

course and method by which the functions concerning liquors are channeled and determined, including the nature and requirements of formal and informal procedures, the forms, records, reports, and other documents required, and contents of applications, notices, registrations, permits, bonds, and other documents. Supplies of prescribed forms may be obtained from the offices of assistant regional commissioners (alcohol and tobacco tax), except that Forms 52–A, 52–B, 122, 133, 338, 2051, 2054–2060, 2621, and 2637 must be provided by the users at their own expense. Users and commercial printers may procure specimen copies of such forms from such offices. The following is a brief description of the several regulations arranged according to the principal subjects and operations concerned:

* * * * * * *

(2) *Miscellaneous liquor transactions.* * * *

(ii) Authorizations to execute bonds and consents on behalf of corporate sureties;

(iii) Refunds of tax and duty paid on distilled spirits, wine, rectified products, and beer lost as a result of floods, hurricanes, or other disasters;

(iv) Application of section 6423, Internal Revenue Code of 1954, as amended, to refund or credit of tax on distilled spirits, wines, and beer;

(v) Regulations in effect on June 30, 1959, which were prescribed on July 1, 1959, as interim regulations; and

(vi) Manufacture and sale of certain compounds, preparations, and products containing alcohol.

* * * * * * *

(4) *Manufacture and use of containers of distilled spirits.*—Part 175 of this chapter contains the regulations relating to the traffic in containers of distilled spirits of a capacity of not more than five wine gallons. The regulations cover the manufacture, sale, and use of liquor bottles for packaging distilled spirits for other than industrial use; use of liquor bottles for purposes other than packaging distilled spirits; labeling of distilled spirits; permits and revocation proceedings; imports and exports of liquor bottles; records, reports, and inventories of liquor bottles; reuse or refilling of liquor bottles (see also Part 194 of this chapter); and the purchase, sale and possession of refilled or used liquor bottles.

* * * * * * *

(12) *Production and removal of wine.*—Part 240 of this chapter contains the regulations relative to the establishment and operation of bonded wine cellars, including bonded wineries, for the production, cellar treatment, and storage of wines, including amelioration, sweetening, addition of volatile fruit-flavor concentrates, addition of wine spirits (including distillates containing aldehydes), blending, and other cellar treatment; removals; taxpayment; return of unmerchantable taxpaid wine; use of wine for distilling material and manufacture of vinegar; and record and report requirements.

* * * * * * *

(16) *Establishment and operations of breweries.*—Part 245 of this chapter contains the regulations relating to the production (including concentration and reconstitution incident thereto) and removal of beer and cereal beverages. The regulations cover the location, construction, equipment, and operations of breweries; and the qualification of such establishments, including the ownership, control and management thereof.

* * * * * * *

(18) *Liquor dealers.*—Part 194 of this chapter contains the regulations relative to the special (occupational) taxes imposed on wholesale and retail dealers in liquors, wholesale and retail dealers in beer, and limited retail dealers; restrictions on purchases of distilled spirits; reuse or refilling of liquor bottles (see also Part 175 of this chapter); sale or possession of refilled or used liquor bottles; repackaging of alcohol for industrial use; recordkeeping and reporting requirements; and provisions relating to entry of premises and inspection of records by internal revenue officers.

* * * * * * *

(21) *Production of volatile fruit-flavor concentrates.*—Part 198 of this chapter contains the regulations relating to the manufacture, removal, sale, storage, transfer in bond, transportation, recordkeeping and reporting requirements, and

use of volatile fruit-flavor concentrates. It includes provisions regarding the location, qualification, use, and operations of concentrate plants.

* * * * * * *

(28) *Exportation of liquors.*—Part 252 of this chapter contains the regulations relating to exportation (including, where applicable, lading for use on vessels and aircraft, transfer to a foreign-trade zone, or transfer to a manufacturing bonded warehouse, Class 6, of distilled spirits (including specially denatured spirits), beer (including beer concentrate), and wine, whether without payment of tax, free of tax, or with benefit of drawback. It includes requirements with respect to removal, shipment, lading, deposit, evidence of exportation, losses, claims, and bonds.

PAR. 16. Section 601.306 is revised to read as follows:

§ 601.306 APPLICATION FOR APPROVAL OF INTERLOCKING DIRECTORS AND OFFICERS UNDER SECTION 8 OF THE FEDERAL ALCOHOL ADMINISTRATION ACT.

Any person who is an officer or director of a corporation now engaged in business as a distiller, rectifier, or blender of distilled spirits, or of an affiliate thereof, who desires to take office in other companies similarly engaged, must obtain permission to do so from the Director of the Alcohol and Tobacco Tax Division. Applications for such permission to take office shall be prepared and filed in accordance with instructions available from the assistant regional commissioner (alcohol and tobacco tax) or from the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington, D.C., 20224.

PAR. 17. Section 601.307 is amended to read as follows:

§ 601.307 RULINGS.

The procedure for rulings in alcohol tax matters is set forth in § 601.328.

PAR. 18. Section 601.309 is amended to read as follows:

§ 601.309 REPRESENTATIVES.

Subpart E, conference and practice requirements, is applicable to all representatives of the taxpayer before the Service, in the office of the Director, Alcohol and Tobacco Tax Division, or in the office of the assistant regional commissioner (alcohol and tobacco tax).

PAR. 19. The center heading preceding § 601.311 is amended to read as follows:

Cigars, Cigarettes, and Cigarette Papers and Tubes

PAR. 20. Section 601.311 is amended to read as follows:

§ 601.311 IMPOSITION OF TAXES; REGULATIONS.

(a) *Taxes.*—Subchapter A of chapter 52 of the Internal Revenue Code of 1954, as amended, imposes taxes on cigars, cigarettes, and cigarette papers and tubes manufactured in or imported into the United States. Subchapter D of chapter 78 of the Code imposes a tax (equal to the internal revenue tax imposed in the United States upon the like articles of merchandise of domestic manufacture) on cigars, cigarettes, and cigarette papers and tubes of Puerto Rican manufacture brought into the United States and withdrawn for consumption or sale, and on such articles brought into the United States from the Virgin Islands.

(b) *Regulations.*—The procedural requirements with respect to matters relating to cigars, cigarettes, and cigarette papers and tubes are contained in the regulations listed below:

(1) Part 200 of this chapter relates 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.

(2) Part 270 of this chapter relates to the manufacture of cigars and cigarettes; the payment by manufacturers of cigars and cigarettes of internal revenue taxes imposed by chapter 52 of the Code; and the qualification of and operations by manufacturers of cigars and cigarettes.

(3) Part 275 of this chapter relates to cigars, cigarettes, and cigarette papers and tubes imported into the United States from a foreign country or brought into the United States from Puerto Rico, the Virgin Islands, or a possession of the United States; the removal of cigars from a customs bonded manufacturing ware-

house, Class 6; and the release of such articles from customs custody, without payment of internal revenue tax or customs duty attributable to the internal revenue tax.

(4) Part 285 of this chapter relates to the manufacture of cigarette papers and tubes; the payment by manufacturers of cigarette papers and tubes of internal revenue taxes imposed by chapter 52 of the Code; and the qualification of and operations by manufacturers of such articles.

(5) Part 290 of this chapter relates to the exportation (including supplies for vessels and aircraft and transfers to a foreign-trade zone) of cigars, cigarettes, and cigarette papers and tubes, without payment of tax, or with benefit of drawback of tax, and the qualification of and operations by export warehouse proprietors.

(6) Part 295 of this chapter relates to the removal of cigars, cigarettes, and cigarette papers and tubes, without payment of tax, for use of the United States.

(7) Part 296 of this chapter relates to the provisions of a miscellaneous nature or not of continuing application. Included are regulations relating to:

(i) Limitations imposed by section 6423 of the Code on the refund or credit of tax paid or collected on cigars, cigarettes, and cigarette papers and tubes;

(ii) Losses of cigars, cigarettes, and cigarette papers and tubes caused by disasters occurring in the United States on or after September 3, 1958;

(iii) Purchase, receipt, possession, offering for sale, or sale or other disposition of cigars and cigarettes by dealers in such products;

(iv) Authorizations to execute bonds and extensions of coverage of bonds on behalf of corporate sureties; and

(v) Periods to be covered by tax returns filed by manufacturers for the deferred payment of taxes on cigars and cigarettes.

PAR. 21. Section 601.312 is amended by revising paragraphs (b), (b–1), and (d). These amended provisions read as follows:

§ 601.312 QUALIFICATION AND BONDING REQUIREMENTS.

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(b) *Manufacturers of cigarette papers and tubes.*—Every person, before commencing business as a manufacturer of cigarette papers and tubes, is required to qualify with the Internal Revenue Service by filing bond and other required documents with the assistant regional commissioner (alcohol and tobacco tax) for the region in which operations are to be conducted.

(b–1) *Puerto Rican manufacturers of cigars and cigarettes.*—Every manufacturer of cigars and cigarettes in Puerto Rico who desires to defer payment in Puerto Rico of the internal revenue tax imposed by section 7652(a) of the Code on cigars and cigarettes of Puerto Rico manufacture coming into the United States must file a bond with the Director's Representative of the Office of International Operations, in Puerto Rico. Such bond is conditioned on the principal's paying, at the time and in the manner prescribed in the regulations, the full amount of tax computed on the tobacco products which are released for shipment to the United States. No bond is required if the tax is prepaid.

* * * * * * *

(d) *Drawback of tax.*—Taxpaid cigars, cigarettes, and cigarette papers and tubes may be exported with benefit of drawback of tax. Drawback may be allowed only to the person who paid the tax on such articles and who files claim and otherwise complies with the provisions contained in the applicable regulations referred to in § 601.311. As a condition precedent to the allowance of any drawback claim, the claimant is required to file a bond in an amount not less than the amount of tax covered in the claim.

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PAR. 22. Section 601.313 is amended by revising paragraphs (a) and (c). These amended provisions read as follows:

§ 601.313 COLLECTION OF TAXES.

(a) *Cigars and cigarettes.*—Taxes on cigars and cigarettes are paid by the manufacturer on the basis of a return. If the manufacturer has filed a proper bond, he may defer payment at the time of removal and file semimonthly returns

to cover the taxes. If the manufacturer has not filed such a bond or if he has defaulted in any way in paying his taxes, he is required to file a prepayment return prior to removal of such products, and to continue so doing until the assistant regional commissioner (alcohol and tobacco tax) finds that the revenue will not be jeopardized by deferred payment. Tax returns, with remittances, are filed by the domestic manufacturer with the appropriate district director of internal revenue. Taxes on cigars produced in a customs bonded manufacturing warehouse, Class 6, are paid on the basis of a return to the collector of customs in accordance with customs procedures and regulations. Taxes on cigars and cigarettes imported or brought into the United States from a foreign country, Puerto Rico, the Virgin Islands, or a possession of the United States are paid by the importer to the collector of customs on the basis of a return made on the customs form by which release from customs custody is to be effected. However, taxes on cigars and cigarettes manufactured in Puerto Rico and brought into the United States may be prepaid in Puerto Rico on the basis of a return. If a Puerto Rican manufacturer has filed a proper bond, he may defer payment at the time of release for shipment to the United States and file a semimonthly return to cover the taxes. If the manufacturer has not filed such a bond or if he has defaulted in any way in payment of his taxes, he must file a prepayment return prior to removal of such products for shipment to the United States, and continue to do so until the Director's Representative of the Office of International Operations in Puerto Rico finds that the revenue will not be jeopardized by deferred payment. Tax returns in Puerto Rico, with remittances, are filed with the Director's Representative.

* * * * * * *

(c) *General.*—Detailed information about the payment of taxes on cigars, cigarettes, and cigarette papers and tubes, including the forms to be used, records to be kept, and reports and inventories to be filed, is contained in the respective regulations referred to in § 601.311.

PAR. 23. Section 601.314 is amended to read as follows:

§ 601.314 ASSESSMENTS.

When additional or delinquent tax liability on cigars, cigarettes, and cigarette papers and tubes is disclosed by an investigation or by an examination of the taxpayer's records, a notice (except where delay may jeopardize collection of the tax, or where the amount is nominal or the result of an evident mathematical error) is forwarded to the taxpayer advising him of the basis for, and amount of, the liability and affording him an opportunity to show cause, in writing, against assessment.

PAR. 24. Section 601.315 is amended by revising paragraphs (a), (b), (c), (d), (e), and (f) and adding a new paragraph (g). These amended and added provisions read as follows:

§ 601.315 CLAIMS.

(a) *Abatement of assessment.*—Abatement of the unpaid portion of an assessment of any tax on cigars, cigarettes, and cigarette papers and tubes, or any liability in respect thereof, may be allowed to the extent that such assessment is excessive in amount, is assessed after expiration of the applicable period of limitation, or is erroneously or illegally assessed. The taxpayer against whom such assessment has been made may file a claim for abatement of the tax on Form 843 with the assistant regional commissioner (alcohol and tobacco tax) for the region in which the tax or liability was assessed.

(b) *Allowance of tax.*—Relief from the payment of tax on cigars, cigarettes, and cigarette papers and tubes may be extended to a manufacturer by allowance of the tax, where such articles, after removal from the factory upon determination of tax 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, while in the possession or ownership of the manufacturer who removed such articles, or are withdrawn by him from the market. A claim for allowance is filed with the assistant regional commissioner (alcohol and tobacco tax) for the region in which the cigars, cigarettes, and cigarette papers and tubes were removed from the factory. A manufacturer may not anticipate allowance of his claim by making an adjusting entry in a tax return, pending consideration and action on the claim by the assistant regional commissioner.

(c) *Remission of tax liability.*—Remission of tax liability on cigars, cigarettes, and cigarette papers and tubes may be extended to a manufacturer or export warehouse proprietor liable for the tax, where such articles, before removal, or after removal for tax-exempt purposes (including transfers in bond), are lost (otherwise than by theft) or destroyed, by fire, casualty, or act of God, while in the possession or ownership of the manufacturer or export warehouse proprietor. Remission of tax liability on shortages of cigars and cigarettes in bond may be extended to manufacturers of these products. A claim for remission of such tax liability is filed with the assistant regional commissioner (alcohol and tobacco tax) for the region in which the factory or warehouse is located.

(d) *Refund of tax.*—Taxes paid by return, or otherwise, on cigars, cigarettes, and cigarette papers and tubes lost (otherwise than by theft) or destroyed, by fire, casualty, or act of God, while in the possession or ownership of the manufacturer, importer, or export warehouse proprietor, or withdrawn by him from the market, may be refunded. A claim for refund of tax is filed on Form 843 with the assistant regional commissioner (alcohol and tobacco tax) for the region in which the tax was paid. If tax was paid in more than one region, a claim may be filed with the assistant regional commissioner for any one of the regions in which tax was paid.

(e) *Losses caused by disaster.*—Payment of an amount equal to the amount of internal revenue taxes paid or determined and customs duties paid on cigars, cigarettes, and cigarette papers and tubes removed from the factory or released from customs custody, which were lost, rendered unmarketable, or condemned by a duly authorized official by reason of a "major disaster" as determined by the President of the United States, may be made only if, at the time of the disaster, such articles were being held for sale by the claimant. A claim for payment of the internal revenue taxes for such losses is filed on Form 843 with the assistant regional commissioner (alcohol and tobacco tax) for the internal revenue region in which the articles were lost, rendered unmarketable, or condemned. A separate claim in respect of customs duties is also filed on Form 843 with the same assistant regional commissioner.

(f) *Drawback of tax.*—Drawback may be allowed only to the person who paid the tax on cigars, cigarettes, and cigarette papers and tubes which are shipped to a foreign country, Puerto Rico, and the Virgin Islands, or a possession of the United States. A claim for drawback of tax is filed with the assistant regional commissioner (alcohol and tobacco tax) for the region in which such articles covered by the claim are held by the claimant. See the appropriate regulation listed under § 601.311 for information as to proper form to be used.

(g) *Credit of tax.*—Taxes paid on cigars, cigarettes, and cigarette papers and tubes lost (otherwise than by theft) or destroyed, by fire, casualty, or act of God, while in the possession or ownership of the manufacturer, or withdrawn by him from the market, may be credited. A claim for credit of tax is filed with the assistant regional commissioner (alcohol and tobacco tax) for the region in which the tax was paid. If the tax was paid in more than one region, a claim may be filed with the assistant regional commissioner for any one of the regions in which tax was paid. See the appropriate regulation listed under § 601.311 for information as to the proper form to be used.

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PAR. 25. Section 601.317 is amended to read as follows:

§ 601.317 RULINGS.

The procedure for rulings in tobacco tax matters is set forth in § 601.328.

PAR. 26. Section 601.319 is amended to read as follows:

§ 601.319 APPLICABLE LAWS.

Chapter 53 of the Internal Revenue Code of 1954 (26 U.S.C. 5801–5862), the provisions of which are chiefly derived from the National Firearms Act, as amended (act of June 26, 1934, 48 Stat. 1236), imposes a tax on the manufacture, and transfer in the United States, of machine guns and certain other types of firearms, and an occupational tax upon every importer and manufacturer of, and dealer and pawnbroker in, such machine guns and firearms. Section 1(b)(2) of the act of August 9, 1939 (53 Stat. 1291; 49 U.S.C. 781–788) makes provision for the seizure of vessels, vehicles and aircraft on which are transported, carried, or possessed, any firearm with respect to which there has been committed any violation of the National Firearms Act or any regulations issued pursuant thereto. The Federal Firearms Act (53 Stat. 1250; 15 U.S.C. 901–909) makes it unlawful

for any manufacturer or dealer (except a manufacturer or dealer having a license issued under the provisions of the act), or any person who is a fugitive from justice or, except as provided in § 177.31 of this chapter, any person who is under indictment for, or has been convicted of, a crime punishable by imprisonment for a term exceeding one year, to transport, ship, or receive in interstate or foreign commerce any firearm or ammunition.

PAR. 27. Section 601.322 is amended to read as follows:

§ 601.322 RULINGS.

The procedure for rulings in matters in the firearms area is set forth in § 601.328.

PAR. 28. Section 601.327 is amended to read as follows:

§ 601.327 OFFERS IN COMPROMISE.

(a) *Liabilities (other than forfeiture) under Internal Revenue Code.*—Persons desiring to submit offers in compromise in order to avoid prosecution proceedings, and taxpayers who disclaim liability in whole or in part for taxes or claim inability to pay the taxes in full, may submit offers in compromise to the district director of internal revenue. 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, (ii) the failure to file returns of, or to pay, occupational taxes with respect to distilled spirits, wines, beer, or firearms, and (iii) the failure to pay firearms "making" or transfer taxes; (2) criminal liabilities of retail dealers in liquor arising from violations of the internal revenue laws relating to liquor, including the reuse or refilling of liquor bottles; and (3) liabilities arising under chapter 52 of the Code (cigars, cigarettes, and cigarette papers and tubes). The Director, Alcohol and Tobacco Tax Division, has the authority to accept or reject offers in compromise of civil liability (of less than $100,000) and criminal liability arising under chapters 51 and 53 of the Code in cases not subject to compromise by assistant regional commissioner (alcohol and tobacco tax). The Commissioner accepts or rejects all other offers in compromise except those in compromise of liabilities listed in paragraphs (b) and (c) of this section. (For offers in compromise generally, see § 601.203.) Form 656 is used in all cases arising under this paragraph, 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. Offers received by the district director which come within the purview of the assistant regional commissioner (alcohol and tobacco tax) or the Director, Alcohol and Tobacco Tax Division, are forwarded to such assistant regional commissioner for consideration and appropriate action. When final action has been taken, the district director, the assistant regional commissioner (when applicable), 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 prosecution or collection proceedings are resumed. If the offer is accepted, the proponent 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.

(b) *Violations of Federal Alcohol Administration Act.*—The Federal Alcohol Administration Act provides penalties for violations of its provisions. The Director, Alcohol and Tobacco Tax Division, is authorized to compromise such liabilities. Persons desiring to submit such offers in compromise may submit such offers on Form 656–D to the assistant regional commissioner (alcohol and tobacco tax) or an internal revenue officer under his jurisdiction. Such offers are considered by such assistant regional commissioner and are forwarded to the Director, Alcohol and Tobacco Tax Division, for final action. When the offer is acted upon, the proponent and the assistant regional commissioner (alcohol and tobacco tax) are notified of the acceptance or rejection of the offer. If the offer is rejected, the sum submitted with the offer in compromise is returned to the proponent. If the offer is accepted, the proponent is notified and the case is closed.

(c) *Forfeiture liabilities.*—The assistant regional commissioner (alcohol and tobacco tax) is authorized to compromise liabilities to administrative forfeiture of personal property seized under the laws administered and enforced by the Internal Revenue Service, including the internal revenue laws pertaining to wagering. Persons desiring to submit offers in compromise of such liabilities

may submit such offers on Form 656–E to the supervisor-in-charge (alcohol and tobacco tax). Such offers are forwarded to the assistant regional commissioner (alcohol and tobacco tax) for final action. When the offer is acted upon, the proponent and the assistant regional commissioner (alcohol and tobacco tax) are notified of the acceptance or rejection of the offer. If the offer is rejected, the sum submitted with the offer in compromise is returned to the proponent. If the offer is accepted, the proponent 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. 29. The following new center heading and regulations are inserted following § 601.327:

RULINGS

§ 601.328 RULINGS.

(a) *Requests for rulings.*—Any person who is in doubt as to any matter arising in connection with:

(1) Operations or transactions in the alcohol tax area or under the Federal Alcohol Administration Act;

(2) Operations or transactions in the tobacco tax area; or

(3) The taxes relating to machine guns and certain other firearms imposed by chapter 53 of the Code; the registration by importers and manufacturers of, and dealers in such firearms; the registration of such firearms; and the licensing of manufacturers of, and dealers in, firearms or ammunition under sections 901 through 909 of title 15 of the United States Code, may request a ruling thereon by addressing a letter to the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington, D.C., 20224, or the assistant regional commissioner (alcohol and tobacco tax) of the region in which the inquirer's business is located. Since a ruling as defined in paragraph (a)(2) of § 601.201 can issue only from the National Office, any such request made to an assistant regional commissioner will be referred by him to the Director, Alcohol and Tobacco Tax Division, for reply unless the issues involved are clearly covered by currently effective rulings or come within the plain intent of the statutes or regulations.

(b) *Routine requests for information.*—Routine requests for information should be addressed to the assistant regional commissioner (alcohol and tobacco tax) of the region in which the inquirer is located.

PAR. 30. Section 601.402 is amended by revising paragraph (a), subparagraphs (1) and (3) of paragraph (c), and subparagraphs (1) and (2) of paragraph (d). These amended provisions read as follows:

§ 601.402 SALES TAXES COLLECTED BY RETURN.

(a) *General.*—Sales taxes collected by return include the following:

(1) The retailers excise taxes, imposed by chapter 31 of the Code, with respect to:

Diesel Fuel;
Special motor fuels.

(2) The manufacturers excise taxes, imposed by chapter 32 of the Code, with respect to the following items:

(i) Motor vehicles and related items:
Automobiles, trucks, buses, trailers;
Truck parts and accessories;
Tires, tubes and tread rubber;
Gasoline and lubricating oil.

(ii) Recreational equipment:
Fishing rods, creels and reels;
Artificial lures, baits and flies;
Pistols and revolvers;
Other firearms, shells and cartridges.

* * * * * * *

(c) *Returns, refunds, and credits.*—(1) *Returns.*—The sales taxes referred to in paragraph (a) of this section are collected by means of returns. Any

person liable for tax is required to file returns with the district director of internal revenue for the district in which the principal place of business of such person is located. A procedure similar to the Depositary Receipt procedure with respect to the payment of certain Federal employment taxes, described in paragraph (a)(5) of § 601.401, is prescribed with respect to the sales taxes referred to in paragraph (a) of this section. For information relating to the use of depositary receipts for the payment of such taxes, see the applicable regulations and the instructions on Form 720, Quarterly Federal Excise Tax Return.

* * * * * * *

(3) *Payments to certain ultimate purchasers of gasoline and lubricating oil.*—Sections 6420, 6421, and 6424 of the Code provide for certain payments to ultimate purchasers of gasoline used on a farm for farming purposes, used for certain nonhighway purposes, or used by local transit systems, and of lubricating oil used otherwise than in a highway motor vehicle. For periods after June 30, 1965, payments allowable under sections 6420, 6421, and 6424 of the Code may be taken by an income taxpayer as a credit against the tax due on his income tax return. Governmental agencies and certain exempt organizations may file claims for allowable payments on Form 2240 or Form 843. Applicable regulations and instructions accompanying the prescribed forms provide detailed procedures.

(d) *Registration and bonding requirements.*—(1) Under temporary regulations effective January 1, 1959, an article may, in general, be sold tax free under chapter 32 of the Code by the manufacturer for certain uses, provided the seller, first purchaser, and second purchaser, as the case may be, have been registered. In the case of State governments, registration is optional. Also, the requirements for registration do not apply to sales or purchases by the United States, or to a purchaser located in a foreign country or a possession of the United States where an article is sold for export. Any person who has been issued a certificate of registry prior to January 1, 1959, which has not been revoked, is registered for purposes of the temporary regulations. Any other person entitled to sell or purchase articles tax free under such regulations who has not previously registered, may register by completing Form 637 setting forth the prescribed information and forwarding it to his district director. Such person shall be considered to be registered for purposes of making such tax-free sales or purchases upon receipt of a validated Form 637 from his district director.

(2) If not previously registered, producers and importers of gasoline and manufacturers of lubricating oil (including wholesale distributors of gasoline who qualify as producers under applicable regulations) must, before incurring any liability for tax under section 4081 or 4091 of the Code, make application for registration on Form 637. Detailed instructions as to the filing of applications for registration by producers and importers of gasoline and manufacturers of lubricating oil are prescribed in applicable regulations.

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PAR. 31. Section 601.403 is amended by revising paragraph (a) and subparagraphs (1) and (2) of paragraph (c), by deleting subparagraph (1) of paragraph (e), and by redesignating subparagraphs (2) and (3) of paragraph (e) as subparagraphs (1) and (2), respectively. These amended provisions read as follows:

§ 601.403 MISCELLANEOUS EXCISE TAXES COLLECTED BY RETURN.

(a) *General.*—Miscellaneous excise taxes collected by return include the following:

(1) *Communications.*—Subchapter B of chapter 33 of the Code imposes a tax on amounts paid for local telephone service, toll telephone service, and teletypewriter exchange service.

(2) *Transportation of persons by air.*—Subchapter C of chapter 33 of the Code imposes a tax with respect to transportation of persons by air, including seating or sleeping accommodations furnished in connection with such transportation.

(3) *Foreign insurance policies.*—Chapter 34 of the Code imposes a tax on the issuance of foreign insurance policies.

(4) *Wagers.*—Subchapter A of chapter 35 of the Code imposes a tax on wagers as defined therein.

(5) *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 October 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.

(6) *Sugar.*—Chapter 37 of the Code also imposes a tax upon manufactured sugar manufactured in the United States.

(7) *Circulation other than of national banks.*—Subchapter E of chapter 39 of the Code imposes a tax with respect to (i) the average circulation outstanding of any bank, association, corporation, company or person, and (ii) the circulation paid out by every person, firm, association other than national bank associations, and every corporation, State bank, or State banking association.

(8) *Interest equalization.*—Chapter 41 of the Code imposes (subject to specified exemptions) a tax on the acquisition by United States persons of foreign securities from a foreign person. The tax became effective July 19, 1963.

(9) *Hydraulic mining.*—The act entitled "An Act to create the California Debris Commission and regulate hydraulic mining in the State of California", approved March 1, 1893, as amended (33 U.S.C. 661–687), imposes a tax with respect to certain hydraulic gold mining in the State of California.

* * * * * * *

(c) *Collection of tax.*—(1) Imposed taxes.—The tax on the manufacture of sugar is collected in the same manner as manufacturers sales taxes. See § 601.402. 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.

(2) *Collected taxes.*—The other miscellaneous excise taxes referred to in this section are imposed on the person making the payment for the telephone, air transportation or other service involved. These taxes are required to be collected by the telephone company, airline, or other person receiving the payment. All taxes collected in this manner are held by the collecting agent in trust for the United States until deposited in accordance with the Depositary Receipt procedure or paid over to the district director of internal revenue. The collecting agencies are required to file returns and the tax is payable, without notice from the district director, at the time fixed for filing the returns. 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 rendered, the amount paid therefor, and the date on which paid. Upon receipt of this information the district director will proceed against the person to whom the facilities were provided or the services rendered to assert the amount of tax due, affording such person the same district conference, protest and appellate rights as are available to other excise taxpayers. In addition, when a field or office audit of a collecting agency's records, or of a taxpayer's records, discloses that the collecting agency failed during prior reporting periods to collect taxes due, the district director may assert such taxes directly against the person to whom the facilities were provided or the services rendered, whether or not the collecting agency had attempted collection or the person liable for the tax had refused payment thereof.

* * * * * * *

(e) *Licensing and registration.*—(1) *Hydraulic mining.* * * *
(2) *Wagering.* * * *

PAR. 32. Section 601.404 is amended by revising paragraph (b)(1), by deleting paragraph (b)(3), by deleting paragraph (c)(7), by redesignating paragraph (c)(8) as paragraph (c)(7), by revising paragraph (d)(2), by deleting paragraph (d)(3), by revising paragraphs (f)(1), (f)(2), and (f)(4), by revising paragraph (g), by deleting

paragraph (i), by revising paragraphs (j)(1) and (j)(3), and by revising paragraph (k). These amended provisions read as follows:

§ 601.404 MISCELLANEOUS EXCISE TAXES COLLECTED BY SALE OF REVENUE STAMPS.

* * * * * * *

(b) *Documentary stamp taxes.*—(1) *Deeds of conveyance.*—Chapter 34 of the Internal Revenue Code imposes a tax on deeds of conveyance of realty sold.

* * * * * * *

(c) *Commodity stamp taxes.* * * *

(7) *White phosphorous matches.* * * *

(d) *Occupational stamp taxes.* * * *

(2) *Coin-operated gaming devices.*—Subchapter B of chapter 36 of the Code imposes an occupational tax with respect to coin-operated gaming devices, or similar devices operated without a coin.

* * * * * * *

(f) *General procedure.*—(1) The documentary and commodity stamp taxes are paid by having affixed to the document, package, container, etc., an internal revenue adhesive stamp or stamps in an amount equal to the tax due and by thereafter canceling such stamps in the manner prescribed. In addition, documentary stamp taxes may be paid by stamps produced by authorized documentary stamp meter machines. Payment of occupational taxes is evidenced by the posting or displaying of a special occupational tax stamp on the premises where the business is operated. If the taxpayer required to display the special occupational tax stamp has no fixed place of business, the stamp must be kept on his person. The stamps used for such purposes are prepared by the Internal Revenue Service and distributed through the district director of internal revenue.

(2) Documentary stamp taxes are payable with respect to every transfer of real property. Commodity stamp taxes are payable with respect to the manufacture, importation, or transfer, as the case may be, of the contents of each package or container. Occupational taxes are payable annually for the privilege of doing business beginning with July 1 of each year, when the taxpayer is in business on that date, or from the beginning of the month in which the business is commenced on a pro rata basis.

* * * * * * *

(4) 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. In situations (i) where the documents, commodities, etc., subject to stamp tax are no longer in existence or (ii) where, for other reasons, such documents, etc., cannot be stamped, or (iii) where it is discovered that occupational tax stamps are due for prior taxable years, or (iv) where a taxpayer, after being advised of his liability, refuses to affix stamps, the tax is collected by assessment.

* * * * * * *

(g) *Liability for delinquent tax.*—When liability for delinquent tax is disclosed by the taxpayer or is discovered as a result of an examination of the taxpayer's books and records, the delinquent tax may be collected by assessment.

* * * * * * *

(i) [Deleted]

(j) *Provisions special to commodity stamp taxes.*—(1) Provision is made for the withdrawal of filled cheese from factories, free of tax, for the use of the United States. The procedure to be followed and the form of exemption certificate to be used in the case of such withdrawals are prescribed in the applicable regulations. Provision is also made for the exportation without payment of tax on adulterated butter. The procedure to be followed in the case of such exportation is prescribed in the applicable regulations.

* * * * * * *

(3) Every manufacturer of adulterated and process or renovated butter, filled cheese, or white phosphorous matches must also give notice and register with the district director on Form 213 before engaging in the business and furnish a satisfactory bond on Form 214. Persons required to register with the district

director or furnish bond should consult the applicable regulations and the appropriate forms.

(k) *Provisions applicable to special or occupational stamp taxes.*—Every person liable to pay any occupational tax imposed under subtitle D of the Code is required to register with the district director of internal revenue his name or style, place of residence, trade or business, and the place where such trade or business is carried on. In the case of a partnership the names of the partners and their place of residence must be so registered. See section 7011 of the Code. 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 the occupational tax for coin-operated gaming devices), Form 11–C (relating to occupational tax with respect to wagering).

PAR. 33. Section 601.601 is amended by revising paragraph (a)(1) and paragraph (c). These amended provisions read as follows:

§ 601.601 RULES AND REGULATIONS.

(a) *Formulation.*—(1) Internal revenue rules take various forms. The most important rules are issued as regulations and Treasury decisions, prescribed by the Commissioner and approved by the Secretary or his delegate. Other rules may be issued over the signature of the Commissioner or the signature of any other official to whom authority has been delegated. The channeling of rules varies with the circumstances. Regulations and Treasury decisions, except those relating to alcohol, tobacco, and certain firearms, are prepared in the Office of the Chief Counsel. Alcohol, tobacco, and certain firearms regulations and Treasury decisions are prepared in the Office of the Assistant Commissioner (Compliance) and reviewed in the Office of the Chief Counsel. 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 decision are forwarded to the Secretary or his delegate for further consideration and final approval.

* * * * * * *

(c) *Petition to change rules.*—Interested persons are privileged to petition for the issuance, amendment, or repeal of a rule. A petition for the issuance of a rule should identify the section or sections of law involved; and a petition for the amendment or repeal of a rule should set forth the section or sections of the regulations involved. The petition should also set forth the reasons for the requested action. Such petitions will be given careful consideration and the petitioner will be advised of the action taken thereon. Petitions should be addressed to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C., 20224.

* * * * * * *

PAR. 34. Paragraph (c) of section 601.602 is amended to read as follows:

§ 601.602 FORMS AND INSTRUCTIONS.

* * * * * * *

(c) *Procurement of forms and instructions.*—Copies of all necessary forms, and instructions as to their preparation and filing, may be obtained from district directors of internal revenue or, where appropriate, from assistant regional commissioners (alcohol and tobacco tax).

PAR. 35. Section 601.702 is amended by revising paragraphs (a)(4), (a)(7), and (d)(1). These amended provisions read as follows:

§ 601.702 PUBLICATION AND PUBLIC INSPECTION.

(a) *General.* * * *

(4) *Record of seizure and sale of real estate.*—Record 21, "Record of seizure and sale of real estate," is open for public inspection in offices of district directors of internal revenue and copies are furnished on application. See Treasury Decision 5428 (C.B. 1945, 462), approved January 11, 1945, 10 F.R. 622.

However, Record 21 does not list real estate seized for forfeiture under the internal revenue laws (section 7302 of the Code).

* * * * * * *

(7) *Information returns of certain tax-exempt organizations and certain trusts.*—Information furnished on the public portion of Form 990–A and information furnished pursuant to section 6034 of the Code (relating to annual information required of trusts claiming deduction under section 642(c) of the Code) on Form 1041–A is available for public inspection. The public inspection portion of Form 990–A is, however, only retained for a four-year period. Information furnished for years ending prior to December 31, 1962, shall be available for public inspection in the office of the district director with whom the Form 990–A or Form 1041–A was filed. Information furnished for years ending on or after December 31, 1962, shall be available for public inspection in the Office of the Director, Public Information Division, Internal Revenue Service, Washington, D.C., 20224, as well as in the office of the district director with whom the forms were filed.

* * * * * * *

(d) *Requests.*—(1) Requests for information in connection with matters of official record in which the procedure for inspection is not set out in rules referred to in the preceding paragraphs of this section should be submitted to the Commissioner of Internal Revenue, Washington, D.C., 20224. The request should clearly state the information desired and must set forth the interest of the applicant in the subject matter and purpose for which the information is desired. If the applicant is an agent or attorney acting for another he will attach to the application evidence of his authority to act for his principal. If such evidence is satisfactory, such agent or attorney will be given access to any record to which his principal would be given access. The determination as to whether the information requested is available for disclosure in any particular case will be made by the Commissioner of Internal Revenue or such other officer authorized under the provisions of law referred to in paragraph (a) of this section.

(R.S. 161; 5 U.S.C. 22)

[SEAL]

SHELDON S. COHEN,
Commissioner of Internal Revenue.

(Filed by the Division of the Federal Register on February 16, 1966, at 8:45 a.m., and published in the issue of the Federal Register for February 17, 1966, 31 F.R. 2818)

SECRETARY'S AUTHORIZATION

(Also Part I, Section 4261; 26 CFR 49.4261–1.)

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, PART 49.—FACILITIES AND SERVICES EXCISE TAXES

Exemption from tax on transportation of persons by air of amounts paid by the Department of Defense to Military Air Transport Service contract and charter carriers.

By virtue of the authority vested in me by section 4293 of the Internal Revenue Code of 1954 (68 Stat. 511; 26 U.S.C. 4293), exemption is hereby authorized from the tax imposed by section 4261 of such Code with respect to amounts paid by the Department of Defense for transportation of persons by air when such payment is made pursuant to MATS Form 8, Civil Aircraft Certificate.

[SEAL]

HENRY H. FOWLER,
Secretary of the Treasury.

December 10, 1965.

(Filed by the Division of the Federal Register on Dec. 17, 1965, 8:48 a.m., and published in the issue of the Federal Register for Dec. 18, 1965, 30 F.R. 15658)

DELEGATION ORDER NO. 2[1]

REVOCATION NOTICE

(Effective December 8, 1965)

Authority to communicate and consult on tax matters with the Finance Ministry of Sweden

Commissioner Delegation Order No. 2, dated April 21, 1955 [C.B. 1955–2, 892], delegated to the Assistant Commissioner (Technical) and the Director, International Tax Relations Division, authority to communicate and consult on tax matters with the Finance Ministry of Sweden. The International Tax Relations Division was abolished in 1962 and its functions (except the preparation and issuance of rulings concerning the interpretation or application of tax conventions) have been transferred to organizations other than Technical.

Accordingly, Commissioner Delegation Order No. 2, dated April 21, 1955, is hereby revoked.

SHELDON S. COHEN,
Commissioner.

DELEGATION ORDER NO. 15 (Rev. 1)

(Effective May 13, 1966)

Inspection of certain returns by Department of Health, Education, and Welfare

Pursuant to the authority contained in 26 CFR 301.6103(a)–100, District Directors, Service Center Directors, and the Director of International Operations, are hereby authorized upon request, in accordance with prescribed procedures, to make available for inspection by any duly authorized officer or employee of the Department of Health, Education, and Welfare any individual income tax return made in respect of a tax imposed under chapter 1 or chapter 2 of the Internal Revenue Code, as may be needed in its administration of the provisions of Title II of the Social Security Act, as amended. Such authorization includes the furnishing of a copy of the return or any data on such return.

The authority delegated herein may be redelegated, but not lower than to Division Chiefs except that the Director of International Operations may redelegate to the Director's Representative in Puerto Rico.

This Order supersedes Delegation Order No. 15, issued January 11, 1956 [C.B. 1956–1, 1012].

SHELDON S. COHEN,
Commissioner.

(Filed by the Division of the Federal Register on May 17, 1966, 8:49 a.m., and published in the issue of the Federal Register for May 18, 1966, 31 F.R. 7250)

[1] 30 F.R. 15440.

DELEGATION ORDER NO. 23 (Rev. 4)

(Effective February 11, 1966)

Settlement of Tort Claims and claims made by an employee of the Internal Revenue Service for damage to or loss of personal property incident to his service

1. Pursuant to Treasury Department Order No. 145 (Rev. 2), dated October 28, 1959 and Treasury Department Order No. 177–22 (Rev. 1), dated October 18, 1965, there is hereby delegated to the Assistant Commissioner (Administration), the Director, Facilities Management Division, the Chief, Emergency Planning Branch, and the Safety Management Officer in the Emergency Planning Branch:

(a) The authority, under 28 U.S.C. 2672 to consider, ascertain, adjust, determine, settle and pay claims for money damages of $2,500 or less, for injury, loss, or death, caused by the negligent or wrongful act or omission of any employee of the Internal Revenue Service;

(b) The authority to consider, ascertain, adjust and determine claims under the Act of December 28, 1922, 42 Stat. 1066;

(c) The authority under the Military Personnel and Civilian Employees' Claims Act of 1964, as amended, to settle and pay claims made by an employee of the Internal Revenue Service, for damage to or loss of personal property incident to his service.

2. This authority may not be redelegated.

3. This Order supersedes Delegation Order No. 23 (Rev. 3) issued April 15, 1963 [C.B. 1963–1, 430].

SHELDON S. COHEN,
Commissioner.

(Filed by the Division of the Federal Register on February 15, 1966, 8:47 a.m., and published in the issue of the Federal Register for February 16, 1966, 31 F.R. 2785)

DELEGATION ORDER NO. 66 (Rev. 1)

CHIEF COUNSEL'S ORDER NO. 1958–11 (Rev. 1)

(Effective January 28, 1966)

Authorities of Regional Appellate Division and of Regional Counsel in Protested Cases and in Tax Court cases.

Pursuant to the authority vested in the undersigned, it is ordered that:

1. (a) In each case in which a taxpayer has protested the determination of liability made by the office of a District Director of Internal Revenue or by the office of the Director of International Operations, the Regional Commissioner is authorized exclusively to represent the Commissioner (1) in the determination of liability for income, profits, estate, and gift tax in cases not docketed in the Tax Court of the United States, whether before or after issuance of a statutory notice; and (2) in the determination of liability for the excise and employment taxes designated in paragraph 5 of this Order. In each region the Assistant Regional Commissioner (Appellate), as Chief of the Appellate Division of the region, is authorized and each Chief, Appellate Branch Office, and each Associate Chief is authorized to repre-

sent the Regional Commissioner in the determination of tax liability in such case; and each Assistant Chief is authorized to represent the Regional Commissioner in the determination of tax liability in any such case in which the net deficiency or the net overassessment determined by the District Director or by the Director of International Operations does not exceed $50,000 and the determination of the Appellate Division does not involve a net overassessment in excess of $50,000.

(b) The authorities delegated in subparagraph (a) of this paragraph are subject to the exceptions set forth in paragraph 3 of this Order and, except as provided in paragraph 4, they may not be redelegated.

2. (a) In each income, profits, estate, and gift tax case docketed in the Tax Court, in conformity with the provisions of Delegation Order No. 60—Chief Counsel's Order No. 1958–5, dated April 17, 1958 [C.B. 1958–1, 681], the Regional Commissioner is authorized exclusively to represent the Commissioner in the functions delegated to the Regional Appellate Division in that joint Order. In each region the Assistant Regional Commissioner (Appellate), as Chief of the Appellate Division of the region, is authorized and each Chief, Appellate Branch Office, and each Associate Chief is authorized to represent the Regional Commissioner in the performance of those functions; and each Assistant Chief is authorized to represent the Regional Commissioner in the performance of those functions in any such case in which the net deficiency or net overassessment determined in the statutory notice does not exceed $50,000 and the basis of disposition does not involve a net overassessment in excess of $50,000.

(b) The authorities delegated in subparagraph (a) of this paragraph are subject to the exceptions set forth in paragraph 3 of this Order and they may not be redelegated.

3. The authorities delegated by this Order to the Regional Commissioners do not include authority to:

(a) Eliminate the ad valorem fraud penalty in any income, profits, estate or gift tax case in which the penalty has been determined by the district office in connection with a tax year or period, or which is related to or affects such year or period, for which criminal prosecution against the taxpayer (or a related taxpayer involving the same transaction) has been recommended to the Department of Justice for willful attempt to evade or defeat tax, or for willful failure to file a return, except upon the recommendation or concurrence of the Regional Counsel;

(b) Act in any case in which a recommendation for criminal prosecution is pending, except with the concurrence of the Regional Counsel; nor

(c) Modify any decision of the Excess Profits Tax Council with respect to any issue arising under section 722 of the Internal Revenue Code of 1939, except with the concurrence of the Director of the Appellate Division or his delegate.

4. In any case not docketed in the Tax Court in which a statutory notice was issued by the office of a District Director, the Assistant Regional Commissioner (Appellate) may relinquish the jurisdiction of the Appellate Division by waiver to the office of that District Director. Similarly, the Assistant Regional Commissioner (Appel-

late) for the region which includes Washington, D.C., may relinquish the jurisdiction of the Appellate Division by waiver to the office of the Director of International Operations in any case in which the office of that Director issued the statutory notice. No such waiver shall be made in any case in which criminal prosecution has been recommended and not finally disposed of; nor in any case in which the determination in the statutory notice includes the ad valorem fraud penalty. Notwithstanding any such waiver, upon filing of a petition with the Tax Court, jurisdiction shall revest in the Appellate Division.

5. The excise and employment taxes subject to the provisions of this Order include any Federal excise or employment tax:

(a) Under the Internal Revenue Code of 1939, except any tax imposed by:

(1) Chapter 8, 15, 23, 26, or 27A;

(2) Subchapter B of Chapter 25;

(3) Part V, VI, VII, or VIII of Subchapter A of Chapter 27;

(4) Subchapter B of Chapter 28, insofar as it relates to liquor and tobacco; or

(5) Chapter 9A, insofar as it relates to distilled spirits, wines, cordials, or fermented malt liquors.

(b) Under the Internal Revenue Code of 1954, except any tax imposed by:

(1) Chapter 35 of Subtitle D;

(2) Subchapter A, Chapter 39 of Subtitle D;

(3) Subtitle E; or

(4) Subchapter D, Chapter 78 of Subtitle F, insofar as it relates to liquor and tobacco.

6. (a) In the performance of his functions under this Order, each Regional Counsel shall be subject to the general supervision and control of the Chief Counsel. With the approval of the Chief Counsel, Regional Counsel may redelegate any function by this Order vested in Regional Counsel.

(b) The Regional Counsel will consider all memoranda prepared in the Regional Appellate Division recommending the issuance of statutory notices, prior to the issuance of such statutory notices by the Regional Appellate Division.

7. The instructions contained in this Order are intended to supplement the instructions contained in Delegation Order No. 60—Chief Counsel's Order No. 1958–5, dated April 17, 1958 [C.B. 1958–1, 681], and supersede other prior instructions to the extent that such other prior instructions are inconsistent herewith.

8. This Order supersedes Delegation Order No. 66, Chief Counsel's Order No. 1958–11, issued August 6, 1958 [C.B. 1958–2, 1093], and Amendment 1 thereto, issued August 4, 1959, C.B. 1959–2, 908.

SHELDON S. COHEN,
Commissioner.

MITCHELL ROGOVIN,
Chief Counsel.

(Filed by the Division of the Federal Register on Feb. 3, 1966, 8:46 a.m., and published in the issue of the Federal Register for Feb. 4, 1966, 31 F.R. 2393)

DELEGATION ORDER NO. 83 (Rev. 2)

(Effective May 13, 1966)

Authority to permit inspection of certain returns and related documents

Pursuant to authority vested in the Commissioner of Internal Revenue by 26 CFR 301.6103(a)–1, District Directors, the Director of International Operations, Service Center Directors, and the Director of the Collection Division, are authorized:

1. To permit inspection of returns in their custody by any applicant eligible therefor in accordance with paragraph (c) of section 301.6103 (a)–1, including any applicant with respect to whom inspection is made discretionary with the Secretary or the Commissioner or the delegate of either, provided such applicant meets the requirements embodied by such paragraph. The authority delegated in this paragraph of this order is limited to returns as filed by or on behalf of the taxpayer, including any schedules, lists and other written statements which have been filed with the Internal Revenue Service by or on behalf of the taxpayer or which have previously been furnished by the Service to the taxpayer.

2. To permit inspection of returns in their custody by United States attorneys and attorneys of the Department of Justice in accordance with paragraph (g) of section 301.6103(a)–1, and to furnish returns, or copies thereof, to such attorneys in accordance with paragraph (h) of such section. The authority delegated in this paragraph of this order is limited to returns as filed by or on behalf of the taxpayer, including any schedules, lists and other written statements which have been filed with the Internal Revenue Service by or on behalf of the taxpayer or which have previously been furnished by the Service to the taxpayer, except that other records or reports containing information included or required by statute to be included in the return may be furnished (a) when the return or copy thereof is requested for official use in the prosecution of claims and demands by, and offenses against, the United States, or the defense of claims and demands against the United States or officers and employees thereof, in cases arising under the internal revenue laws or related statutes which were referred by the Department of the Treasury to the Department of Justice for such prosecution or defense, or (b) in cases not so referred, when so authorized by the Assistant Commissioner (Compliance).

3. The authority delegated in paragraph 1 may be redelegated, but not lower than to Division Chiefs except that the Director of International Operations may redelegate to the Director's Representative in Puerto Rico. The authority delegated in paragraph 2 may not be redelegated.

4. This Order supersedes Delegation Order No. 83 (Rev. 1), issued February 12, 1965 [C.B. 1965–1, 699].

SHELDON S. COHEN,
Commissioner.

(Filed by the Division of the Federal Register on May 17, 1966, 8:49 a.m., and published in the issue of the Federal Register for May 18, 1966, 31 F.R. 7249)

DELEGATION ORDER NO. 86 (Rev. 2)

(Effective May 13, 1966)

Authority to permit inspection of certain returns by certain applicants pursuant to 26 CFR 601.702(d)

Pursuant to authority vested in the Commissioner of Internal Revenue, authority is hereby delegated to District Directors, Service Center Directors, and the Director of International Operations, to permit inspection of returns in their custody, inspection of which may be authorized by the Commissioner of Internal Revenue pursuant to 26 CFR 601.702(d), to the same persons and subject to the same conditions as prescribed for such persons in 26 CFR 301.6103(a)-1(c).

The authority delegated herein is limited to returns as filed by or on behalf of the taxpayer, including any schedules, lists and other written statements which have been filed with the Internal Revenue Service by or on behalf of the taxpayer or which have previously been furnished by the Service to the taxpayer.

Whenever it is determined that a return or related document as defined above is available for disclosure in a particular case, a copy or certified copy may be furnished the party requesting the same.

The authority delegated herein may be redelegated, but not lower than to Division Chiefs except that the Director of International Operations may redelegate to the Director's Representative in Puerto Rico.

This Order supersedes Delegation Order No. 86 (Rev. 1), issued February 12, 1965 [C.B. 1965-1, 700].

SHELDON S. COHEN,
Commissioner.

(Filed by the Division of the Federal Register on May 17, 1966, 8:48 a.m., and published in the issue of the Federal Register for May 18, 1966, 31 F.R. 7249)

DELEGATION ORDER NO. 88 (Rev. 1)

(Effective December 30, 1965)

Issuance of notices of revocation and reestablishment of exemption

Pursuant to the provisions of 26 CFR 1.503(a)-1, the authority to determine that an organization has engaged in a prohibited transaction and to notify the organization of the revocation of exemption is delegated to District Directors of Internal Revenue.

District Directors are also delegated the authority to determine that such an organization will not knowingly again engage in a prohibited transaction and that the organization also satisfies all other requirements under section 501(c)(3) or section 401(a) of the Internal Revenue Code of 1954, and to notify such organization of the reestablishment of its exemption pursuant to 26 CFR 1.503(d)-1.

Authority delegated in this Order may be redelegated only to Chiefs of Audit Division.

This Order supersedes Delegation Order No. 88, issued October 25, 1962 [C.B. 1962–2, 397].

SHELDON S. COHEN,
Commissioner.

(Filed by the Division of the Federal Register on Jan. 6, 1966, 8:47 a.m., and published in the issue of the Federal Register for Jan. 7, 1966, 31 F.R. 227)

DELEGATION ORDER NO. 88 (Rev. 2)

(Effective February 11, 1966)

Issuance of notices of revocation and reestablishment of exemption

Pursuant to the provisions of 26 CFR 1.503(a)–1, the authority to determine that an organization has engaged in a prohibited transaction and to notify the organization of the revocation of exemption is delegated to District Directors of Internal Revenue.

District Directors are also delegated the authority to determine that such an organization will not knowingly again engage in a prohibited transaction and that the organization also satisfies all other requirements under section 501(c)(3) or section 401(a) of the Internal Revenue Code of 1954, and to notify such organization of the reestablishment of its exemption pursuant to 26 CFR 1.503(d)–1.

Authority delegated in this Order may be redelegated only to Chiefs of Audit Division.

This Order supersedes Delegation Order No. 88 (Rev. 1) [page 592, this Bulletin], issued December 30, 1965, and Delegation Order No. 54 [C.B. 1957–2, 1091], issued October 22, 1957.

SHELDON S. COHEN,
Commissioner.

(Filed by the Division of the Federal Register on Feb. 15, 1966, 8:47 a.m., and published in the issue of the Federal Register for Feb. 16, 1966, 31 F.R. 2785)

(Also Part I, Sections 4371, 4374;
26 CFR 145.5–1.)

T.D. 6868 [1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 145.—TEMPORARY REGULATIONS IN CONNECTION WITH THE EXCISE TAX REDUCTION ACT OF 1965

Policies issued by foreign insurers

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

In order to prescribe temporary regulations, which shall remain in force and effect until superseded by permanent regulations, to reflect

[1] 30 F.R. 15737.

the amendments made to sections 4371 and 4374 of the Internal Revenue Code of 1954 (relating to tax on policies issued by foreign insurers) by section 804 of the Excise Tax Reduction Act of 1965 (79 Stat. 160) [Public Law 89-44, C.B. 1965-2, 568], the following regulations are hereby prescribed:

§ 145.5-1 Imposition and payment of tax on policies issued by foreign insurers.—(a) *In general.*—Section 804 of the Excise Tax Reduction Act of 1965 (79 Stat. 160) amends section 4374 of the Internal Revenue Code of 1954 to provide that the Secretary or his delegate may prescribe by regulations that the tax imposed by section 4371, relating to the tax on policies issued by foreign insurers, shall be paid by return in lieu of by the affixing of documentary tax stamps. In addition, section 804 of such Act amends section 4371 of the Code to provide that if the tax imposed by section 4371 is paid by return under regulations prescribed under section 4374, the tax shall be computed on the premium paid in lieu of the premium charged. This section prescribes regulations under sections 4371 and 4374 with respect to premiums paid on or after January 1, 1966.

(b) *Payment of tax.*—(1) *Duty to remit tax.*—With respect to premiums paid on or after January 1, 1966, the tax imposed by section 4371 shall be remitted by the person who makes the payment of the premium to a foreign insurer or reinsurer or to any nonresident agent, solicitor, or broker. For purposes of this subparagraph, the person who makes payment means that resident person who actually transfers the money, check, or its equivalent to the foreign insurer or reinsurer (including transfers to any bank, trust fund, or similar recipient, designated by the foreign insurer or reinsurer), or to any nonresident agent, solicitor, or broker. (See section 4372 (a) for definition of foreign insurer or reinsurer.) For persons liable for the tax imposed by section 4371, see section 4384 and the regulations thereunder.

(2) *Filing of returns.*—Every person required to remit under this section the tax imposed by section 4371 shall make a return of such tax on Form 720.

(3) *When liability for tax attaches.*—The liability for the tax imposed by section 4371 with respect to premiums paid on or after January 1, 1966, shall attach at the time the premium payment is transferred to the foreign insurer or reinsurer (including transfers to any bank, trust fund or similar recipient, designated by the foreign insurer or reinsurer), or to any nonresident agent, solicitor, or broker. A person required to remit tax under this section may remit such tax before the time the tax attaches if he keeps records consistent with such practice.

(4) *Tax paid on the basis of premium charged.*—With respect to a premium paid on or after January 1, 1966, to the extent that tax imposed by section 4371 was paid on the basis of the premium charged before January 1, 1966, in accordance with the provisions of § 47.4371-2 (Documentary Stamp Tax), no further tax is due under this section.

(c) *Rate and computation of tax.*—(1) *In general.*—(i) With respect to premiums paid on or after January 1, 1966, the tax under section 4371(1) is imposed at the rate of 4 cents on each dollar, or fractional part thereof, of the premium payment. For example, upon a premium payment of $10.10 the tax amounts to 44 cents.

(ii) With respect to premiums paid on or after January 1, 1966, the tax under section 4371 (2) and (3) is imposed at the rate of 1 cent on each dollar, or fractional part thereof, of the premium payment. For example, upon a premium payment of $10.10 the tax amounts to 11 cents.

(2) *Meaning of premium.* For purposes of this section, the term "premium" means the agreed price or consideration for assuming and carrying the risk or obligation, and includes any additional assessment or charge which may be assessed or charged under the contract, whether payable in one sum or installments.

(d) *Administrative provisions applicable.*—All the provisions of §§ 46.6011(a)–1 through 46.6404(a)–1 (except § 46.6011(a)–3) (Miscellaneous Excise Taxes Payable by Return) of this chapter shall, insofar as not inconsistent with this section, apply in respect of the tax imposed by section 4371 with respect to premiums paid after December 31, 1965, as though such tax were imposed by section 4501(a). For purposes of applying such provisions, the person who pursuant to paragraph (b) of this section is required to remit the tax imposed by section 4371 shall be treated as the person liable for such tax.

(e) *Records required with respect to foreign insurance policies.*—(1) Each person required under the provisions of paragraph (b) of this section to remit the tax imposed by section 4371 shall keep or cause to be kept accurate records of all policies or other instruments subject to such tax upon which premiums have been paid. Such records must identify each such policy or other instrument in such manner so as to clearly establish: (i) the gross premium paid; (ii) whether such policy or other instrument is (*a*) a policy of casualty insurance or an indemnity bond subject to tax under section 4371(1), (*b*) a policy of life, sickness, or accident insurance or an annuity contract subject to tax under section 4371(2), or (*c*) a policy of reinsurance subject to tax under section 4371(3); (iii) the identity of the insured (as defined in section 4372(d)); (iv) the identity of the foreign insurer or reinsurer (as defined in section 4372(a)); and (v) the total premium charged and, if the premium is to be paid in installments, the amount and anniversary date of each such installment.

(2) The records required under the provisions of this paragraph must be kept on file at the place of business or at some other convenient location, for a period of at least 3 years from the date any part of the tax became due or the date any part of the tax is paid, whichever is later, in such manner as to be readily accessible to authorized internal revenue officers or employees.

(3) The person having control or possession of a policy or other instrument subject to tax under section 4371 shall retain such policy or other instrument for at least 3 years from the date any part of the tax with respect to such policy was paid.

(f) *Use of documentary stamps.*—Except as provided in paragraph (b)(4) of this section, documentary stamps shall not be used in payment of the tax imposed by section 4371 with respect to premiums paid on or after January 1, 1966.

(g) *Penalty for failure to file return.*—Any person who on or after January 1, 1966, fails to comply with the requirements of paragraph (b) of this section with intent to evade the tax shall, in addition to

other penalties provided therefor, pay a fine of double the amount of tax. (See section 7270.)

Because of the need for prompt guidance with respect to the procedures authorized by this Treasury Decision, it is found impracticable to issue it 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 limitations 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).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved December 17, 1965.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on Dec. 20, 1965, 8:50 a.m., and published in the issue of the Federal Register for Dec. 21, 1965, 30 F.R. 15737)

T.D. 6869[1]

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

Election by individuals to be subject to tax at corporate rates.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., 20224

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

Sections 1.962 to 1.962–4 of the Income Tax Regulations (26 CFR Part 1) as set forth in Treasury Decision 6858 [C.B. 1965–2, 248], approved October 21, 1965 (30 F.R. 13694), supersede §§ 16.5 and 16.5–1 as set forth in Treasury Decision 6703 [C.B. 1964–1 (Part 1), 614] (26 CFR Part 16), approved January 29, 1964 (29 F.R. 1616).

Because this Treasury Decision is procedural in nature, 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 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.C. 7805).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved December 27, 1965.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on Dec. 30, 1965, 8:46 a.m., and published in the issue of the Federal Register for Dec. 31, 1965, 30 F.R. 17164)

(Also Part I, Section 819; 26 CFR 1.819–2.) T.D. 6878 [1]

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

Percentage to be used by foreign life insurance companies in computing income tax for the taxable year 1965 and estimated tax for the taxable year 1966.

DEPARTMENT OF THE TREASURY,
Washington, D.C., 20220

To Officers and Employees of the Treasury Department and Others Concerned:

Section 819(b) of the Internal Revenue Code of 1954, as added by the Life Insurance Company Income Tax Act of 1959 (73 Stat. 136), provides for the determination of a percentage to be used in determining a "minimum figure" for each foreign life insurance company described in section 819(a). Where this minimum figure exceeds the foreign life insurance company's surplus held in the United States, the amount of the "policy and other contract liability requirements" (determined under section 805 without regard to section 819(b)), and the amount of the "required interest" (determined under section 809(a) without regard to section 819(b)), must each be reduced by an amount determined by multiplying such excess by the "current earnings rate" (as defined in section 805(b)(2)). Accordingly, it is hereby determined that for purposes of computing the 1965 income tax for foreign life insurance companies a percentage of 15.8 shall be used in determining the "minimum figure" under section 819(b).

It is presently anticipated that the data with respect to domestic life insurance companies for 1965 required for the computation of the percentage to be used by foreign life insurance companies in computing their estimated tax for the taxable year 1966 will not be available in time for the filing of the declaration of estimated tax for such taxable year. Accordingly, it is hereby determined that for purposes of computing the estimated tax for the taxable year 1966 and payments of installments thereof by foreign life insurance companies, a percentage of 15.8 (the percentage applicable for 1965) shall be used in determining the minimum figure under section 819(b). No additions to tax shall be made because of any underpayment of estimated tax for the taxable year 1966 which results solely from the use of this percentage.

Because the percentage announced in this Treasury Decision is computed from information contained in the income tax returns of domestic life insurance companies for the year 1964, which are not open to public inspection, the public accordingly cannot effectively participate in the determination of such figure. Therefore, it is 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 said Act.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on Mar. 1, 1966, 8:46 a.m., and published in the issue of the Federal Register for Mar. 2, 1966, 31 F.R. 3285)

(Also Part I, Sections 446, 481;
26 CFR 1.446–1, 1.481–1.)

Rev. Proc. 66–1 [1]

Procedure for changing practice of reporting diversion payments received under the provisions of the United States Department of Agriculture 1963 Wheat Stabilization Program and the 1963 Feed Grain Program.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide an administrative procedure whereby cash basis taxpayers may expeditiously obtain consent to change their accounting practice of reporting payments received under the United States Department of Agriculture 1963 Wheat Stabilization Program and the 1963 Feed Grain Program. Taxpayers complying with the provisions hereof will be deemed to have obtained the consent of the Commissioner of Internal Revenue to change their practice of reporting diversion payments received under such programs.

SEC. 2. BACKGROUND.

.01 Wheat and feed grain diversion payments received by a cash basis taxpayer are includible in gross income when they are received by him, or made available to him, whichever is earlier. See Rev. Rul. 65–97, C.B. 1965–1, 211, and Rev. Rul. 65–98, C.B. 1965–1, 213.

.02 Under existing procedure, a cash basis taxpayer who has established an accounting practice of reporting wheat and feed grain diversion payments in the year in which they are actually received wishing to minimize the effect of reporting in one year's income payments attributable to two crop years, is required to request application of the administrative procedure under Revenue Procedure 64–16, C.B. 1964–1 (Part 1), 677.

SEC. 3. APPLICATION.

This Revenue Procedure is applicable to any cash basis taxpayer who wishes to request relief from the doubling up of wheat and feed grain diversion payments from the year in which they are actually received to the practice of reporting such diversion payments in the year in which they are received, or made available, whichever is earlier. To obtain relief the taxpayer must comply with the requirements of section 4, below. Taxpayers satisfying these requirements will be deemed to be in compliance with the provisions of Revenue Procedure 64–16.

SEC. 4. REQUIREMENTS.

.01 For purposes of this Revenue Procedure the collateral agreement required by Revenue Procedure 64–16 will take the form of a simple signed statement along the following lines.

> I am a cash basis taxpayer and I wish to change my practice of reporting wheat and feed grain diversion payments for Federal income tax purposes, beginning with the year 1965. I agree to include such payments in the year in which they are made available to me instead of the year in which they are actually received and further agree that I will report one-tenth of the amount of the payment received in 1965 which was attributable to 1964 until

[1] Also released as Technical Information Release 789, dated December 21, 1965.

the total amount of that payment has been included in my taxable income.

.02 The statement required by this section must be attached to the taxpayer's 1965 Federal income tax return, or an amended return for the year 1965, in the event the taxpayer was not aware of this procedure at the time the 1965 return was filed.

SEC. 5. RECORDS.

The taxpayer must maintain adequate records with respect to the wheat and feed grain diversion payments so that the District Director may verify the data concerning the change.

SEC. 6. EFFECTIVE DATE.

This Revenue Procedure shall be effective for taxable years wherein diversion payments attributable to 1964 were deferred to 1965.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Sections 5367, 5383, 5384.) Rev. Proc. 66–2

Transitional procedures are prescribed for terminating record-keeping requirements under the wine reserve inventory and establishing new records of amelioration, and for completing the sweetening, after December 31, 1965, of wine in reserve inventory on that date.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide transitional procedures to be followed by proprietors of bonded wine cellars as the result of the deletion of the wine reserve inventory and intermediate storage provisions from sections 5383 and 5384 of the Internal Revenue Code of 1954, as amended effective January 1, 1966, by section 806(b) of the Excise Tax Reduction Act of 1965, Public Law 89–44, C.B. 1965–2, 568, and procedures for completing sweetening of wine removed from reserve inventory as of the close of business December 31, 1965.

SEC. 2. FORM 2054, WINE FERMENTATION RECORD.

.01 As of the beginning of business January 1, 1966, each Wine Fermentation Record, Form 2054, shall be closed, and a new record of amelioration shall be established for each kind of fruit or berries, including grapes. The balance of wine, column (o), Form 2054, and the gallons of ameliorating credits, column (y), Form 2054, in each account, shall be transferred to the new record of amelioration; an appropriate explanatory notation, such as "Received from Form 2054," shall be made in the new record of amelioration. No particular form is prescribed for the record of amelioration, but regulations, 26 CFR part 240, will require that such record reflect all quantities in gallons and contain all data necessary to enable internal revenue officers to readily ascertain that the limitations on amelioration have been complied with. Each separate record shall include data as follows:

(a) The quantity of juice (exclusive of pulp) deposited in fermenters.

(b) For juice from fruit or berries, other than grapes, the maximum quantity of pure dry sugar or liquid sugar authorized for adjustment of the total solids content.

(c) The maximum quantity of ameliorating material to which the juice is entitled.

(d) The quantity of ameliorating material used, including pure dry sugar or liquid sugar used for adjustment of total solids content.

(e) The quantity of ameliorating material authorized but not yet used.

.02 At the time the Wine Fermentation Record, Form 2054, is closed and the balance of wine included in such record is transferred to the new record of amelioration, the quantity of any such wine held in intermediate storage shall, if the fermentation thereof has been completed, be accurately determined and reported in column (c), Form 2056, Record of Still Wine, as wine produced; wine held in intermediate storage on December 31, 1965, shall, if the fermentation thereof has not been completed, become wine in fermenters, on January 1, 1966.

SEC. 3. FORM 2055, WINE RESERVE INVENTORY RECORD.

As of the close of business December 31, 1965, each Wine Reserve Inventory Record, Form 2055, shall be closed by making a final entry in column (f) showing that all wine is, at that time, withdrawn from the reserve inventory. The quantity of wine so withdrawn shall be reported in column (g) of the appropriate Record of Still Wine, Form 2056, as wine received from reserve inventory. Also, the quantity of wine so withdrawn from reserve inventory, and the quantity of wine received from reserve inventory, shall be reported in the usual manner in part I, section A, of the Monthly Report of Wine Cellar Operations, Form 702, for December 1965.

SEC. 4. FORM 2056, RECORD OF STILL WINE.

.01 The quantity of wine received from reserve inventory as provided in section 3 of this Revenue Procedure shall be entered in column (g) of the appropriate Form 2056, as of the close of business December 31, 1965. Also, the quantity of completely fermented wine which was held in intermediate storage on December 31, 1965, shall, as of the beginning of business January 1, 1966, and as provided in section 2.02 of this Revenue Procedure, be entered in column (c), Form 2056, as wine produced by fermentation.

.02 Commencing January 1, 1966, all sweetening of wine shall be recorded on Form 2056, in columns (d) and (o); and the kind of sweetening material used (if pure dry sugar or liquid sugar is used) shall be entered in column (b), except that where a particular lot of wine is sweetened with both sugar (dry or liquid) and juice (concentrated or unconcentrated), a separate entry therefor shall be made on Form 2056, and the quantity of sugar and type of juice used for sweetening shall be shown in column (b).

.03 Commencing January 1, 1966, the amelioration of wine *after completion of fermentation and removal from fermenters* shall be recorded on Form 2056. For this purpose Form 2056 may be modified by changing the heading of an unused column in the right-hand portion of the form to read "Used for Amelioration" and by chang-

ing the heading of column (g) to read "Produced by Amelioration."

SEC. 5. MONTHLY REPORT OF WINE CELLAR OPERATIONS, FORM 702, AND INVENTORY OF WINE, FORM 702-C.

.01 The Monthly Report of Wine Cellar Operations, Form 702 (Rev. 3-65), for the month of December 1965, shall reflect the close-out of the reserve inventory as provided for in section 3 of this Revenue Procedure, and on the Inventory of Wine, Form 702-C, for December 31, 1965, all still wine shall be reported as "Still Wine in Permanent Storage."

.02 The quantity of wine in intermediate storage as of December 31, 1965, shall be reported in the usual manner in part VII of Form 702 (Rev. 3-65); thereafter part VII of Form 702 (Rev. 1-66) will be used to report the quantity of "Still Wine in Fermenters Last of Month."

SEC. 6. MARKINGS ON TANKS.

Each tank which on December 31, 1965, is designated as "Intermediate Storage" or "Reserve Storage" shall, as of January 1, 1966, be designated to reflect its intended use, such as "Fermenting Tank" (or "Fermenter") or "Storage Tank."

SEC. 7. SWEETENING OF WINE WITHDRAWN FROM RESERVE INVENTORY AS OF DECEMBER 31, 1965.

Wine withdrawn as of the close of business December 31, 1965, from reserve inventory, as provided in section 3 of this Revenue Procedure, may, if sweetening has not been completed, be sweetened on and after January 1, 1966, as provided in this section, but only if such wine is kept separate from other wine until sweetening operations are completed. Wine so withdrawn from reserve inventory may be sweetened with pure dry sugar or liquid sugar to the extent that:

.01 In the case of grape wine, the total solids content of the finished wine does not exceed (a) 17 percent by weight if the alcohol content is 14 percent or more by volume, or (b) 21 percent by weight if the alcohol content is less than 14 percent by volume; or

.02 In the case of fruit or berry wine, the total solids content of the finished wine does not exceed 21 percent by weight.

The use of liquid sugar under this section shall be limited so that the resultant volume will not exceed the volume which could result from the maximum authorized use of pure dry sugar only.

SEC. 8. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and should be addressed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.702: Publication and public inspection. (Also Part I, Section 6103; 301.6103(a)-1, 301.6103(a)-2.) — Rev. Proc. 66-3

Procedures to be followed by District Directors of the Internal Revenue Service in permitting inspection of Federal tax returns filed

under the Internal Revenue Code of 1954, and in furnishing copies of such returns and documents.

Revenue Procedure 62–9, C.B. 1962–1, 432, superseded.

SECTION 1. PURPOSE.

This Revenue Procedure sets forth instructions concerning the inspection by certain persons, of tax returns and related documents filed under the Internal Revenue Code of 1954, and the furnishing of copies of such returns and documents, as provided in sections 301.6103(a)–1 and 301.6103(a)–2 of the Regulations on Procedure and Administration.

SEC. 2. AUTHORITY.

District Directors of the Internal Revenue Service are authorized by Delegation Order No. 83 (Rev. 1), C.B. 1965–1, 699, to process applications by certain persons to inspect returns and related documents and may permit such inspection of such returns and related documents in their official custody. In response to requests for copies, they may furnish copies of such returns and related documents. For the purposes of this Revenue Procedure the term "District Director" also includes the Director of International Operations.

SEC. 3. RETURNS WHICH MAY BE INSPECTED UNDER THIS REVENUE PROCEDURE.

Returns in respect of the taxes imposed by chapters 1, 2, 3, and 6 (income taxes), chapter 5 (tax on transfers to avoid income tax), chapter 11 (estate tax), chapter 12 (gift tax), chapter 23 (unemployment tax), chapter 32 (manufacturers excise taxes), subchapters B, C, and D of chapter 33 (communications tax, transportation taxes, and tax on safe deposit boxes, respectively), subchapter B of chapter 37 (tax on coconut and palm oil), and chapter 41 (interest equalization tax) of the Code shall be open to inspection as hereinafter provided to certain persons having a material interest which will be affected by information contained in such returns.

SEC. 4. TIME AND PLACE OF INSPECTION.

Returns may be inspected in the office of the District Director where such returns and related documents are on file. Inspection shall be made only in the presence of an internal revenue officer or employee and only during the regular hours of business of the Internal Revenue Service Office.

SEC. 5. APPLICATIONS FOR INSPECTION.

.01 Applications for permission to inspect returns, or for copies of returns, shall be made in writing to the District Director with whom the return was filed. The application should set forth the following:

(1) The name and address of the person for whom the return was made.

(2) The kind of tax reported on the return.

(3) The taxable period covered by the return.

(4) The reason why inspection is desired.

(5) A statement, or other satisfactory evidence, that the applicant is a person entitled to make the inspection or to be furnished with the copy requested.

.02 Taxpayers and others authorized to inspect returns who come to the office in person will be required to sign a request for the information desired.

.03 No information contained in returns or related documents may be given over the telephone under any circumstances.

SEC. 6. RETURN OF INDIVIDUAL.

A return of an individual shall be open to inspection—

.01 By the individual for whom the return was made.

.02 If the individual for whom the return was made is legally incompetent, by the committee, trustee, or guardian of his estate.

.03 If the individual for whom the return was made has died—

(1) By the administrator, executor, or trustee of this estate.

(2) In the discretion of the District Director, by any heir at law, next of kin, or beneficiary under the will, of such decedent, upon submission of satisfactory evidence that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return.

.04 If the property of the individual for whom the return was made is in the hands of a receiver or trustee in bankruptcy, by such receiver or trustee.

.05 By the duly constituted attorney in fact of any of the foregoing persons, subject to the conditions of inspection prescribed herein for such person.

SEC. 7. JOINT RETURN OF INCOME TAX.

A joint income tax return of husband and wife shall be open to inspection—

.01 By either of the individuals for whom the return was made.

.02 If either of the individuals for whom the return was made is legally incompetent, by the committee, trustee, or guardian of the estate of such individual.

.03 If either of the individuals for whom the return was made has died—

(1) By the administrator, executor, or trustee of the estate of such decedent.

(2) In the discretion of the District Director, by any heir at law, next of kin, or beneficiary under the will, of such decedent, upon submission of satisfactory evidence that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return.

.04 If the property of either of the individuals for whom the return was made is in the hands of a receiver or trustee in bankruptcy, by such receiver or trustee.

.05 By the duly constituted attorney in fact of any of the foregoing persons, subject to the conditions of inspection prescribed herein for such person.

SEC. 8. RETURN OF PARTNERSHIP.

A return of a partnership shall be open to inspection—

.01 By any person who was a member of the partnership during any part of the period covered by the return upon submission of satisfactory evidence of such membership.

.02 If an individual who was a member of the partnership during any part of the period covered by the return is legally incompetent, by the committee, trustee, or guardian of his estate.

.03 If an individual who was a member of the partnership during any part of the period covered by the return has died—

(1) By the administrator, executor, or trustee of his estate.

(2) In the discretion of the District Director, by any heir at law, next of kin, or beneficiary under the will, of such decedent, upon submission of satisfactory evidence that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return.

.04 If the property of the partnership is in the hands of a receiver or trustee in bankruptcy, by such receiver or trustee.

.05 By the duly constituted attorney in fact of any of the foregoing persons, subject to the conditions of inspection prescribed herein for such person.

SEC. 9. RETURN OF ESTATE.

A return of an estate shall be open to inspection—

.01 By the administrator, executor, or trustee of the estate.

.02 In the discretion of the District Director, by any heir at law, next of kin, or beneficiary under the will, of the decedent for whose estate the return was made, upon submission of satisfactory evidence that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return, or, if any such heir at law, next of kin, or beneficiary has died or is legally incompetent, by the administrator, executor, committee, trustee, or guardian of his estate, upon a like submission of evidence.

.03 By the duly constituted attorney in fact of any of the foregoing persons, subject to the conditions of inspection prescribed herein for such person.

SEC. 10. RETURN OF A TRUST.

A return of a trust shall be open to inspection—

.01 By the trustee or trustees, jointly or severally.

.02 By any person who was a beneficiary of the trust during any part of the period covered by the return, upon submission of satisfactory evidence that the person was such a beneficiary.

.03 If any individual who was a beneficiary of the trust during any part of the period covered by the return is legally incompetent, by the committee, trustee, or guardian of his estate.

.04 If any individual who was a beneficiary of the trust during any part of the period covered by the return has died—

(1) By the administrator, executor, or trustee of his estate.

(2) In the discretion of the District Director, by any heir at law, next of kin, or beneficiary under the will, of such decedent, upon submission of satisfactory evidence that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return.

.05 By the duly constituted attorney in fact of any of the foregoing persons, subject to the conditions of inspection prescribed herein for such person.

SEC. 11. RETURN OF A CORPORATION.

A return of a corporation shall be open to inspection:

.01 By any person designated by action of its board of directors, or other similar governing body, upon submission of satisfactory evidence of such action.

.02 By any officer or employee of the corporation upon written request signed by any principal officer and attested by the secretary, or other officer, under the corporate seal, if any.

.03 By the duly constituted attorney in fact of the corporation.

.04 If the property of the corporation is in the hands of a receiver or trustee in bankruptcy, by such receiver or trustee, or by the duly constituted attorney in fact of such receiver or trustee.

.05 In the discretion of the District Director, if the corporation has been dissolved, by any person who, under these provisions in section 11, might have inspected the return at the date of dissolution.

.06 For provisions relating to inspection of corporation income and unemployment tax returns by shareholders see section 301.6103(c)-1 of the Regulations on Procedure and Administration, published in Treasury Decision 6546, C.B. 1961-1, 682, at 686.

SEC. 12. ESTATE TAX RETURNS.

A return or notice in respect of estate tax imposed by chapter 11 of the Code shall be open to inspection—

.01 By the executor, or his successor in office, or the duly constituted attorney in fact of such executor or successor.

.02 In the discretion of the District Director, by any other person upon submission of satisfactory evidence that such person has a material interest either in ascertaining any fact disclosed by the return or notice or in obtaining information as to the payment of the tax.

SEC. 13. GIFT TAX RETURNS.

A return in respect of gift tax imposed by chapter 12 of the Code shall be open to inspection—

.01 By the donor or his duly constituted attorney in fact.

.02 In the discretion of the District Director, by any other person upon submission of satisfactory evidence that such person has a material interest either in ascertaining any fact disclosed by the return or in obtaining information as to the payment of the tax.

SEC. 14. GUIDELINES WITH RESPECT TO WHAT DOCUMENTS MAY BE INSPECTED.

Generally, in addition to the return, inspection will be limited to documents filed by or on behalf of the taxpayer, including any schedules, lists and other written statements which have been filed with the Internal Revenue Service by or on behalf of the taxpayer or which have previously been furnished by the Service to the taxpayer.

The general guidelines with respect to what documents, other than the return, may or may not be open to inspection, and copies furnished by District Directors or the Director of International Operations are as follows:

.01 Schedules, information returns, protests, briefs, face of claims, waivers, and other statements or documents designed to be supplemental to or to become part of the return may be inspected.

.02 Examiners' reports may be inspected to the extent that such reports have previously been furnished to the taxpayer; therefore, the transmittal letter portion of a revenue agent's report, or a separate confidential report which contains information for Service use only, may not be inspected.

.03 Conference reports may not be inspected with the exception of the pages showing recomputation of tax liability.

.04 Work papers of examiners, engineers' reports, cover letters of the reports in which opinions are expressed, reports of special agents and interoffice communications, may not be inspected unless specific authorization is given by the Commissioner of Internal Revenue.

.05 Inspection of claims for refund will be limited to the face of the claim only, since the back of the claim contains Service records.

.06 Typed copies of office copies of notices of adjustment may be furnished; no photostatic copies of notices of adjustment are to be made.

SEC. 15. CHARGES FOR COPIES OF RETURNS AND RELATED DOCUMENTS.

Effective February 1, 1966, charges for furnishing copies of returns and related documents and for certifications of such returns and documents will be as follows:

.01 A charge of $1 per page will be made for a copy of each return or other document.

.02 For each copy of Form 1040A, or a return or other document of similar size, a charge of $1 will be made, even though both sides of the documents are furnished.

.03 For each copy of a page which is substantially larger than the size used in the largest income tax return, the basic rate of $1 per page may be increased in proportion to the size (in multiples of 50 cents) to such amount that appears reasonable under the circumstances.

.04 For each certification a charge of $1 will be made.

.05 A bill for the cost of furnishing copies and preparing certifications will be made at the time the documents are furnished.

SEC. 16. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 62–9, C.B. 1962–1, 432, is superseded.

SEC. 17. CROSS REFERENCES.

For inspection of returns filed pursuant to the Internal Revenue Code of 1939, see Revenue Ruling 229, C.B. 1953–2, 152.

26 CFR 601.702: Publication and public inspection. Rev. Proc. 66–4

(Also Part I, Sections 6103, 6106; 301.6103 (a)–1, 301.6103(b)–1, 301.6106–1.)

Procedures concerning permissible inspection of certain Federal tax returns filed under the Internal Revenue Code of 1954 and procuring copies thereof by State governments.

Revenue Procedure 62–18, C.B. 1962–2, 408, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the procedures relating to (1) the inspection by State governments of certain Federal tax returns and related documents filed under the Internal Revenue Code of 1954, (2) the furnishing to State governments of copies of such returns and documents, and (3) the furnishing to State governments of abstract data from such returns and documents.

SEC. 2. AUTHORITY TO INSPECT.

.01 By virtue of sections 301.6103(a)–1(d), 301.6103(b)–1, and 301.6106–1 of the Regulations on Procedure and Administration published in Treasury Decision 6543, C.B. 1961–1, 671; Treasury Decision 6546, C.B. 1961–1, 682, and Treasury Decision 6809, C.B. 1965–1, 531; the Commissioner of Internal Revenue may, upon application by the Governor of a State, open certain Federal tax returns to certain State tax officials, bodies, or commissions for certain State and local purposes depending upon the type of Federal tax return of which inspection is requested.

.02 Returns which may be open to inspection and the respective State tax officials, bodies, or commissions by whom or which inspection may be made are set forth in this Revenue Procedure.

SEC. 3. INSPECTION OF RETURNS MADE IN RESPECT OF THE TAXES IMPOSED BY CHAPTER 5, CHAPTER 11, CHAPTER 12, CHAPTER 23, CHAPTER 32, SUBCHAPTERS B, C, AND D OF CHAPTER 33, SUBCHAPTER B OF CHAPTER 37, AND CHAPTER 41 OF THE CODE.

Under authority of section 301.6103(a)–1(d) of the regulations, the Commissioner, upon application by the Governor of the State as specified in section 3.04, may grant permission for inspection of certain returns by the respective State tax officials and for the respective purposes set forth in this section.

.01 *Estate and gift tax returns.*—Returns and notices in respect of estate tax imposed by Chapter 11 of the Code and returns in respect of gift tax imposed by Chapter 12 of the Code may, in the discretion of the Commissioner or his delegate, be made available for inspection by any properly authorized official, body, or commission, lawfully charged with the administration of any tax law of a State, for the purpose of such administration, provided like cooperation is given by the State with respect to inspection of returns of estate, inheritance, legacy, succession, gift, or other tax of the State for use of the Commissioner and his representatives in the administration of the Federal tax laws.

.02 *Unemployment tax returns.*—Returns in respect of the unemployment tax imposed by Chapter 23 of the Code may, in the discretion of the Commissioner or his delegate, be made available for inspec-

tion by any properly authorized official of a State provided (a) such State has a law certified to the Secretary of the Treasury as having been approved in accordance with section 3304 of the Code and (b) the inspection is solely for the purpose of administering such law.

.03 *Excise tax returns.*—Returns in respect of excise taxes imposed by Chapter 5 of the Code (tax on transfers to avoid income tax); Chapter 32 of the Code (manufacturers excise taxes); subchapters B, C, and D of Chapter 33 of the Code (communications tax, transportation taxes, and tax on safe deposit boxes); subchapter B of Chapter 37 of the Code (tax on coconut and palm oil); and Chapter 41 (interest equalization tax) may, in the discretion of the Commissioner or his delegate, be made available for inspection by any properly authorized official, body, or commission, lawfully charged with the administration of any tax law of the State, for the purpose of such administration.

.04. *Applications for inspection.*

1. *In general.*—Application for the inspection provided for in sections 3.01, 3.02, and 3.03 shall be made in writing, signed by the Governor of the State, and addressed to the Commissioner of Internal Revenue, Washington, D.C. 20224. The applications for the respective types of returns shall state the following:

a The title of the official, body, or commission by whom or which inspection is to be made;

b A specific reference to the law of the State which such official, body, or commission is charged with administering and the law under which he or it is so charged;

c The purpose for which the inspection is to be made; and

d If the inspection of an estate or gift tax return is requested, the fact that the State gives like cooperation with respect to the inspection of returns of an estate, inheritance, legacy, succession, gift, or other tax of the State, for use of the Commissioner or his representatives in the administration of the Federal tax laws.

2. *Procedure as to returns filed in the internal revenue district within or including the State requesting inspection.*

a *General inspection.*—Upon application, permission may be granted for general inspection of the returns of the taxes specified in sections 3.01, 3.02, and 3.03 which are filed in the district within or including such State. If such general inspection is desired, the application made to the Commissioner in accordance with section 3.041 shall include a statement that general inspection is desired of a specified class or classes of returns (for example, estate tax returns, gift tax returns, etc.). Permission granted to a State for the general inspection provided for in this subdivision shall, except as hereinafter provided in the case of unemployment tax returns, continue in effect until such time as the Commissioner by written notice to the Governor of the State provides that such inspection will be permitted only on the basis of periodic application therefor. Permission for general inspection of unemployment tax returns will terminate without notice at such time as the State ceases to have a law certified to the Secretary as having been approved in accordance with section 3304 of the Code. The Governor of the State shall supply in writing to the District Director of Internal Revenue with whom the returns to be inspected were filed a list of the names of the

individuals designated to make the inspection on behalf of the official, body, or commission named in the application to the Commissioner, and shall keep such list current by appropriate deletions or additions as may be necessary.

b Inspection of specific returns. Permission granted pursuant to section 3.042a for general inspection of returns of a particular tax includes permission to inspect specifically identified returns of such tax when desired. However, if a State is interested only in examining certain returns of particular taxpayers, the application for inspection of such returns shall be made in writing to the Commissioner as provided in section 3.041 and in addition to the information outlined in such subparagraph shall state the name and address of each taxpayer whose return or returns it is desired to inspect, the kind of tax reported on each such return, the taxable period covered by such return, and the names of the individuals designated to make the inspection on behalf of the official, body, or commission named in the application.

3. *Returns filed in other internal revenue districts.*—In the case of returns filed in an internal revenue district other than one within or including the State requesting inspection, permission for the inspection provided for in sections 3.01, 3.02, and 3.03 will be granted only with respect to specifically identified returns. The application for such inspection shall be made to the Commissioner as provided in section 3.042a and, in addition to the information outlined therein and in section 3.042b shall specify the internal revenue district or office in which the returns to be inspected are believed to have been filed.

.05 *Time and place of inspection.*—A convenient time and place for the inspection of returns will be arranged by the internal revenue officer (District Director or Director of International Operations) with whom the returns were filed. The inspection will be permitted only in the presence of an internal revenue officer or employee and only in an office of the Internal Revenue Service during the regular hours of business of such office.

SEC. 4. INSPECTION OF CORPORATION RETURNS OF INCOME TAX OR UNEMPLOYMENT TAX.

.01 Under the provisions of sections 301.6103(b)–1(a) and 301.6106–1 of the regulations, the proper tax officers of a State shall have access, upon application made in accordance with the provisions of this paragraph, to the returns filed by any corporation with respect to the taxes imposed by chapters 1, 3, and 6 of the Code and with respect to the unemployment tax imposed by chapter 23 of the Code, or to abstracts of such returns. Application for access to the returns of any corporation, or abstracts thereof, shall be in writing, signed by the Governor of the State and addressed to the Commissioner of Internal Revenue, Washington, D.C., 20224. The application shall set forth the reason why access is desired; the names and official positions of the officers designated to have such access; and, with respect to each return to which access is desired, the name and address of the corporation filing the return, the kind of tax (income tax or unemployment tax) reported on the return, and the taxable year covered by the return.

.02 *Time and place of inspection.*—The internal revenue officer, District Director, or Director of International Operations, with whom the returns were filed is authorized to make such returns available in accordance with permission granted by the Commissioner. Such officer shall set a convenient time and place for the inspection. The inspection will be permitted only in the presence of an internal revenue officer or employee and only in an office of the Internal Revenue Service during the regular hours of business of such office.

.03 In addition to the inspection provided for in this section, corporation returns of income tax or unemployment tax may be made available, upon proper application, under the provisions of section 3 (with respect to unemployment tax returns) and section 5 (with respect to corporation income tax returns) of this Revenue Procedure, to properly authorized State officials, and upon the conditions and for the purposes set forth in these sections.

SEC. 5. INSPECTION OF INCOME TAX RETURNS.

.01 *In general.*—Under the provisions of section 301.6103(b)-1(b) of the regulations, income tax returns filed with respect to the taxes imposed by chapters 1, 2, 3, and 6 of the Code shall, upon application made in accordance with the provisions of this paragraph, be open to inspection by any official, body, or commission, lawfully charged with the administration of any State tax law or any properly designated representative of such official, body, or commission, if the inspection is for the purpose of such administration or for the purpose of obtaining information to be furnished to local taxing authorities as provided in section 6103(b)(2) of the Code. The application shall be made in writing and signed by the Governor of the State and shall be addressed to the Commissioner of Internal Revenue, Washington, D.C., 20224. The application shall state the following:

1 The title of the official, body, or commission by whom or which the inspection is to be made;

2 By specific reference, the State tax law which such official, body, or commission is charged with administering and the law under which he or it is so charged;

3 The purpose for which the inspection is to be made; and

4 If the inspection is for the purpose of obtaining information to be furnished to local taxing authorities, (1) the title of the official, body, or commission of each political subdivision of the State, lawfully charged with the administration of the tax laws of such political subdivision, to whom or to which the information secured by the inspection is to be furnished, and (2) the purpose for which the information is to be used by such official, body, or commission.

.02 *Procedure as to returns filed in the internal revenue district within or including the State requesting inspection.*

1 *General inspection.*—Permission may be granted by the Commissioner to any State for general inspection of returns of the taxes imposed by chapters 1, 2, 3, and 6 of the Code which are filed in an internal revenue district within or including such State. If such general inspection is desired, the application made to the Commissioner in accordance with section 5.01 shall include a statement that

general inspection is desired of returns filed in the internal revenue district or districts within or including the State with respect to the taxes imposed by chapters 1, 2, 3, and 6 of the Code. Permission granted for the general inspection provided for in this subparagraph shall continue in effect until such time as the Commissioner by written notice to the Governor of the State provides that such inspection will be permitted only on the basis of periodic applications therefor. The Governor shall supply to the district director with whom the returns to be inspected were filed a written list of the names of the individuals designated to make the inspection on behalf of the official, body, or commission named in the application to the Commissioner, and shall keep such list current by appropriate deletions or additions as may be necessary.

2 *Inspection of specific returns.*—Permission for the general inspection provided in section 5.021 of this section includes permission to inspect a specifically identified return when desired. However, a State interested only in examining the returns of particular taxpayers may inspect such returns on written application therefor to the Commissioner. The application in such case shall state, in addition to the information outlined in section 5.01, the name and address of each taxpayer whose return or returns it is desired to inspect, the taxable year covered by each such return, and the names of the individuals designated to make the inspection on behalf of the official, body, or commission named in the application.

.03 *Procedure as to returns filed in other internal revenue districts.*—In the case of returns filed with the Director of International Operations or in an internal revenue district other than one within or including the State requesting the inspection, permission for the inspection provided for in section 5.01 will be granted only with respect to specifically identified returns. The application for such inspection shall be made to the Commissioner as provided in section 5.01 and, in addition to the information outlined therein and in section 5.022, shall specify the internal revenue district or office in which the returns to be inspected are believed to have been filed.

.04 *Time and place of inspection.*—The internal revenue officer (District Director, or Director of International Operations) with whom the returns were filed is authorized to make such returns available in accordance with permission granted by the Commissioner. Such officer shall set a convenient time and place for the inspection. The inspection will be permitted only in the presence of an internal revenue officer or employee and only in an office of the Internal Revenue Service during the regular hours of business of such office.

SEC. 6. INSPECTION OF RETURNS STORED IN FEDERAL RECORDS CENTERS.

District Directors may not authorize inspection by State tax officers at Federal records centers of tax returns stored in such centers. However, if the State has previously been granted authorization for inspection of returns by the National Office and certain of these returns are stored in a Federal records center, the State should be permitted to inspect these returns in the district office, only on a name-by-name basis after the returns have been requisitioned and obtained from the Federal records center.

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SEC. 7. DOCUMENTS AND INFORMATION WHICH MAY BE INSPECTED.

.01 State tax officers authorized previously to inspect returns may also inspect information returns, schedules, etc., designed to be supplemental to or to become a part of the returns as well as certain records and reports relating to returns, as follows:

1 Schedules, information returns, protests, briefs, waivers, and other statements or documents designed to be supplemental to or to become a part of the return, may be inspected.

2 Examiners' reports may be inspected to the extent that such reports have previously been furnished to the taxpayer; therefore, the transmittal letter portion of a revenue agent's report, or a separate confidential report which contains information for Service use only, may not be inspected.

3 Conference reports may not be inspected, with the exception of the pages showing recomputation of tax liability.

4 Work papers of examiners, engineers' reports, cover letters of the reports in which opinions are expressed, reports of special agents and interoffice communications may not be inspected unless specific authorization is given by the Commissioner.

5 Inspection of claims for refund will be limited to the face of the claim only, since the back of the claim contains Service records.

6 Typed copies of office copies of certificates of overassessment may be furnished; no photostatic copies of certificates of overassessment may be made.

SEC. 8. COPIES, ABSTRACTS, OR TRANSCRIPTS OF RETURNS.

.01 Any official, body, or commission lawfully charged with the administration of any State tax law, or any properly designated representative of such official, body, or commission, by whom or which inspection of a return may be permitted under sections 301.6103(a) and 301.6103(a)–2, 301.6103(b)–1 and 301.6106–1 of the regulations, may be furnished with a copy of such return upon request.

.02 If the request for a copy of a return is made other than at the time of inspection of such return by the applicant, the request shall be in writing, shall adequately identify the return, a copy of which is desired, and shall be accompanied by satisfactory evidence that the applicant is a State tax official authorized to inspect the return.

.03 If the State tax official has been authorized by the Commissioner to inspect the return, either through permission for general inspection or permission to inspect a specific return, the application for the copy should be submitted to the District Director, or the Director of International Operations, with whom the return was filed, identifying the return or returns of which a copy is desired.

.04 In all other cases, the application shall be made in writing, shall be signed by the Governor of the State addressed to the Commissioner of Internal Revenue, shall comply with the respective requirements set forth in this procedure governing applications for permission to inspect specific returns, and shall include a request that a copy be furnished.

.05 Request may be made for inspection of, or a copy of, a return, or both.

SEC. 9. PROCEDURE FOR FURNISHING SERVICES.

.01 District Directors, upon authorization by the Commissioner, will provide the necessary inspection, copying, abstract, or transcript service with respect to those returns which are filed in their districts.

.02 When a State is authorized to inspect returns in a District Office, the State generally will be advised that it will be necessary for the State to contact the District Director to determine when the returns and related documents will be available for inspection, copying, abstract, or transcript service. District Directors should cooperate fully with properly designated State tax officers and arrange mutually convenient dates for the inspection of, or the obtaining of information from, returns and related documents. Care should be taken that any dates arranged will not interfere with the normal flow of returns during filing periods, or interrupt investigative or administrative processes involving active use of returns and related documents.

.03 District Directors may also receive from the National Office, from time to time, lists of names, addresses, taxable periods involved, and classes of returns, with instructions to furnish copies of the returns and related documents, or abstracts or transcripts of information therefrom, when they are available, to designated State officials.

SEC. 10. STATE ABSTRACT OR TRANSCRIPT SERVICE, CHARGES, AND STATEMENTS OF ACCOUNT.

.01 States will be required to provide forms upon which such abstracts or transcripts are to be furnished. They will be forwarded periodically to the State tax commission or similar body which requested the service.

.02 Charges for State abstract or transcript service will be at the rate of $2.50 per hour.

.03 Effective February 1, 1966, charges for copies of returns and certifications furnished to States will be made as follows:

1 For each copy of a return or other document, $1 a page.

2 For each copy of Form 1040A, or a return or other document of similar size, a charge of $1 each will be made, even though both sides of the document are furnished.

3 For each copy of a page which is substantially larger than the size used in the largest income tax return, the basic rate of $1 per page may be increased in proportion to the size (in multiples of 50 cents) to such amount that appears reasonable under the circumstances.

4 For each certification, $1.

5 No charges will be made pursuant to this Revenue Procedure for abstracts of information which are furnished to States pursuant to special cooperative agreements between the States and the Federal Government for the mutual exchange of tax information.

SEC. 11. TERMS USED.

References to the district or office in which a return is filed shall, for the purposes of applications for inspection and the inspection, mean the district or office having official custody of the return. If it is believed that the district or office where the return was filed is different from the district or office having official custody, applications

made in accordance with this procedure should include statements to that effect, specifying the several locations.

SEC. 12. PENALTIES FOR UNAUTHORIZED DISCLOSURE OF FEDERAL TAX INFORMATION BY STATE EMPLOYEES.

Section 7213(a)(2) of the Internal Revenue Code provides that any officer, employee, or agent of any State or political subdivision, who divulges (except as authorized in section 6103(b), or when called upon to testify in any judicial or administrative proceeding to which the State or political subdivision, or such State or local official, body, or commission, as such, is a party), or who makes known to any person in any manner whatever not provided by law, any information acquired by him through an inspection permitted him or another under section 6103(b), or who permits any income return or copy thereof, or any other information acquired by him through an inspection permitted him or another under section 6103(b) to be seen or examined by any person except as provided by law, shall be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than $1,000, or imprisoned not more than one year, or both, together with the costs of prosecution.

SEC. 13. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure supersedes Revenue Procedure 62–18, C.B. 1962–2, 408.

SEC. 14. CROSS REFERENCES.

For procedures relating to inspection by States of returns filed under the Internal Revenue Code of 1939, see Rev. Rul. 54–349, C.B. 1954–2, 122.

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26 CFR 601.311: Imposition of taxes; regulations. (Also Part III–B, Section 5702; 270.11.) — Rev. Proc. 66–5

Manufacturers of tobacco products have the initial responsibility in determining whether a roll of tobacco is a cigar or a cigarette and to taxpay it accordingly. Samples of reconstituted tobacco intended for use as a wrapper for rolls of tobacco and of the finished product and the package need not be submitted for a tax determination if the manufacturer is confident that the wrapper material is a "substance containing tobacco" and that the product is clearly distinguishable as a cigar or clearly distinguishable as a cigarette.

Revenue Procedure 65–23, C.B. 1965–2, 1005, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to furnish manufacturers of tobacco products advice concerning rolls of tobacco wrapped in reconstituted tobacco.

SEC. 2. BACKGROUND.

The Excise Tax Reduction Act of 1965, Public Law 89–44, C.B. 1965–2, 568, amended the definitions of "cigar" and "cigarette" in section 5702 of the Internal Revenue Code of 1954. Revenue Procedure 65–23, C.B. 1965–2, 1005, advised manufacturers of tobacco products of the continuance of the procedure to be followed to secure an official determination of the rate of tax applicable to the tobacco

product when reconstituted tobacco was used as a wrapper for rolls of tobacco. Reconsideration of the matter has resulted in the changed procedures expressed herein.

SEC. 3. PROCEDURES.

.01 Manufacturers of tobacco products have the initial responsibility in determining whether material, intended for use as a wrapper for rolls of tobacco, is a "substance containing tobacco," and in determining whether a roll of tobacco wrapped in such material is a cigar or a cigarette and to taxpay it accordingly. Significant areas of consideration are appearance of the product, the type of tobacco used in its filler, and its packaging and labeling (including marketing practices).

.02 If a manufacturer of tobacco products is confident that the material he intends to use as a wrapper for rolls of tobacco is a "substance containing tobacco," and that the finished product is clearly distinguishable as a cigar or clearly distinguishable as a cigarette, he need not obtain a tax determination from the Director, Alcohol and Tobacco Tax Division, prior to marketing the product.

.03 If, however, a manufacturer of tobacco products is not so confident that the material he intends to use as a wrapper for rolls of tobacco is a "substance containing tobacco," or that the finished product is clearly distinguishable as a cigar or clearly distinguishable as a cigarette, he should submit samples of the finished product (not less than 10) and the package as the products will be offered to consumers. The samples should be transmitted for a tax determination to the Director, Alcohol and Tobacco Tax Division, Washington, D.C., 20224. Attention: Tobacco Tax Branch.

.04 On occasion, Alcohol and Tobacco Tax Inspectors may pick up tax-exempt samples of products and the packages in which they will be offered to the consumer, for examination and testing purposes.

SEC. 4. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington, D.C., 20224. Attention: Tobacco Tax Branch.

SEC. 5. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 65–23, C.B. 1965–2, 1005, is hereby superseded.

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26 CFR 601.204: Changes in accounting periods and in methods of accounting. (Also Part I, Section 442; 1.442–1.)

Rev. Proc. 66–6

Approval of the Commissioner will be granted for change in annual accounting period under certain circumstances even though the short taxable year resulting from the change has a net operating loss as defined in section 172 of the Internal Revenue Code of 1954.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce the procedure generally followed by the Internal Revenue Service in approving a request for change in annual accounting period for which a substantial

business purpose exists, even though the short taxable year resulting from the change would have a net operating loss as defined in section 172 of the Internal Revenue Code of 1954.

SEC. 2. BACKGROUND.

Section 442 of the Code provides that if a taxpayer changes his annual accounting period, the new accounting period shall become the taxpayer's taxable year only if the change is approved by the Secretary or his delegate.

Section 1.442–1(a)(1) of the Income Tax Regulations provides that if a taxpayer wishes to change his annual accounting period, he must obtain prior approval from the Commissioner or the change must be authorized under the regulations.

Under the provisions of section 1.442–1(c) of the regulations corporations, other than electing small business corporations as defined in section 1371(b) of the Code, are permitted to change their accounting period without the prior approval of the Commissioner if certain conditions are met. One of these conditions is that the short period required to effect the change of annual accounting period is not a taxable year in which the corporation has a net operating loss as defined in section 172 of the Code.

Where individual taxpayers are concerned and where corporate taxpayers are unable to meet these conditions, prior approval of the Commissioner is required to effect a change of annual accounting period, and generally the change will be approved where the taxpayer establishes a substantial business purpose for making the change. In determining whether a substantial business purpose has been established, consideration will be given to all the facts and circumstances, including the tax consequences resulting from the change.

A change in accounting period may result in tax benefits not otherwise available to the taxpayer. This might happen, for example, in the case of a change in accounting period where the short taxable year includes a slack period of operations reflecting a loss which would produce a net operating loss carryback to a prior taxable year. Thus, if a taxpayer whose seasonal period of operations extends from May through October changes from a calendar year to a fiscal year ending April 30th, the short period ending April 30th would terminate just before the opening of the new season, and such short period would reflect expenses but little or no income. Because the income of the short period is distorted in relation to the annual income of the taxpayer, approval for the change will not be granted unless the distortion, if substantial, is eliminated by appropriate adjustments.

SEC. 3. PROCEDURE.

The Service will ordinarily approve a request for a change in accounting period under the following circumstances, provided the taxpayer otherwise qualifies for such change:

(i) The change results in a short period of nine months or longer and the net operating loss for the full 12-month period beginning with the first day of the short period equals or exceeds the net operating loss for the short period, or

(ii) The net operating loss for the short period cannot be carried back to prior taxable years, or

(iii) The net operating loss for the short period is not substantial in amount. For such purposes a net operating loss is considered not substantial if it does not exceed the greater of (1) $5,000 or (2) one percent of the taxpayer's average annual taxable income for the three years preceding the short period or $25,000, whichever is smaller.

In other cases involving a net operating loss in the short period the Commissioner may, under the authority of section 1.442–1(b)(1) of the regulations, approve a request for change in accounting period if the taxpayer agrees, in lieu of a net operating loss carryback, to deduct the amount of the net operating loss ratably over the 10-year period following the short period.

(Also Part I, Sections 167, 446; 26 CFR 1.167(a)–2, 1.446–1.) Rev. Proc. 66–7

Guidelines for depreciating returnable glass bottles

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to furnish taxpayers with a guide for depreciating returnable bottles used in a trade or business the cost of which is not otherwise recoverable.

SEC. 2. BACKGROUND.

.01 Returnable bottles used by a taxpayer in its trade or business are subject to an allowance for depreciation under section 167(a) of the Internal Revenue Code of 1954 where, under the method of accounting used by the taxpayer, the basis of the bottles is not otherwise recoverable.

.02 A taxpayer wishing to change to the method of depreciating bottles must obtain the prior consent of the Commissioner of Internal Revenue by filing an application for change in accounting method on Form 3115, Application for Change in Accounting Method, within 90 days after the beginning of the taxable year in which it is desired to make the change.

SEC. 3. MANNER OF DEPRECIATING RETURNABLE BOTTLES.

.01 Taxpayers either adopting in the first instance the method of depreciating returnable bottles or wishing to change to such method may depreciate the bottles subject to the conditions set forth below.

.02 Where the deposit value (that is, the amount normally required by the taxpayer as a deposit) is less than the original cost, the amount which may be depreciated is the cost of the bottles reduced by their deposit value. Normally, the amount deductible due to breakage of bottles while in the taxpayer's possession is limited to the deposit value of the bottles. Since the deposit value of the bottles will be excluded from the amount which may be depreciated, the deposits in the taxpayer's possession will not give rise to gain or loss.

26 CFR 601.602: Forms and instructions. Rev. Proc. 66–8
(Also Part I, Sections 3201, 3211, 3221; 31.3201–1, 31.3211–1, 31.3221–1.)

Computation of employer tax, employee tax, and employee representative tax imposed under the Railroad Retirement Tax Act, with respect to compensation paid during 1966 for services rendered after 1936 and before October 1, 1965.

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 Quarterly Railroad Retirement Tax Return, and employee representative tax to be reported on Form CT–2, Employee Representative's Quarterly Railroad Retirement Tax Return, under the Railroad Retirement Tax Act (chapter 22, subtitle C, Internal Revenue Code of 1954), with respect to compensation paid during 1966 for services rendered after 1936 and before October 1, 1965.

SEC. 2. BACKGROUND.

The January 1966 revision of Form CT–1 and Form CT–2 will provide entry spaces and rates for computing tax with respect to compensation for services performed after September 30, 1965. Because of the infrequency of payments of compensation for services rendered before October 1, 1965, the forms will not provide a schedule for computation of tax with respect to such compensation. Instead, a single entry line will be provided for the reporting of such tax, which may be computed by reference to this Revenue Procedure. See section 7 of this Revenue Procedure, however, relating to the reporting of employee representative tax with respect to compensation earned before 1947.

SEC. 3. MAXIMUM AMOUNT OF COMPENSATION EARNED IN A MONTH WHICH IS SUBJECTED TO TAX.

The employee tax, employer tax, and employee representative tax apply to compensation which does not exceed the amount shown below, for services rendered in a calendar month:

Period in which services were rendered	Maximum per calendar month
After Oct. 31, 1963, and before 1966	$450
After May 31, 1959, and before Nov. 1, 1963	400
After June 30, 1954, and before June 1, 1959	350
After 1936 and before July 1, 1954	300

NOTE: See secs. 5 and 6, below, for special rules for calendar months ended before 1947.

If an employee is paid total compensation by two or more employers for services rendered in a calendar month, and the total exceeds the maximum amount subject to tax for that month, the amount of compensation paid by each employer which is subject to tax should be computed in accordance with the rules stated in paragraph G of the instructions relating to Form CT–1 (except that the monthly maximum applicable to that month should be used in lieu of the amount stated in paragraph G).

If in any calendar month an individual renders services as an employee representative and as an employee, and if the total compensation paid to him for the services exceeds the monthly maximum, the measure of the employee representative tax is the monthly maximum minus the amount of compensation paid to him for services rendered during the month as an employee.

SEC. 4. COMPUTATION OF EMPLOYER TAX AND EMPLOYEE TAX.

The schedule shown below is provided as a guide for computing the employer tax and employee tax applicable to compensation paid during 1966 for services rendered after 1936 and before October 1, 1965.

1. Computation of employee tax on compensation for services rendered before October 1, 1965:

Period in which compensation, paid during quarter, was earned (a)	Compensation paid during quarter for such services, subject to employee tax (b)	Rate of employee tax on such compensation (c)	Amount of employee tax (col. (b) × col. (c)) (d)
Oct. 1, 1965 through Dec. 31, 1965	$	7⅛ percent	$
Jan. 1, 1965 through Sept. 30, 1965		8⅛ percent	
Calendar years 1962, 1963, and 1964		7¼ percent	
June 1, 1959 through Dec. 31, 1961		6¾ percent	
Jan. 1, 1947 through May 31, 1959		6¼ percent	
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		2¾ percent	
Totals	$	XXXXXXX	$

2. Computation of employer tax on compensation for services rendered before October 1, 1965:

Period in which compensation, paid during quarter, was earned (e)	Compensation paid during quarter for such services, subject to employer tax (f)	Rate of employer tax on such compensation (g)	Amount of employer tax (col. (f) × col. (g)) (h)
Oct. 1, 1965 through Dec. 31, 1965	$	7⅛ percent	$
Jan. 1, 1965 through Sept. 30, 1965		8⅛ percent	
Calendar years 1962, 1963, and 1964		7¼ percent	
June 1, 1959 through Dec. 31, 1961		6¾ percent	
Jan. 1, 1937 through May 31, 1959		6¼ percent	
Totals	$	XXXXXXXX	$

3. Total employee tax (from column (d)), above ..... $_____.
4. Total employer tax (from column (h)), 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 column (f), include in the explanation a statement of the computations which cause the amounts to be different. See secs. 5 and 6, below.

SEC. 5. EMPLOYEE TAX WITH RESPECT TO COMPENSATION EARNED BEFORE 1947.

The employee tax imposed by section 2(a) of the Carriers Taxing Act of 1937, 45 U.S.C. 261, and by section 1500 of the Internal Revenue Code of 1939 prior to its amendment by Public Law 572, 79th Congress, 2d session, July 31, 1946, 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. 6. EMPLOYER TAX WITH RESPECT TO COMPENSATION EARNED BEFORE 1947.

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 paragraph G of the instructions relating to Form CT–1 (except that the employer tax does not apply to compensation in excess of $300 for such services).

It should be noted that the amount of compensation, if any, subject to employee tax (column (b) in section 4, above) generally will be less than the amount of compensation subject to employer tax (column (f) section 4, above) for the reason that the latter amount must be computed without regard to compensation paid to the employee before 1947.

SEC. 7. COMPUTATION OF EMPLOYEE REPRESENTATIVE TAX.

The rates shown below are applicable to compensation paid during 1966 for services rendered after 1936 and before October 1, 1965, as an employee representative.

Period in which compensation, paid during quarter, was earned	Rate of employee representative tax
Oct. 1, 1965, through Dec. 31, 1965	14¼ percent
Jan. 1, 1965, through Sept. 30, 1965	16¼ percent
Calendar years 1962, 1963, and 1964	14½ percent
June 1, 1959, through Dec. 31, 1961	13½ percent
Jan. 1, 1947, through May 31, 1959	12½ percent
Calendar year 1946	7 percent
Calendar years 1943, 1944, and 1945	6½ percent
Calendar years 1940, 1941, and 1942	6 percent
Calendar years 1937, 1938, and 1939	5½ percent

Employee representative tax with respect to compensation paid for services rendered as an employee representative before 1947 should be reported on Form CT–2 for the calendar quarter in which the services were rendered, and not on the Form CT–2 for the quarter in which the compensation is paid. If a return on Form CT–2 was filed for the calendar quarter in which the services were rendered, any subsequent payment of compensation for services rendered in such quarter should be reported on a Form CT–2, which is marked "Amended" and which is altered to show the applicable rate of tax.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Section 5552; 245.30.) Rev. Proc. 66–9

Approval of the Fischer & Porter Company Magnetic Meter Monitoring System SE #5264.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to inform brewers and others concerned of the approval of a new metering system for use in breweries.

SEC. 2. APPROVAL.

The Fischer & Porter Magnetic Meter Monitoring System SE #5264 is approved for metering beer in breweries under 26 CFR Part 245. This system is the same as the approved Fischer & Porter Company Tamper-Proof Turbine Meter and Totalizer System, announced in Revenue Procedure 64–2, C.B. 1964–1 (Part 1), 641, except that a magnetic meter is used in place of a turbine type meter.

SEC. 3. CONTROLS.

The panel containing the totalizers and means of setting adjustment factors is to be kept under separate lock and key under Government control. The brewer will control all other operating controls.

SEC. 4. INSTALLATION AND TEST OF METERS.

For testing brewers' meters, the Alcohol and Tobacco Tax Division ordinarily has available only master meters having 2-inch flanged connections. Therefore, brewery meters must be so installed as to be readily tested by such 2-inch meters. Also, where brewery meters normally operate in excess of the maximum rate of flow for Govern-

ment master meters—usually 90 to 100 gallons per minute—provision must be made to test such brewery meters at a lesser rate of flow.

SEC. 5. INQUIRIES.

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.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Sections 162, 164, 274, 1016; 1.162–17, 1.164–1, 1.274–5, 1.1016–3.)

Rev. Proc. 66–10 [1]

In examining income tax returns filed by employees or self-employed individuals for taxable years beginning after December 31, 1964, the Internal Revenue Service will accept a simplified method for computing deductions for the costs of operating passenger automobiles (including vehicles such as pickup or panel trucks) for business purposes.

With respect to returns filed for taxable years beginning after December 31, 1964, Revenue Procedure 64–10, C.B. 1964–1 (Part 1), 667, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to establish certain procedures to be followed by the Internal Revenue Service in examining income tax returns filed for taxable years beginning after December 31, 1964, by employees or self-employed individuals who claim deductions for the costs of operating passenger automobiles (including vehicles such as pickup or panel trucks) for business purposes. Under these procedures, a simplified method of computing deductible costs of operating passenger automobiles will be accepted.

SEC. 2. BACKGROUND.

Section 162(a) of the Internal Revenue Code of 1954 provides that 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. Under that provision, an employee or a self-employed individual may deduct the cost of operating a passenger automobile owned by him to the extent that it is used in a trade or business. Any portion of the operating cost which is attributable to personal use, rather than use for a business purpose, is not deductible.

SEC. 3. OPTIONAL METHOD OF COMPUTING OPERATING COSTS.

Subject to the conditions and limitations set forth below, deductions will be accepted if computed at a standard mileage rate of (a) ten cents per mile for the first 15,000 miles of use each year for business purposes and (b) seven cents per mile for use for business purposes in excess of 15,000 miles per year. Computation under this method is optional on a yearly basis.

.01 A deduction computed under this method shall be in lieu of all operating and fixed costs of the automobile allocable to business

[1] Also released as Technical Information Release 798, dated February 16, 1966.

purposes. Such items as gasoline (including State and local taxes), oil, repairs, license tags, insurance, and depreciation are included in operating and fixed costs. However, parking fees and tolls attributable to use for business purposes may be deducted as separate items. Gasoline taxes allocable to use for nonbusiness purposes (and allowable under section 164 of the Code) may be deducted in addition to the deduction computed under this method.

.02 The use of the simplified method is limited to a self-employed individual or an employee who operates only one automobile at a time for business purposes. Where a person alternates in using different automobiles on different occasions for business purposes, the standard mileage rate applies to the total business mileage of such automobiles, as if they were one, to arrive at a deduction. Similarly, if an individual replaces his automobile during the year, the total business mileage for the year of both automobiles must be used, as if they were one, in applying the standard mileage rate.

.03 This method is not acceptable for computing the deductible costs of (A) vehicles used for hire, such as taxicabs, or (B) two or more automobiles used simultaneously, such as in fleet operations.

.04 In any year in which the simplified method has been used, straight-line depreciation will be considered to have been allowed. The allowable depreciation will act to reduce the basis of the automobile in determining adjusted basis as required by section 1016(a) of the Code.

.05 This simplified method is not available for use where depreciation has been claimed in the past on an automobile by use of a depreciation method other than straight line, or where additional first-year depreciation has been claimed.

.06 The optional method provided by this Revenue Procedure will be accepted in examining the return of an employee irrespective of whether he received a reimbursement or allowance for such business automobile expenses from his employer, provided that such reimbursement or allowance is reflected in his return. For the reporting requirements of employees, see sections 1.162–17 and 1.274–5(e) of the Income Tax Regulations.

.07 For this method of computing automobile cost to be acceptable, a self-employed individual or employee is required to establish his business mileage (A) for local transportation, in accordance with section 1.162–17(d) of the regulations, and (B) for other travel, in accordance with section 1.274–5 of the regulations. The provisions of such regulations relating to substantiation of the amount of an expenditure are inapplicable to deductions computed under this Revenue Procedure.

SEC. 4. EFFECT ON OTHER DOCUMENTS.

With respect to returns filed for taxable years beginning after December 31, 1964, this Revenue Procedure supersedes Revenue Procedure 64–10, C.B. 1964–1 (Part 1), 667 (erroneously designated as Revenue *Ruling* 64–10 in the Cumulative Bulletin), which relates to periods after December 31, 1962.

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 611; 1.611–2.)

Rev. Proc. 66–11 [1]

Guidelines for computing cost depletion deductions by taxpayers in the Southern High Plains of Texas and New Mexico who extract ground water from the Ogallala formation for irrigation purposes.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to furnish guides for taxpayers entitled to cost depletion deductions for the exhaustion of their capital investment in the ground water extracted by them in the Southern High Plains of Texas and New Mexico and disposed of by them in their business of irrigation farming.

SEC. 2. BACKGROUND.

.01 In Revenue Ruling 65–296, C.B. 1965–2, 181, dated December 13, 1965, it is stated that the Internal Revenue Service will follow the decision of the United States Court of Appeals for the Fifth Circuit in *United States* v. *Marvin Shurbet, et ux.*, 347 Fed. (2d) 103 (1965), in the disposition of cases involving taxpayers engaged in the business of irrigation farming in the Southern High Plains of Texas and New Mexico.

.02 In that case, the Court held that the taxpayers are entitled to a cost depletion deduction for the exhaustion of their capital investment in the ground water extracted and disposed of by them in their business of irrigation farming. The Court specifically stated, however, that its decision was not meant to furnish a precedent for the allowance of cost depletion except under the peculiar conditions of the Southern High Plains.

SEC. 3. DISCUSSION AND CONCLUSIONS.

.01 The Court found in the *Shurbet* case that one of the ways the taxpayer may establish the cost of the ground water at the time of acquisition is by comparing differences between the fair market values of dry lands and lands which contain water for irrigation in the area at that time. Any value attributable to nonfarm use of the land must be excluded from such cost and only the normal agricultural value at that time will be taken into account. As to any cost to be allocated to ground water for counties in the Southern High Plains area, the Service may use any other reasonable means of verifying claimed values, including, where proper, a range of acceptable values expressed as a percentage of the purchase price. In each allocation, appropriate consideration must be given to the value allocated to all improvements including the residence, if any, at the time of acquisition.

.02 Cost depletion will be allowed to irrigation farmers in the Southern High Plains under facts established to be similar to those in the *Shurbet* case. Taxpayers claiming cost depletion deductions on underground water deposits must establish to the satisfaction of the

[1] Also released as Technical Information Release 802, dated Feb. 23, 1966.

district director both the amount of water present at acquisition and their cost basis of the water. A proper allocation based upon relative market value as of the date of acquisition is necessary in cases where the water deposit was acquired with the land for a single price.

.03 In addition, the taxpayer will be required to establish the net amount of exhaustion of the water deposit beneath his land during the taxable year. In establishing the net amount of exhaustion of the water deposit underneath a taxpayer's land during the taxable year, the Service will not recognize that there has been any exhaustion in any year in which a recharge of water increases the water saturation level over its level at the end of a prior year of decrease. It is obvious that where there is an increase in any given year of available water, the taxpayer's supply has not been depleted during such year. Nor will any further deduction for depletion be allowed until such time as the water table again declines to a level below the previously known lowest level. See example below.

.04 The determination of the saturated thickness (the thickness of that part of the formation containing water) at acquisition subject to depletion and the net decrease of that depletable saturated thickness during a given year are dependent upon the particular facts in each case, and each taxpayer claiming a cost depletion deduction must establish these factors in his case to the satisfaction of the district director.

SEC. 4. EXAMPLE.

Taxpayers should maintain appropriate records to support depletion deductions claimed. The following example shows a general format which may be used for computing cost depletion in claiming a cost depletion deduction.

(1) *Facts*

In 1957 *A*, a farmer, who was on a calendar year basis, acquired some farmland in the Ogallala area of the Texas High Plains region. He paid $12,000 for the property, of which $10,000 represented the cost of the land and $2,000 the cost of improvements, including an irrigation well which was producing an ample supply of water from a reservoir with a depletable saturated thickness on the date of purchase of 250 feet. *A*'s land had a value of $10,000 whereas without water it would have been worth only $6,000. As of the beginning of the taxable year 1962, the depletable saturated thickness was 200 feet and decreased to 190 feet as of the end of the year. In 1963, there was a further net decline of 20 feet. In 1964, the water formation actually rose above the previous year's saturated thickness so that there was no actual depletion of the water. But in 1965, the water level sank 15 feet. Of this amount, 10 feet was merely recapture of the prior excess, so that only the net decline of 5 feet was depletable. It is assumed that in some year subsequent to 1965 the remaining water would be drained off, and from that time on there would be no more water to deplete.

The cost depletion computation and depletion summary set forth below show the manner in which cost depletion would be computed for 1962 and subsequent years on the basis of the foregoing facts.

(2) *Cost Depletion Computation—Water*

Cost of land and improvements at acquisition	$12,000
Less: Cost of improvements	−2,000
Cost of land (surface and ground water)	10,000
Fair market value of surface land at acquisition	−6,000
Cost of ground water at acquisition	$4,000
Depletable saturated thickness of Ogallala formation at date of acquisition	250 feet

Computation of unit cost=

$$\frac{\text{Original basis}}{\text{Original number of feet}} = \frac{\$4{,}000}{250} = \$16 \text{ per foot}$$

Computation of depletion allowance for taxable year=unit cost × feet decrease.

Depletable saturated thickness, beginning of taxable year (1962)	200 feet
Depletable saturated thickness, end of taxable year (1962)	190 feet
Depletable net decrease (1962)	10 feet

Depletion allowance (1962) =$16 per foot×10 feet=$160.

(3) *Depletion Summary*

Year	Saturated thickness (in feet)			Unit cost per foot*	Depletion allowance
	Beginning of year	End of year	Depletable net decrease		
(1)	(2)	(3)	(4)	(5)	(6)
1962	200	190	10	$16	$160
1963	190	170	20	16	320
1964	170	180	none	16	none
1965	180	165	5	16	80

*Cost of ground water at acquisition ($4,000) divided by original saturated thickness (250 feet).

(Also Part I, Section 1038.) Rev. Proc. 66–12 [1]

On August 5, 1965, proposed regulations under section 1038 of the Internal Revenue Code of 1954, relating to certain reacquisitions of real property, were published in the Federal Register (30 F.R. 9768).

Consistent with the announcement in Technical Information Release 753, dated August 6, 1965, the Internal Revenue Service will accept as valid, elections made before September 4, 1965, in accordance with those proposed regulations to have the provisions of section 1038 of the Code apply to reacquisitions of real property occurring in certain taxable years beginning after December 31, 1957, and before September 3, 1964.

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26 CFR 601.204: Changes in accounting periods and in methods of accounting. Rev. Proc. 66–13
(Also Part I, Section 442; 1.442–1.)

Procedures for changes in accounting period by tax exempt organizations.

[1] Based on Technical Information Release 753, dated August 6, 1965.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide an administrative procedure whereby organizations wholly exempt from Federal income tax may expeditiously obtain approval of a change in annual accounting period. Such organizations complying with the provisions hereof will be deemed to have obtained the approval of the Commissioner of Internal Revenue for a change in accounting period.

SEC. 2. BACKGROUND.

Under existing procedure, an organization wholly exempt from Federal income tax desiring to change its annual accounting period is required under the provisions of section 1.442–1(b)(1) of the Income Tax Regulations to file an application on Form 1128, Application for Change in Accounting Period, with the Commissioner of Internal Revenue on or before the last day of the month following the close of the short period for which a return is required to effect the change of accounting period.

SEC. 3. APPLICATION.

Subject to the conditions contained in this section and in section 5 below, any organization wholly exempt from Federal income tax desiring to change its annual accounting period, and whose exempt status is the same for the short period for which a return is required to effect a change in accounting period and for the taxable year immediately preceding such short period, may change its annual accounting period by filing an application on Form 1128 with the District Director of Internal Revenue for the district in which the organization files its return. Reference to this Revenue Procedure should be made a part of the application. The application shall be filed on or before the last day of the month following the close of the short period for which a return is required to effect the change of accounting period. Unless a letter is received by the organization from the District Director denying approval because the Form 1128 is not timely filed, it may be assumed that the change has been approved. The organization must attach a copy of the application to the return filed for the short period.

SEC. 4. EXEMPT ORGANIZATIONS NOT COVERED BY THIS PROCEDURE.

This Revenue Procedure does not apply to Farmers' Cooperatives exempt from Federal income tax under section 521 of the Internal Revenue Code of 1954, or organizations having unrelated business income as defined in section 512(a) of the Code. Such organizations shall file applications on Form 1128 with the Commissioner in accordance with section 1.442–1(b)(1) of the regulations.

SEC. 5. RECORDS.

The books of the organization must be closed as of the last day of the new taxable year. Returns for subsequent taxable years must be made on the basis of a full 12 months ending on the last day of the new taxable year.

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SEC. 6. EFFECTIVE DATE.

This Revenue Procedure shall be effective for any change of annual accounting period where the last day of the short period required to effect the change ends on or after April 30, 1966.

SEC. 7. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the Commissioner of Internal Revenue, Attention: T:I:C:1:AM&P, Washington, D.C., 20224.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Section 5552; 245.30.)

Rev. Proc. 66–14

The Fischer & Porter Co. Magnetic Meter Monitoring System SE #5281 has been approved by the Internal Revenue Service for use by brewers in measuring beer.

All meters which have been approved for use in measuring beer are listed.

Revenue Procedures 58–22, 60–30, 61–12, 64–2, 65–7, 65–14, 65–30, 66–9 superseded.

SECTION 1. PURPOSE.

The purposes of this Revenue Procedure are (1) to announce the approval of the Fischer & Porter Magnetic Meter Monitoring System SE #5281, and (2) to list all beer meters that have been previously approved.

SEC. 2. APPROVAL OF METER.

The Fischer & Porter Co. Magnetic Meter Monitoring System SE #5281, manufactured by the Fischer & Porter Co., Warminster, Pa., is approved for metering beer in breweries under 26 CFR Part 245. This metering system is a modification of the approved Fisher & Porter Co. Magnetic Meter Monitoring System #5264, announced in Revenue Procedure 66–9, page 621, this Bulletin. The modified system incorporates an auxiliary power supply which obviates the necessity for the solenoid valve and slow-flow cutoff features.

SEC. 3. METERS PREVIOUSLY APPROVED.

The following beer meters have been previously approved for metering beer in breweries under 26 CFR Part 245.

.01 Figure 486 Xacto Meter, and Figure 786 Xacto Meter, manufactured by Bowser, Inc., Ft. Wayne, Ind.

.02 Pittsburgh Equitable Meter, manufactured by Rockwell Manufacturing Co., Pittsburgh, Pa.

.03 Potter Flow Meter, equipped with Maximum Security System SY–81–4000, manufactured by the Potter Aeronautical Corp., Union, N.J. (Rev. Proc. 58–22, C.B. 1958–2, 1140, as modified by Rev. Procs. 61–12, C.B. 1961–1, 899, and 65–7, C.B. 1965–1, 734.)

.04 2BL and 3BL Rotocycle Beer Meters, manufactured by Rockwell Manufacturing Co., Pittsburgh, Pa., equipped with either registers approved for piston-type meters or the Brodie Register, Series 22265. (Rev. Proc. 60–30, C.B. 1960–2, 1008, as modified by Rev. Proc. 65–14, C.B. 1965–1, 825.)

.05 Tamper-Proof Turbine Meter and Totalizer System, manufactured by the Fischer & Porter Co., Warminster, Pa. (Rev. Proc. 64–2, C.B. 1964–1 (Part 1), 641.)

.06 A. O. Smith Model SY–81 meter, equipped with Model 1537 Security System. (Rev. Proc. 65–30, C.B. 1965–2, 1024.)

.07 Fischer & Porter Co. Magnetic Meter Monitoring System SE #5264, manufactured by the Fischer & Porter Co., Warminster, Pa. (Rev. Proc. 66–9, page 621, this Bulletin.)

SEC. 4. CONTROLS.

On all electronic meters, the panels containing the totalizers and means of setting adjustment factors are to be kept under separate lock and key under Government control. The brewer will control all other operating controls.

SEC. 5. INSTALLATION AND TEST OF METERS.

For testing brewers' meters, the Alcohol and Tobacco Tax Division ordinarily has available only master meters having 2-inch flanged connections. Therefore, brewery meters must be so installed as to be readily tested by such 2-inch meters. Also, where brewery meters normally operate in excess of the maximum rate of flow for Government master meters—usually 90 to 100 gallons per minute—provisions must be made to test such brewery meters at a lesser rate of flow.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

Revenue Procedures 58–22, C.B. 1958–2, 1140; 60–30, C.B. 1960–2, 1008; 61–12, 1961–1, 899; 64–2, C.B. 1964–1 (Part 1), 641; 65–7, C.B. 1965–1, 734; 65–14, C.B. 1965–1, 825; 65–30, C.B. 1965–2, 1024; and 66–9, page 621, this Bulletin, are hereby superseded.

SEC. 7. INQUIRIES.

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.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 4482; 41.4482(b)–1.)

Rev. Proc. 66–15

A weight of 3,000 pounds may be excluded in computing the "actual unloaded weight" of packer-type refuse collection trucks.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to establish a procedure to be followed by the Internal Revenue Service in examining highway use tax returns covering rear loading compaction-type refuse collection trucks. Under these procedures, a standard weight exclusion factor will be accepted for purposes of determining the "actual unloaded weight" of these trucks.

SEC. 2. BACKGROUND.

Under section 41.4482(b)–1(b)(2) of the Highway Motor Vehicle Use Tax Regulations the weight of certain parts used only in loading, unloading, and packing cargo, may be excluded in determining the

actual unloaded weight of a vehicle for purposes of the tax on highway use imposed by section 4481(a) of the Internal Revenue Code of 1954.

Many users of automatic packer-type refuse collection trucks have experienced difficulty in identifying excludable parts and substantiating their weight, when trying to determine the actual unloaded weight of this type of truck. For this reason, the taxpayers have requested the Service to establish a standard exclusion factor which will be accepted in lieu of actual identification and substantiation of the weight of excluded parts.

SEC. 3. CONCLUSION.

Upon consideration of data obtained from manufacturers of these trucks or bodies the Service will, in the examination of returns, accept without substantiation the exclusion of 3,000 pounds in computing the "actual unloaded weight" of packer-type refuse collection trucks.

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26 CFR 601.602: Forms and instructions. Rev. Proc. 66–16
(Also Part I, Section 6041; 1.6041–1.)

Substitutes for Form 1099, U.S. Information Return, may be used in lieu of the official form, subject, however, to prescribed conditions.

Revenue Procedure 65–12, C.B. 1965–1,751, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to state the requirements of the Internal Revenue Service relating to substitutes for Form 1099, U.S. Information Return. These requirements are designed to facilitate processing of these forms by optical character recognition techniques, and to provide flexibility in their preparation by payers.

SEC. 2. SUBSTITUTE FORMS.

Substitutes for Form 1099 which adhere to the specifications contained in this procedure may be privately printed without the prior approval of the Internal Revenue Service. Proposed substitutes not meeting these specifications should be submitted to the Service for approval. Requests for approval should contain an explanation of the need for the specific deviations sought.

SEC. 3. PAYMENTS.

.01 All of the payment blocks contained on the official form need not be shown on the substitute form. Only the payments actually needed by the user are necessary on the substitute. Payment blocks in addition to those on the official form may be added to substitute forms in accordance with section 4.02. The arrangement of payment blocks on substitute forms is covered in section 4.05.

.02 In 1965, salaries or other compensation previously reportable in block 4 on Form 1099 were permitted to be reported either on a Form 1099 or a Form W–2, Wage and Tax Statement, but not on both, at the option of the payer. For 1966 and subsequent years, payers should report this type of income only on Form W–2.

SEC. 4. FORMAT SPECIFICATIONS.

.01 For purpose of format specifications, the Form 1099 is divided into two sections: a specified format section and a variable format section. The specified format section includes all payment blocks, payee name, address, and taxpayer identifying number, the format identifier (section 4.04(j)) and payment identifier (section 4.05 (b) and (d)), the format guidelines, and the area within 3/8 inch of the left edge of the document and 1/8 inch to the right of the format or payment identifier. The variable format section consists of the remainder of the document, including the reporting year and payer name, address, and identification number.

.02 Additional data blocks (including additional payment blocks) may be added to substitute Forms 1099, at the option of the payer, or in accordance with State requirements, but these additional data blocks must be contained in the variable format section except as noted in section 4.04(c) below.

.03 *Variable format section layout.*—The arrangement of data in the variable format section may be varied on substitute forms to fit the requirements of State law or to accommodate the needs of the data processing system used by the payer, except that the payment year must always be in the upper right corner of the form.

.04 *Specified format section layout (general).*

(a) The specified format section, including contents, general arrangement and typography, must conform to one of the formats illustrated in Exhibit B, subject to section 4.05. Formats 1, 2, 3, 4, and 5 are preferred; however, formats 6, 7, 8, and 9 are also acceptable.

(b) If format 8 or 9 is used, and the location of the taxpayer identifying number is consistent, a three point vertical rule (0.045 inch) should be preprinted immediately to the left of this number. If format 8 or 9 is used and the location of the taxpayer identifying number is not consistent for all returns, due to the nature of the mechanical equipment used by the payer, this number need not be contained in a special box, nor identified. Preferably, it should be printed to the right of and on the same line as the payee name (or first line of the payee name if there is more than one) but it can also be printed one or two lines above or below the first line of payee name.

(c) Special precaution must be taken if the printing of an account designation number in the specified format section is unavoidable. In this case such number must not be on the same line as or on any line above the taxpayer identifying number, nor on the same line as payments. When possible, the printing of such numbers in the specified format section should be avoided.

(d) If the taxpayer identifying number is a social security number, it must be printed in the following pattern: 000–00–0000. If it is an employer identification number, it must be printed as 00–0000000. Spaces may be used in lieu of hyphens.

(e) When there are multiple payees with different surnames, the identifying number shown must be linked to the surname to which it applies. It is preferred that such linkage be in the form of an asterisk preceding the designated surname.

(f) Payee name, street address, and city and State (including ZIP code) must be on separate lines. City, State, and ZIP code may be on the same line or on separate lines.

(g) The area within ⅜ inch of the left edge of the document (exclusive of stubs) must not contain any prepunched holes and be free of any printing except for the format identifier and format guidelines appropriate to each permissible alternate format as illustrated in Exhibit B. There must be no intervening data or marks between the left edge of the document and the specified format section. In addition, there must always be a clear space of at least ⅛ inch to the right of and below the format and payment identifiers.

(h) There must be a margin of at least ¼ inch from the top edge of the document to any printing. Variable format section data may be placed between the top or bottom edge of the document and the specified format section. If not more than four payment blocks are used, the specified format section may occupy the entire left side of the substitute form at the option of the payer.

(i) The overall dimensions of the specified format section and the dimensions of the individual data blocks contained therein may be varied from the dimensions shown in Exhibits A and B. However, the general arrangement of data within the section and the typography may not be altered, except that substitute forms may be limited to the payments actually being reported.

(j) The appropriate format identifier (1, 2, 3, 4, 5, 6, 7, 8, or 9) must be shown in the upper left corner of Copy A, as illustrated in Exhibits A and B, ¼ inch from the top and left edges. If payment identifiers are used, they should follow the format identifier. See Exhibit C. In addition, the appropriate format guidelines must also be shown on Copy A. The identifiers and guidelines need not be shown on the other copies of the form.

(k) In using any of the formats, care should be taken to prevent disclosure of payment information if a window envelope is used for mailing.

.05 *Specified format section layout (payment blocks and payment identifiers).*

(a) The number of payments reported and the sequence of payments may vary from the number and sequence on the official form. However, payment blocks must always be on one line, and the wording and position within the block of the captions must conform to the wording and position on the official form. There must never be any nonpayment data between any payment block and the left margin of the document.

(b) In addition to the requirements in section 4.05(a), above, when the number or sequence of payments varies from the official form, or when a taxpayer identifying number is on the same line as the payments, a payment identifier must be printed on the form immediately to the right of the format identifier. The payment identifier consists of appropriate codes shown in section 4.05(d) below. The sequence of digits in the payment identifier must correspond exactly to the sequence of payments on the substitute form starting from the left.

(c) The taxpayer identifying number may be on the same line as the payment amounts. When this is done, format 6 or 7 must be used. In these cases, the number will be treated in the same manner as a payment block, and assigned code "0" (numeric zero), as noted in section 4.05(d) below.

(d) The following codes apply when payment identifier numbers are used:

1. Dividends and other distributions on stock.
2. Earnings from savings and loan associations, mutual savings banks, credit unions, etc.
3. Interest.
4. Patronage dividends and certain other distributions by cooperatives.
5. Rents and royalties.
6. Annuities, pensions, and other fixed or determinable income.
7. Foreign items, prizes, awards etc.
0. Taxpayer Identifying Number (used with format 6 or 7 only).

See Exhibit C.

SEC. 5. SPECIFICATIONS.

.01 *Basic form.*—The latest revision of the prescribed Form 1099 should be used as the basis for the privately printed form. A copy of the latest revision of this form may be obtained from any District Director of Internal Revenue.

.02. *Color and quality of paper.*

(a) Paper used for Copy A must be white 100 percent bleached chemical wood, 2½ percent maximum groundwood permissible. No optical brighteners may be added; however, minimal trace amounts will be acceptable. The paper must be: Weight, 40 pound (basis 17 x 22—1,000), tolerance plus/minus 5 percent (weight must be inclusive of any coatings or chemical treatments); brightness, 80 percent or more when measured on a brightness meter in accordance with TAPPI specifications T–452; low finish; free of any dirt specks which would affect optical scanning; and uniformly textured. The minimum qualifications are the typical physical characteristics in weight, caliper, stiffness, and tear resistance normally associated with a 40-pound chemical wood bond or writing paper.

(b) The paper used for other copies must be white, minimum 18-pound (17 x 22—1,000), and of good quality.

.03 *Color and quality of ink.*—All preprinted data and rules on Copy A must be in a black nonreflective ink. A nonreflective ink is one which has 10 percent reflectance or less between the wavelength range of 3,500 and 5,000 Angstroms and 20 percent or less between the wavelength range of 5,000 to 10,000 Angstroms. (These reflectances are referenced to magnesium oxide which is considered 100 percent.)

.04 *Quality of printing.*—Printers must maintain strict quality control during production of substitute Forms 1099. Special care must be taken to insure that the density of ink, as noted in section .03 above, is maintained and that the bar codes are free from picks and

voids. To facilitate satisfactory scanning operations, strict observance of printing and trimming tolerances are required.

.05 *Typography.*—Type must be substantially identical in size and shape with corresponding type on the official form. All horizontal rules on the document and all vertical rules outside the specified format section must be one point (0.015 inch). All vertical rules within the specified format section and format identifier lines must be three point (0.045 inch). When present, mailing guides must be less than ½ point (0.0075 inch). A 0.045-inch vertical rule must precede and follow every payment block, as illustrated in Exhibits A and B, irrespective of the number of payment blocks being reported. The format and payment identifiers must be printed in the 10-point Remington typewriter font as shown in GPO "Specimens of Type Faces." Vertical rules must be parallel to the left edge of the document; horizontal rules, parallel to the top edge.

.06 *Dimensions.*—The official form is 8 inches wide by 3½ inches deep, exclusive of a ½-inch snap-stub on the left side of the form. The substitute forms may vary in width from 7⅜ inches to 8 inches and in depth from 3¼ inches to 3¾ inches, although adherence to the size of the official form is preferred. The snap feature is not required on substitutes. If the substitute forms are in continuous or strip form, they must be burst and stripped to conform to the size specified before they are filed.

.07 *Clear area.*—The back of Copy A must be free of all printing.

.08 *Carbonized forms or "spot carbons."*—Carbonized forms and "spot carbons" are not permissible. Interleaved carbon, if used, should be black and of good quality to preclude smudging.

.09 *The Government Printing Office symbols.*—The Government Printing Office symbols must be omitted.

.10 *Copies B and C.*—Copies B and C are included in the official assembly for the convenience of the payer. Although there is no requirement that privately printed substitute forms include these copies, Copy B will satisfy the requirements of law and regulations concerning the statement of information which is to be furnished the payee and Copy C may be desired by the payer for his records.

SEC. 6. ADDITIONAL INSTRUCTIONS.

.01 *Arrangement of assembly.*—Except as provided in paragraph .02 below, the parts of the assembly shall be arranged, from top to bottom, as follows: Copy A, "For Internal Revenue Service," Copy B, "For Payee," Copy C, "For Payer's Records."

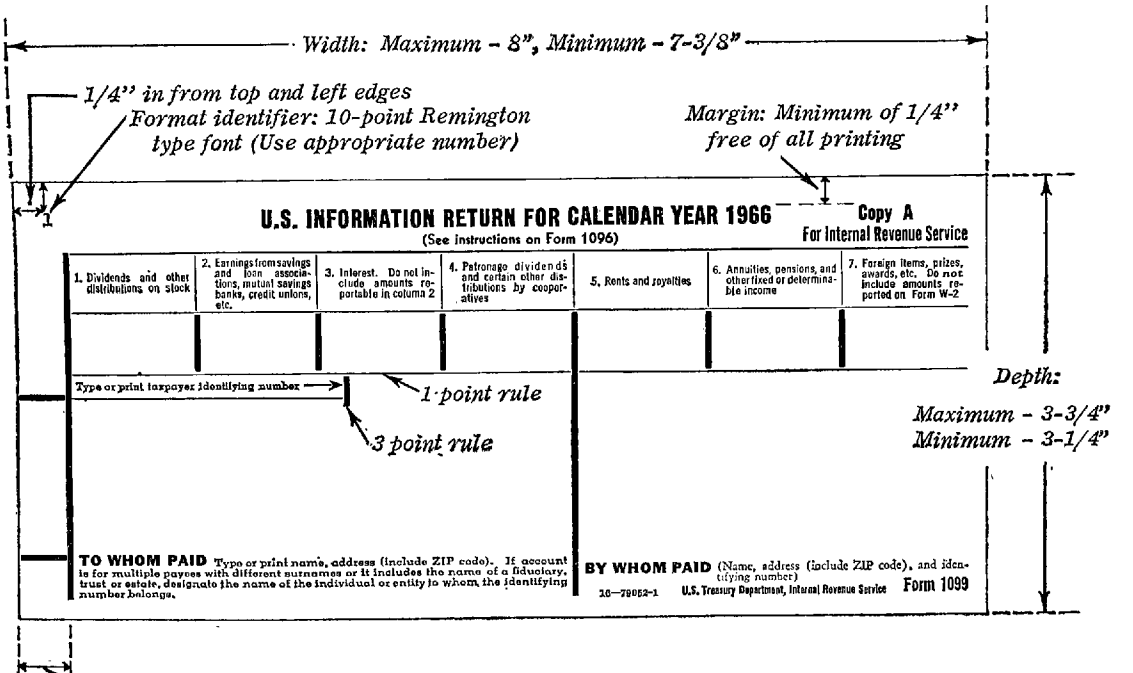
.02 *Additional copies.*—Additional copies may be prepared by payers for States requiring the report. When this is done, one such copy may be inserted between Copies A and B. Forms for delivery to State or local taxing authorities should be clearly labeled to indicate the purpose for which they are intended and should not bear any part of the designation, "Form 1099, U.S. Treasury Department, Internal Revenue Service."

.03 The instructions in the block "To Whom Paid" must be shown on the form.

.04 *Instructions for payers.*

(a) Only originals or ribbon copies may be filed with the Service. Carbon copies are not acceptable.

EXHIBIT A



Back of Copy A must be BLANK

EXHIBIT B

1

U.S. INFORMATION RETURN FOR CALENDAR YEAR 1966

(See instructions on Form 1096)

Copy A
For Internal Revenue Service

1. Dividends and other distributions on stock	2. Earnings from savings and loan associations, mutual savings banks, credit unions, etc.	3. Interest. Do not include amounts reportable in column 2	4. Patronage dividends and certain other distributions by cooperatives	5. Rents and royalties	6. Annuities, pensions, and other fixed or determinable income	7. Foreign items, prizes, awards, etc. Do not include amounts reported on Form W-2

Type or print taxpayer identifying number →

(This format (1) can only be used for substitutes based on the reproduction proof of the official form.)

TO WHOM PAID Type or print name, address (include ZIP code). If account is for multiple payees with different surnames or it includes the name of a fiduciary, trust or estate, designate the name of the individual or entity to whom the identifying number belongs.

BY WHOM PAID (Name, address (include ZIP code), and identifying number)

16—76052-3 U.S. Treasury Department, Internal Revenue Service **Form 1099**

2

3

4

5

6

7

8

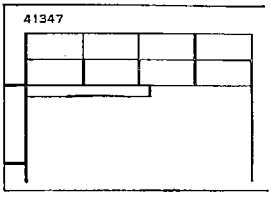
9

NOTES:

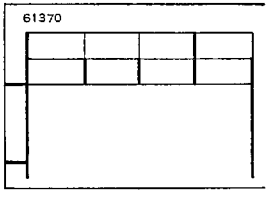
1. Formats 4, 5, 6, 7, 8, and 9 must have payment identifier number(s) following format identifier number. See Note 4 on Exhibit C.
2. When taxpayer-identifying number is located in a payment block, format 6 or 7 must be used.
3. Use 10 point Remington Type Font for format and payment identifier numbers.

EXHIBIT C

Illustration of Payment Identifier Numbers When Formats 4, 5, 6, 7, 8 and 9 are Used



Format 4 with payment identifiers:
1. Dividends and other distributions
3. Interest
4. Patronage dividends and certain other distributions by cooperatives
7. Foreign items

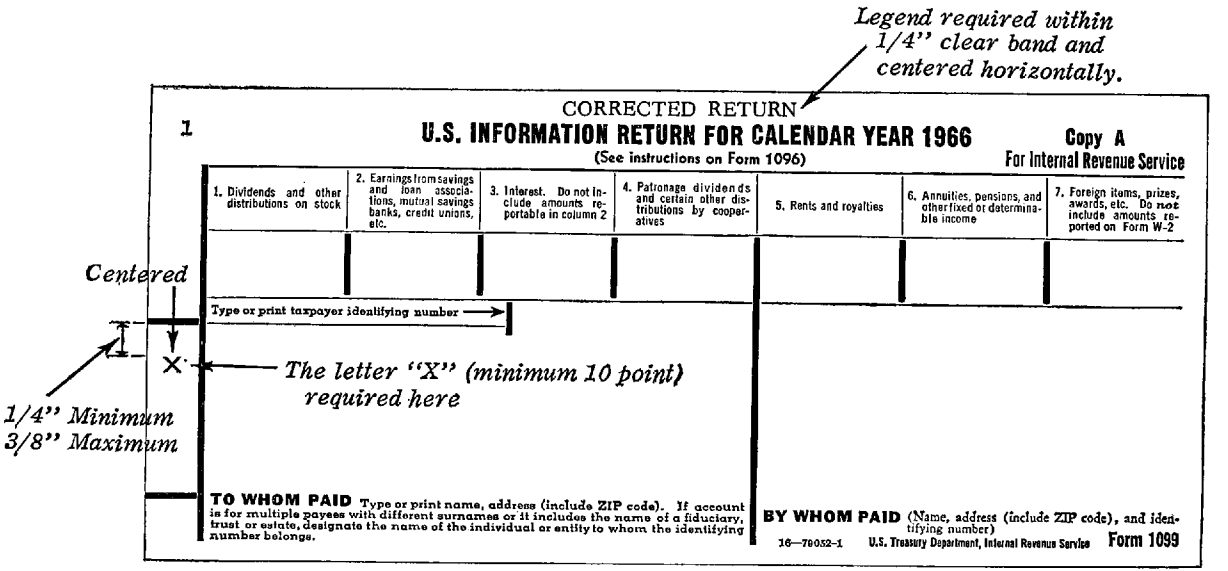


Format 6 with payment identifiers:
1. Dividends and other distributions
3. Interest
7. Foreign items
0. Taxpayer identifying number

NOTES:
1. When taxpayer identifying number is located in a payment block, format 6 or 7 must be used.
2. Use 10 point Remington Type Font for format and payment identifier numbers.
3. Payment blocks must correspond to payment identifier numbers printed. Do not use more payment blocks than payment identifier numbers.
4. If all 7 payment fields are shown and they are in the same sequence as on the official form, payment identifiers need not be shown.

EXHIBIT D

Illustration of additional information required on Form 1099 for amended or corrected returns.



NOTE:

When format 3, 5, 7, or 9 is used the location of the "X" must be centered in the 3/8" clear left margin and 1/4"-3/8" below the middle horizontal 3 point rule.

(b) The Service requests the cooperation of payers in typing or machine printing whenever possible and in providing good quality data entries on the forms; i.e., using black ribbon, inserting data in the middle of blocks, well separated from other printing and guidelines, and taking any other measures that will guarantee a clear, sharp image. However, payers are not expected to purchase typewriters, machines, or special ribbons to prepare the forms.

(c) Corrected returns, Form 1099, must be submitted in accordance with instructions on Exhibit D.

SEC. 7. SUBSTITUTES NOT MEETING ABOVE CONDITIONS.

Proposed substitute forms which do not meet the conditions stated above, and requests for submission of Forms 1099 in the form of tabulating cards or magnetic tape, should be forwarded by letter to the Commissioner of Internal Revenue, Attention: D:S:Pl., Washington, D.C., 20226.

SEC. 8. REPRODUCTION PROOFS.

Reproduction proofs of the official Form 1099 are available upon the request of any person who desires to use reproductions of such form. Requests for reproduction proofs should be addressed to the Commissioner of Internal Revenue, Attention: A:FM:P, Washington, D.C., 20224.

SEC. 9. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure supersedes Revenue Procedure 65–12, C.B. 1965–1, 751.

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26 CFR 601.602: Forms and instructions. Rev. Proc. 66–17
(Also Part I, Section 6041; 1.6041–1.)

Substitutes for Form 1087, Nominee's Information Return, may be used in lieu of the official form, subject, however, to prescribed conditions.

Revenue Procedure 65–18, C.B. 1965–1,837 superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to state the requirements of the Internal Revenue Service relating to substitutes for Form 1087, Nominee's Information Return. These requirements are designed to facilitate processing of these forms by optical character recognition techniques, and to provide flexibility in their preparation by nominees.

SEC. 2. SUBSTITUTE FORMS.

Substitutes for Form 1087 which adhere to the specifications contained in this procedure may be privately printed without the prior approval of the Internal Revenue Service. Proposed substitutes not meeting these specifications should be submitted to the Service for approval. Requests for approval should contain an explanation of the need for the specific deviations sought.

SEC. 3. FORMAT SPECIFICATIONS.

.01 For purpose of format specifications, the Form 1087 is divided into two sections: a specified format section and a variable format section. The specified format section includes the payment blocks, name, address, and identifying number of the actual owner or payee,

the format identifier (section 3.04(j)), the format guidelines, and the area within ⅜ inch of the left edge of the document and ⅛ inch to the right of the format identifier. The variable format section consists of the remainder of the document, including the reporting year and name, address, and identification number of the nominee or record owner.

.02 Additional data blocks (including additional payment blocks) may be added to substitute Forms 1087, at the option of the nominee, or in accordance with State requirements, but these additional data blocks must be contained in the variable format section except as noted in section 3.04(c).

.03 *Variable format section layout.*—The arrangement of data in the variable format section may be varied on substitute forms to fit the requirements of State law or to accommodate the data-processing system used by the nominee, except that the payment year must always be on the top line of the form, subject to section 3.04(h) below.

.04 *Specified format section layout.*

(a) The specified format section, including contents, general arrangement, and typography, must conform to one of the formats illustrated in Exhibit B. Formats 1, 2, 3, 4, and 5 are preferred; however, formats 6 and 7 are also acceptable.

(b) If format 6 or 7 is used, and the location of the taxpayer identifying number is consistent, a three point vertical rule (0.045 inch) should be preprinted immediately to the left of this number. If format 6 or 7 is used and the location of the taxpayer identifying number is not consistent for all returns, due to the nature of the mechanical equipment used by the nominee, this number need not be contained in a special box, nor identified. Preferably, it should be printed to the right of and on the same line as the name of the actual owner or payee (or first line of the payee name if there is more than one) but it can also be printed one or two lines above or below the first line of payee name.

(c) Special precaution must be taken if the printing of an account designation number in the specified format section is unavoidable. In this case such number must not be on the same line as, or on any line above, the taxpayer identifying number, nor on the same line as payments. When possible, the printing of such numbers in the specified format section should be avoided.

(d) If the taxpayer identifying number is a social security number, it must be printed in the following pattern: 000–00–0000. If it is an employer identification number, it must be printed as 00–0000000. Spaces may be used in lieu of hyphens.

(e) When there are multiple payees with different surnames, the identifying number shown must be linked to the surname to which it applies. It is preferred that such linkage be in the form of an asterisk preceding the designated surname.

(f) Payee name, street address, and city and State (including ZIP code) must be on separate lines. City, State, and ZIP code may be on the same line or on separate lines.

(g) The area within ⅜ inch of the left edge of the document (exclusive of stubs) must not contain any prepunched holes and be free of any printing except for the format identifier and format

guidelines appropriate to each permissible alternate format as illustrated in Exhibit B. There must be no intervening data or marks between the left edge of the document and the specified format section. In addition, there must always be a clear space of at least ⅛ inch to the right of and below the format identifier.

(h) There must be a margin of at least ¼ inch from the top edge of the document to any printing.

(i) The overall dimensions of the specified format section and the dimensions of the individual data blocks contained therein may be varied from the dimensions shown in Exhibits A and B. However, the general arrangement of data within the section and the typography may not be altered.

(j) The appropriate format identifier (1, 2, 3, 4, 5, 6, or 7) must be shown in the upper left corner of Copy A, as illustrated in Exhibits A and B, ¼ inch from the top and left edges. In addition, the appropriate format guidelines must also be shown on Copy A. The identifier and guidelines need not be shown on the other copies of the form.

(k) In using any of the formats, care should be taken to prevent disclosure of payment information if a window envelope is used for mailing.

SEC. 4. SPECIFICATIONS.

.01 *Basic form.*—The latest revision of the prescribed Form 1087 should be used as the basis for the privately printed form. A copy of the latest revision of this form may be obtained from any District Director of Internal Revenue.

.02 *Color and quality of paper.*

(a) Paper used for Copy A must be white and 100 percent bleached chemical wood, 2½ percent maximum groundwood permissible. No optical brighteners may be added; however, minimal trace amounts will be acceptable. The paper must be: Weight, 40 pound (basis 17 x 22—1,000), tolerance plus/minus 5 percent (weight must be inclusive of any coatings or chemical treatments); brightness, 80 percent or more when measured on a brightness meter in accordance with TAPPI specifications T–452; low finish; free of any dirt specks which would affect optical scanning; and uniformly textured. The minimum qualifications are the typical physical characteristics in weight, caliber, stiffness, and tear resistance normally associated with a 40-pound chemical wood bond or writing paper.

(b) The paper used for other copies must be white, minimum 18-pound (17 x 22—1,000) and of good quality.

.03 *Color and quality of ink.*—All reprinted data and rules on Copy A must be in a black nonreflective ink. A nonreflective ink is one which has 10 percent reflectance or less between the wavelength range of 3,500 and 5,000 Angstroms and 20 percent or less between the wavelength range of 5,000 to 10,000 Angstroms. (These reflectances are referenced to magnesium oxide which is considered 100 percent.)

.04 *Quality of printing.*—Printers must maintain strict quality control during production of substitute Forms 1087. Special care must be taken to insure that the density of ink, as noted in section .03 above, is maintained and that the bar codes are free from picks and

voids. To facilitate satisfactory scanning operations, strict observance of printing and trimming tolerances are required.

.05 *Typography.*—Type must be substantially identical in size and shape with corresponding type on the official form. All horizontal rules on the document and all vertical rules outside the specified format section must be one point (0.015 inch). All vertical rules within the specified format section and format identifier lines must be three point (0.045 inch). When present, mailing guides must be less than ½ point (0.0075 inch). A 0.045-inch vertical rule must precede and follow each payment block, as illustrated in Exhibits A and B. The format identifier must be printed in the 10-point Remington typewriter font as shown in GPO "Specimens of Type Faces." Vertical rules must be parallel to the left edge of the document; horizontal rules, parallel to the top edge.

.06 *Dimensions.*—The official form is 8 inches wide by 3½ inches deep, exclusive of a ½-inch snap-stub on the left side of the form. The substitute forms may vary in width from 7⅞ inches to 8 inches and in depth from 3¼ inches to 3¾ inches, although adherence to the size of the official form is preferred. The snap feature is not required on substitutes. If the substitute forms are in continuous or strip form, they must be burst and stripped to conform to the size specified before they are filed.

.07 *Clear area.*—The back of Copy A must be free of all printing.

.08 *Carbonized forms or "spot carbons."*—Carbonized forms and "spot carbons" are not permissible. Interleaved carbon, if used, should be black and of good quality to preclude smudging.

.09 *The Government Printing Office symbols.*—The Government Printing Office symbols must be omitted.

.10 *Copies B and C.*—Copies B and C are included in the official assembly for the convenience of the nominee. Although there is no requirement that privately printed substitute forms include these copies, Copy B may be desired by the nominee for his records and Copy C will satisfy the requirements of law and regulations concerning the statement of information which is to be furnished to the actual owner or payee.

SEC. 5. ADDITIONAL INSTRUCTIONS.

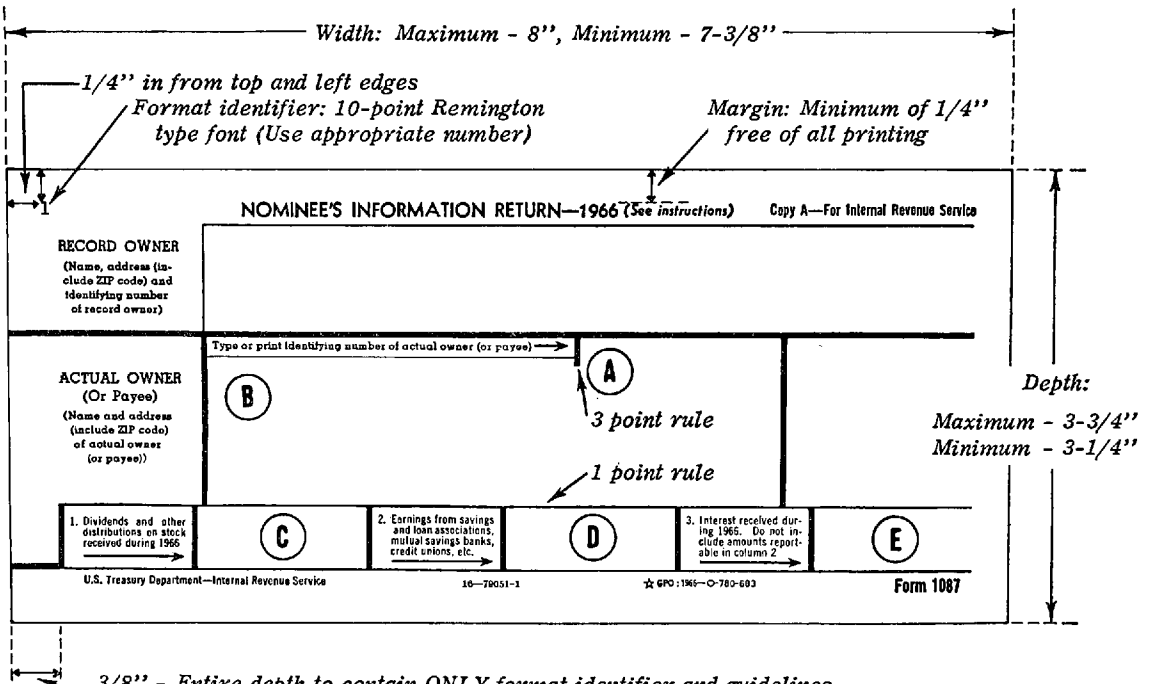
.01 *Arrangement of assembly.*—Except as provided in paragraph .02 below, the parts of the assembly shall be arranged, from top to bottom, as follows: Copy A, "For Internal Revenue Service," Copy B, "For Nominee," Copy C, "For Actual Owner or Payee."

.02 *Additional copies.*—Additional copies may be prepared by nominees for States requiring the report. When this is done, one such copy may be inserted between Copies A and B. Forms for delivery to State or local taxing authorities should be clearly labeled to indicate the purpose for which they are intended and should not bear any part of the designation, "Form 1087, U.S. Treasury Department, Internal Revenue Service."

.03 *Instructions for nominees.*

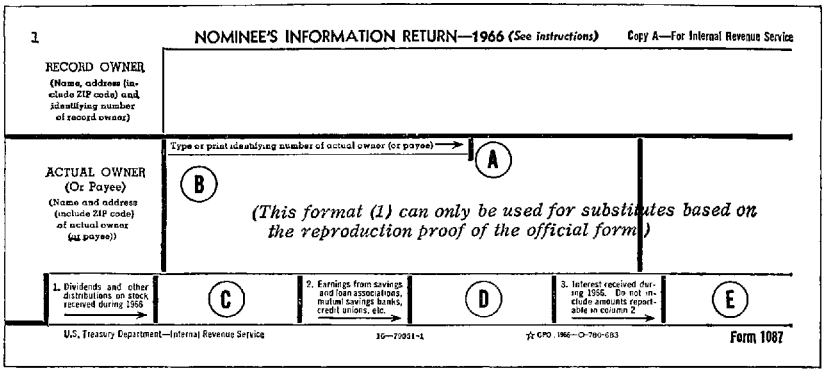
(a) Only originals or ribbon copies may be filed with the Service. Carbon copies are not acceptable.

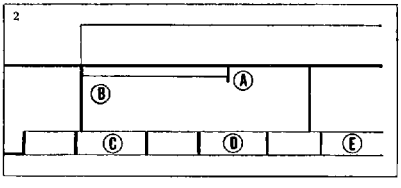
EXHIBIT A

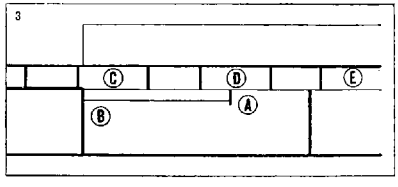


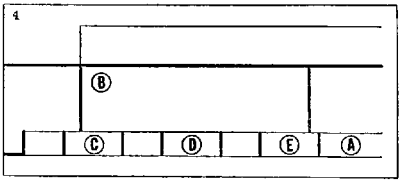
Back of Copy A must be BLANK

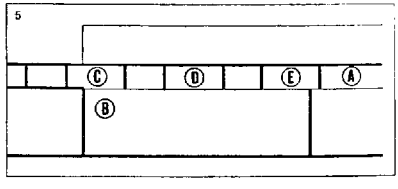
EXHIBIT B

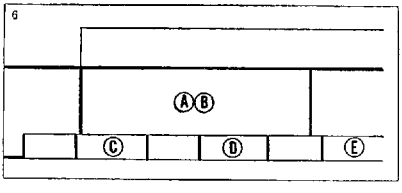

1
NOMINEE'S INFORMATION RETURN—1966 (See instructions)
Copy A—For Internal Revenue Service
RECORD OWNER
(Name, address (include ZIP code) and identifying number of record owner)
Type or print identifying number of actual owner (or payee)
A
ACTUAL OWNER
(Or Payee)
(Name and address (include ZIP code) of actual owner (or payee))
B
(This format (1) can only be used for substitutes based on the reproduction proof of the official form.)
1. Dividends and other distributions on stock received during 1966
C
2. Earnings from savings and loan associations, mutual savings banks, credit unions, etc.
D
3. Interest received during 1966. Do not include amounts reportable in column 2
E
U.S. Treasury Department—Internal Revenue Service
IG—70031-1
☆ GPO : 1966—O-760-683
Form 1087


2
B
A
C
D
E


3
C
D
E
A
B


4
B
C
D
E
A


5
C
D
E
A
B


6
A
B
C
D
E

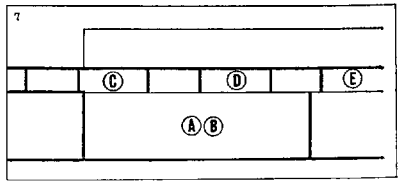
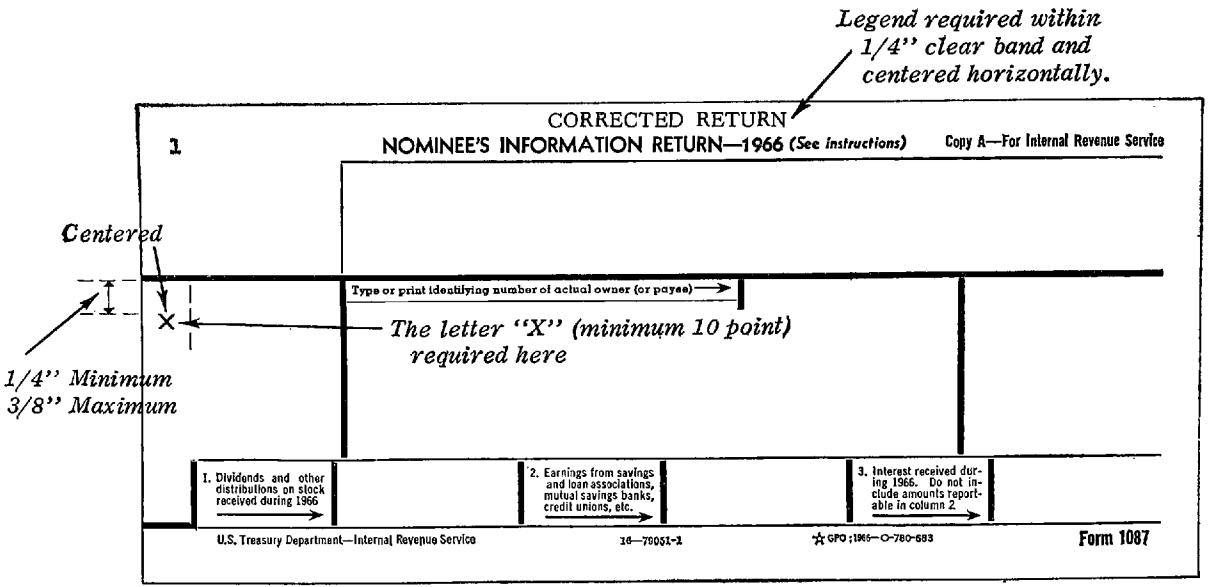

7
C
D
E
A
B

EXHIBIT C

Illustration of additional information required on Form 1087 for amended or corrected returns.



NOTE:

When format 3, 5, or 7 is used the location of the "X" must be centered in the 3/8" clear left margin and 1/4"-3/8" below the middle horizontal 3 point rule.

(b) The Service requests the cooperation of nominees in typing or machine printing whenever possible and in providing good quality data entries on the forms, i.e., using a black ribbon, inserting data in the middle of blocks, well separated from other printing and guidelines, and taking any other measures that will guarantee a clear, sharp image. However, nominees are not expected to purchase typewriters, machines, or special ribbons to prepare the forms.

(c) Corrected returns, Form 1087, must be submitted in accordance with instructions on Exhibit C.

SEC. 6. SUBSTITUTES NOT MEETING ABOVE CONDITIONS.

Proposed substitute forms which do not meet the conditions stated above, and requests for submission of Forms 1087 in the form of tabulating cards or magnetic tape, should be forwarded by letter to the Commissioner of Internal Revenue, Attention: D:S:Pl., Washington, D.C., 20226.

SEC. 7. REPRODUCTION PROOFS.

Reproduction proofs of the official Form 1087 are available upon the request of any person who desires to use reproductions of such form. Requests for reproduction proofs should be addressed to the Commissioner of Internal Revenue, Attention: A:FM:P, Washington, D.C., 20224.

SEC. 8. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure supersedes Revenue Procedure 65–18, C.B. 1965–1,837.

(Also Part I, Section 167; 26 CFR 1.167(a)–1.) Rev. Proc. 66–18

Classification of floating or self-propelled drilling vessels and barges, platforms, and support vessels for depreciation purposes. Revenue Procedure 62–21, C.B. 1962–2, 418, supplemented.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide advice concerning the proper classification of such depreciable assets as floating or self-propelled drilling vessels and barges, platforms, and support vessels within the guideline classes of Revenue Procedure 62–21, C.B. 1962–2, 418.

SEC. 2. CONCLUSION.

Floating or self-propelled drilling vessels and barges, platforms, and support vessels, such as those used in the exploration for oil or gas in offshore operations, are classified in Group 2, Class 2(b), Marine Contract Construction with a guideline class life of 12 years. Included is the vessel itself and all drilling equipment related thereto. Tenders, barges, towboats, crew boats and other vessels used to transport supplies, equipment, and personnel in offshore operations are classified in the same class. For activities of this kind, this classification includes equipment used in both force account and contract construction.

SEC. 3. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 62–21, C.B. 1962–2, 418, is hereby supplemented.

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26 CFR 601.401: Employment taxes. (Also Part I, Sections 3302, 6081; 31.3302(a)–1, 31.6081(a)–1.)

Rev. Proc. 66–19

Extension of time for filing Employer's Annual Federal Unemployment Tax Return, Form 940, for the calendar year 1965 with district directors in New York.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce that on January 27, 1966, the Internal Revenue Service granted an extension of time until February 28, 1966, for the filing of returns on Form 940, Employer's Annual Federal Unemployment Tax Return, under the Federal Unemployment Tax Act for the calendar year 1965 by employers who file the returns with district directors located in the State of New York and who normally would have been required to file such returns on or before January 31, 1966.

SEC. 2. BACKGROUND.

This extension of time, granted because of the effect of a New York City transit strike, parallels a similar action by the State of New York which granted employers an extension of time for filing State contribution reports.

SEC. 3. APPLICATION.

The extension is limited to those employers who file returns on Form 940 with district directors located in the State of New York. The districts in New York are designated as the Manhattan, Brooklyn, Albany, and Buffalo districts. Pursuant to section 3302(a) of the Internal Revenue Code of 1954 and subject to the overall limit on total credits specified in section 3302(c) of the Code, taxpayers who are required to file returns in such districts will be allowed full credit against the Federal tax in respect of contributions for calendar year 1965 which are paid on or before February 28, 1966, into the unemployment fund of any State and the Commonwealth of Puerto Rico. Such credit will be allowed whether or not the taxpayer takes advantage of the extension of time for filing the Federal return.

SEC. 4. INQUIRIES.

Any inquiries concerning this Revenue Procedure should refer to its number and be addressed to the appropriate office of the District Director of Internal Revenue.

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26 CFR 601.315: Claims. (Also Part III–B, Section 5705; 270.283, 275.163.)

Rev. Proc. 66–20

The date of withdrawal of cigars and cigarettes from the market may be shown in claims for credit or refund as the date such prod-

ucts were received on the factory premises or voluntarily destroyed or reduced to tobacco at other than such premises; or in lieu of such dates, the claimant may certify (under penalties of perjury) that the products were so received, destroyed, or reduced, within 6 months prior to the date the claim is filed.

Revenue Procedure 59–2, C.B. 1959–1, 800, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide information as to the date to be shown in claims for credit of tax, Form 2635, Claim—Alcohol and Tobacco Taxes, or claims for refund of tax, Form 843, Claim, filed under section 5705 of the Internal Revenue Code of 1954, on cigars and cigarettes withdrawn from the market.

SEC. 2. BACKGROUND.

The period of limitation for filing claims for credit or refund of tax, as set forth in section 5705(c) of the Code, is 6 months after the date of withdrawal from the market, loss (otherwise than by theft), or destruction of the cigars and cigarettes to which the claim relates.

SEC. 3. ACCEPTABLE DATES ON CLAIM.

It will be acceptable for claimants to show on either Form 2635 or Form 843 as the date of withdrawal from the market, the date that cigars and cigarettes were received on the factory premises (as described in the manufacturer's application for permit), or were voluntarily destroyed or reduced to tobacco, at a place other than such premises. In lieu of a listing of such specific date or dates, the claimant may certify (under penalties of perjury) that the products covered by the claim were received on the factory premises, or voluntarily destroyed or reduced to tobacco, at a place other than such premises, within 6 months prior to the date that the claim is filed.

SEC. 4. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to the number thereof and should be addressed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

Revenue Procedure 59–2, C.B. 1959–1, 800, is hereby superseded.

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26 CFR 601.311: Imposition of taxes; regulations. (Also Part III–B, Section 5723; 270.214, 275.73.) — Rev. Proc. 66–21

The word "cigars" must appear separately on a package of large cigars from that appearing in the class designation.

Revenue Procedure 62–5, C.B. 1962–1, 426, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to explain the requirement concerning the "notice" to appear on packages of large cigars and to furnish suggestions for compliance with the regulations.

SEC. 2. BACKGROUND.

The Internal Revenue Service has received inquiries whether the appearance of the word "cigars" in the class designation on a package of large cigars would fulfill the requirements of 26 CFR 270.214 and 275.73 or if the word "cigars" must be separately stated on the package.

SEC. 3. REQUIREMENT OF REGULATIONS.

Under the return system it is necessary that packages of cigars and cigarettes have positive expressions of the quantity, kind, and class of the cigars and cigarettes contained in the packages. Therefore, for large cigars 26 CFR 270.214 and 275.73 specifically require that packages of such products shall, before removal subject to tax, have adequately imprinted thereon, or on a label securely affixed thereto, the designation "cigars" and the appropriate class designation.

This means that the appearance on the package of the word "cigars" in the class designation for large cigars does not fulfill the requirement of 26 CFR 270.214 or 275.73 and that the word "cigars" must be separately and adequately stated. While such descriptive words as "cigarillos," "cheroots," "blunts," "panatelas," etc., may be used on packages of cigars, they will not be considered as a substitute for the word "cigars."

SEC. 4. SUGGESTIONS FOR COMPLIANCE.

.01 The Internal Revenue Service suggests to manufacturers and importers the following ways in which the word "cigars" may appear on the package. The word "cigars" may be imprinted directly on the package or on a label securely affixed to the package. For example, it may appear in connection with (1) a brand name, such as "Perfect Cigars," (2) the quantity statement, such as "25 cigars," or (3) a slogan, such as "finest quality cigars."

.02 Manufacturers and importers are urged to submit packages to their Assistant Regional Commissioner, Alcohol and Tobacco Tax, for advice where there is any doubt about compliance with the requirement of the regulations.

SEC. 5. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

Revenue Procedure 62–5, C.B. 1962–1, 426, is hereby superseded.

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26 CFR 601.311: Imposition of taxes; regulations. (Also Part III–B, Section 5704; 290.198.) — Rev. Proc. 66–22

Preparation and disposition of notice of removal by manufacturers of tobacco products when tax-exempt cigars and cigarettes are removed from the factory to replace products previously removed and lost, damaged, or destroyed in transit for exportation.

Revenue Procedure 62–22, C.B. 1962–2, 486, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to outline the procedure for the preparation and distribution by manufacturers of tobacco

products of Form 2149, Notice of Removal of Cigars, Cigarettes, Cigarette Papers, or Cigarette Tubes, from Factory for Export, covering shipments of tax-exempt cigars and cigarettes, replacing products lost, damaged, or destroyed in transit for exportation.

SEC. 2. BACKGROUND.

.01 26 CFR 290.198 and 290.199 provide for the preparation and distribution of the several copies of Form 2149, and 26 CFR 290.203 provides for the filing of two copies of the form with the District Director of Customs at the port of exportation, for each shipment removed for exportation.

.02 Where cigars and cigarettes are lost, damaged, or destroyed in transit for exportation (either the total shipment or a part of the shipment) and the manufacturer of tobacco products makes a replacement shipment, the two sets of Form 2149 will, in the aggregate, indicate the removal for exportation of more products than are entered on the export declaration and ship's manifest. Since the District Director of Customs certifies to only the actual quantity exported, the additional Form 2149 covering a replacement shipment often creates confusion and additional work in his office. Therefore, the following procedure should be used when replacement shipments are made.

SEC. 3. PROCEDURE.

.01 *Preparation and Disposition of Forms 2149 Covering Replacement Shipments.*—When tax-exempt cigars and cigarettes are removed from the factory to replace cigars and cigarettes lost, damaged, or destroyed in transit for exportation, Form 2149 should be prepared in accordance with the regulations. This Form 2149 should contain a statement to the effect that the cigars and cigarettes listed thereon were removed from the factory to replace cigars and cigarettes removed under Form 2149, serial number —, which were lost, damaged, or destroyed, as applicable. It should also contain an explanation of the loss, damage, or destruction. Only two copies of the form need be prepared, one copy to be retained by the manufacturer as a part of his records and one copy to be forwarded to the Assistant Regional Commissioner, Alcohol and Tobacco Tax. No copy should be sent to the District Director of Customs for the reason stated in section 2.02 above.

.02 *Accounting for Lost, Damaged, or Destroyed Cigars and Cigarettes.*—Manufacturers are reminded that lost, damaged, or destroyed cigars and cigarettes must be accounted for by taxpayment, by return to the factory, or by the filing of a claim for remission of the tax liability with the Assistant Regional Commissioner, Alcohol and Tobacco Tax.

SEC. 4. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the office of the Assistant Regional Commissioner, Alcohol and Tobacco Tax.

Revenue Procedure 62–22, C.B. 1962–2, 486, is hereby superseded.

26 CFR 601.311: Imposition of taxes; regulations. (Also Part III–B, Sections 5703, 5705, 5741; 270.162, 270.183, 270.184, 270.202, 270.282, 270.283.)

Rev. Proc. 66–23

Procedure for recording and reporting cigars and cigarettes removed subject to tax and treatment of tax determined (including taxpaid) products received into the factory.

Revenue Procedure 63–13, C.B. 1963–1, 501, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the procedure to be followed by manufacturers of tobacco products for recording and reporting cigars and cigarettes removed subject to tax and the treatment of tax determined (including taxpaid) cigars and cigarettes received into the factory.

SEC. 2. BACKGROUND.

Recent inspections disclosed that some manufacturers of tobacco products were not fully reporting the quantities of cigars and cigarettes removed subject to tax because they were reducing the quantity of products actually removed to the extent of tax determined products returned to the factory. The manufacturers based their action on the consideration that (1) no claim for allowance or refund of tax would be made on the returned products, and (2) when such products were again removed subject to tax, the tax would be redetermined and paid. However, there is no basis for this practice in the applicable laws and regulations.

SEC. 3. RECORDING AND REPORTING REMOVALS SUBJECT TO TAX.

A manufacturer of tobacco products must enter in his records and reports the total quantity of cigars and cigarettes removed subject to tax, reflect such quantity in the tax return for the period in which the removals occurred, and pay the full amount of tax (except for authorized adjustments). In no case may the manufacturer, in his reports and tax returns, reduce the quantity of products actually removed subject to tax by the quantity of tax determined products returned to the factory.

SEC. 4. TREATMENT OF TAX DETERMINED PRODUCTS RECEIVED INTO FACTORY.

.01 All tax determined (including taxpaid) cigars and cigarettes (those which have not been returned to an "in bond" status) received into the factory must be segregated and identified as tax determined products and their receipt and disposition entered in the records in the account of taxpaid or tax determined products received. If reshipped, supporting records (such as copies of invoices, bills of lading, shipping tickets, etc.) must clearly identify the products as reshipped tax determined products. Lack of such identification may result in the assessment of tax on the reshipped products. Tax determined cigars and cigarettes so handled would not be included in monthly reports.

.02 If tax determined cigars and cigarettes received into the factory are later to be returned to an "in bond" status, such disposition must be recorded in the taxpaid or tax determined account and the products concurrently picked up in the "received by return to bond" account. Thus, when the cigars and cigarettes are picked up as received by return to bond, they will be included in the monthly reports. When such cigars and cigarettes are then removed subject to tax, they will be so reported and fully covered in the tax return for the period in which they were removed. If the manufacturer wishes to obtain allowance, credit, or refund of tax which has been previously determined or paid on the products returned to bond, he may file claim on Form 2635, Claim—Alcohol and Tobacco Taxes, or Form 843, Claim, as applicable, and follow the procedures prescribed in 26 CFR 270.282, 270.283, 270.311, and 270.313 which involve notifying the Assistant Regional Commissioner, Alcohol and Tobacco Tax, before returning the products to an "in bond" status.

SEC. 5. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

Revenue Procedure 63–13, C.B. 1963–1, 501, is hereby superseded.

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26 CFR 601.315: Claims. Rev. Proc. 66–24
(Also Part III–B, Section 5705; 270.283, 270.311.)

Procedure to be followed in executing Form 3069, Schedule of Tobacco Products or Cigarette Papers or Tubes Withdrawn From the Market, to evidence cigars and cigarettes withdrawn from the market.

Revenue Procedure 63–16, C.B. 1963–1, 504, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the procedure to be followed by a manufacturer of tobacco products (or by his authorized representative) in executing Form 3069, Schedule of Tobacco Products or Cigarette Papers or Tubes Withdrawn From the Market, to evidence withdrawal of cigars and cigarettes from the market by the manufacturer.

SEC. 2. BACKGROUND.

.01 Damaged cigars and cigarettes were destroyed at the premises of a wholesale tobacco dealer under the supervision of an Alcohol and Tobacco Tax Inspector. The dealer prepared Form 3069 with the intention of transmitting the schedule to the manufacturer who would file claim for credit or refund of tax under section 5705 of the Internal Revenue Code of 1954. However, the manufacturer was not aware of the destruction of such products. The matter did not come to his attention until after the destruction of the cigars and cigarettes. Therefore, the manufacturer could not properly claim that he had withdrawn them from the market. Accordingly, a claim for credit or refund of tax on such products is not allowable.

.02 One condition to the credit or refund of tax on domestic cigars and cigarettes under section 5705 of the Code is the withdrawal of the products from the market *by the manufacturer* who paid the tax. However, the law and regulations do not preclude the allowance of a claim where the cigars and cigarettes are destroyed or reduced to tobacco at a location other than the factory premises if the manufacturer takes possession or acquires ownership of the cigars and cigarettes prior to destruction or reduction to tobacco.

SEC. 3. SIGNATURE REQUIRED ON FORM 3069.

The action of the manufacturer in withdrawing cigars and cigarettes from the market must be evidenced by the signature of the manufacturer (or by the signature of the manufacturer's authorized representative) on the schedule, Form 3069 (Rev. 2–62), at Item 12.

SEC. 4. EXECUTION OF SCHEDULE FOR THE MANUFACTURER BY HIS REPRESENTATIVE.

.01 Whenever a manufacturer withdraws cigars and cigarettes from the market and the schedule, Form 3069, is to be executed in his behalf by an employee such as a district manager, distribution manager, etc., not otherwise authorized to sign documents filed with the Assistant Regional Commissioner, Alcohol and Tobacco Tax, the manufacturer is responsible for timely filing Form 1534, Power of Attorney, as provided for in 26 CFR 270.68 authorizing such person to so act. It is the responsibility of the manufacturer to have on file with the Assistant Regional Commissioner, Alcohol and Tobacco Tax, for the region where the claim will be filed a Form 1534 prior to the execution of any schedule for the manufacturer by the person named in the power of attorney. Execution of Form 3069 by a person not authorized to do so may result in the disallowance of the claim. After cigars and cigarettes have been disposed of and a claim for credit or refund filed, the determination will be made in alcohol and tobacco tax offices as to whether the person who executed Form 3069 was duly authorized to act in behalf of the manufacturer.

.02 Manufacturers should fully instruct their representatives in the proper preparation of Form 3069, particularly regarding Items 1, 5, and 8 of the schedule.

SEC. 5. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

Revenue Procedure 63–16, C.B. 1963–1, 504, is hereby superseded.

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26 CFR 601.311: Imposition of taxes; regulations.
(Also Part III–B, Sections 5704, 5723; 270.212, 270.233.)

Rev. Proc. 66–25

Packages containing cigars or cigarettes produced by one manufacturer and transferred in bond, without payment of tax, to another manufacturer of such products should, in the required mark, identify

by name and location, or by permit number, the manufacturer who removes the cigars or cigarettes subject to tax.
Revenue Procedure 64–6, C.B. 1964–1 (Part 1), 664, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to furnish instructions as to which manufacturer's name and location, or permit number (to be shown in the mark as required by 26 CFR 270.212), should appear on packages of cigars or cigarettes produced and packaged by one manufacturer and transferred in bond to another such manufacturer.

SEC. 2. BACKGROUND.

Under the provisions of section 5704(b) of the Internal Revenue Code of 1954 and 26 CFR 270.233, a manufacturer of tobacco products may transfer cigars and cigarettes under his bond, without payment of tax, to the factory of any manufacturer of tobacco products. When so transferred, the cigars and cigarettes are exempt from the packaging requirements of 26 CFR 270.211. However, the regulations contemplate that the cigars or cigarettes may be shipped in bulk or in packages, as desired. When the cigars or cigarettes are transferred in packages, the question has been raised as to which manufacturer the mark on the package should identify.

SEC. 3. IDENTIFICATION OF MANUFACTURER LIABLE FOR TAX.

Packages containing cigars or cigarettes produced by one manufacturer and transferred in bond, without payment of tax, to another manufacturer of such products should, in the mark required by the regulations, identify by name and location (by city and State), or by permit number, the manufacturer who will remove the cigars and cigarettes subject to tax. He becomes liable for the tax on such products upon their receipt and will usually be the proper claimant in respect to credit, refund, or allowance provided by law.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and be addressed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

Revenue Procedure 64–6, C.B. 1964–1 (Part 1), 664, is hereby superseded.

(Also Part I, Section 6041; 26 CFR 1.6041–1.) Rev. Proc. 66–26 [1]

Revenue Ruling 63–271, C.B. 1963–2, 597, provides that a bank acting as a collection agent for the collection of interest on evidences of indebtedness must file information returns for payments of interest of $600 or more which it collects and pays over to the actual owner.

Representatives of banking institutions have explained that their banks have encountered problems in perfecting procedures to furnish the required information returns, Forms 1099, U.S. Information Return for Calendar Year, and 1096, U.S. Annual Information Return. As announced in Technical Information Release 804, those problems may, on a case-by-case basis, constitute reasonable cause for failure

[1] Based on Technical Information Release 804, dated Mar. 3, 1966.

to file the information returns for 1965 and to furnish identifying numbers on such returns.

Therefore, penalties for failure to file information returns for 1965 or to show payees' identifying numbers thereon will not be applied with respect to banks which submitted statements in writing, on or before March 31, 1966, to the District Director of Internal Revenue showing that their failure to comply was due to procedures or problems which they could not solve.

Similar procedures were established with respect to information returns for 1963 and 1964, as announced in Technical Information Releases 569, 701, and 704.

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26 CFR 601.202: Closing agreements. (Also Part I, Section 7121; 301.7121–1.) Rev. Proc. 66–27 [1]

Revenue Procedure 64–24, C.B. 1964–1 (Part 1), 693, provides, in part, that any taxpayer who opened a deposit or account in certain financial institutions prior to November 15, 1962, will be allowed to enter into a closing agreement, as authorized under section 7121 of the Internal Revenue Code of 1954, if he agrees that the full amount of earnings on the deposit or account shall constitute gross income in the year the plan matures, is assigned, or is terminated, whichever occurs first, in accordance with prior rulings of the Service.

Revenue Procedure 64–24 is supplemented to the following extent:

> Closing agreements *shall* be entered into only with those taxpayers who have not reported such earnings currently, and closing agreements *shall not* be entered into with those taxpayers reporting earnings currently in accordance with sections 1.61–7 and 1.451–2 of the Income Tax Regulations.

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26 CFR 145.2–5: Credit or refund of floor stocks of automobile parts and accessories. Rev. Proc. 66–28 [2]

> Under section 209(b) of the Excise Tax Reduction Act of 1965, credit or refund may be claimed by a manufacturer with respect to automobile parts and accessories held by a dealer as floor stocks provided a request is submitted by the dealer to the claimant on or before June 30, 1966. For purposes of this request, it is acceptable for a dealer who does not have an "employer identification number" to use his "account number," which is the same as his social security number.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide an alternative identifying number which may be used by dealers in submitting requests to manufacturers in respect of credit or refund of tax under section 209(b) of the Excise Tax Reduction Act of 1965, Public Law 89–44, C.B. 1965–2, 568, on floor stocks of automobile parts and accessories held by dealers.

SEC. 2. BACKGROUND.

.01 *Law.*—Under section 209(b) of the Act, floor stocks refunds of tax paid on certain articles, including automobile parts and acces-

[1] Based on Technical Information Release 582, dated Apr. 23, 1964.
[2] Also released as Technical Information Release 821, dated May 31, 1966.

sories, are available to the manufacturer, producer, or importer who sold the article, provided specific conditions relating to filing claims, dealer requests for payment and dealer reimbursement are met. In the case of automobile parts and accessories, the article must be held by a dealer on January 1, 1966, not used, and intended for sale by him. On or before June 30, 1966, a dealer must submit to a manufacturer a request with respect to a credit or refund allowable under section 209(b) of the Act for tax paid by such manufacturer on automobile parts and accessories held for sale by the dealer on January 1, 1966, as floor stocks.

.02 *Regulations.*—Paragraph (d)(3)(iv) of section 145.2–5 of the temporary regulations in connection with the Excise Tax Reduction Act of 1965, Treasury Decision 6857, C.B. 1965–2, 987, provides that the dealer's request to the manufacturer must contain the dealer's employer identification number.

.03 *Inability to furnish employer identification number.*—It has been brought to the attention of the Internal Revenue Service that a number of dealers, who have no employees and are not required to file Form 720, Quarterly Federal Excise Tax Return, have not previously obtained employer identification numbers and need authority to use alternative identifying numbers.

SEC. 3. CONCLUSION.

In those cases where a dealer is not otherwise required by law or regulations to have an employer identification number, for purposes of section 145.2–5(d)(3)(iv) of the temporary regulations, the requirement that a dealer furnish his "employer identification number" in connection with his request for floor stocks credit or refund on automobile parts or accessories will be treated as having been met if the dealer furnishes his "account number," which is the same as his social security number.

(Also Part I, Sections 6109, 7701; 26 CFR 1.6109–1, 301.7701–11.) Rev. Proc. 66–29

Section 6109 of the Internal Revenue Code of 1954 requires the use of identifying numbers on Federal tax returns, statements, and related documents. Under the provisions of section 1.6109–1 of the Income Tax Regulations and section 301.7701–11 of the Regulations on Procedure and Administration, the identifying number (account number) of an individual is that individual's social security account number.

Ordinarily, each individual must have his or her own account number. However, the Internal Revenue Service will accept for this purpose the "benefit numbers" of any persons who were drawing social security benefits as widows age 62 or over before January 1, 1963, if they have no numbers of their own. The benefit number is the social security number of the deceased husband. All other widows should obtain their own account numbers.

ANNOUNCEMENT OF THE DISBARMENT AND SUSPENSION OF ATTORNEYS AND AGENTS FROM PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

Under Section 261, Title 5 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any enrolled person who has violated the rules and regulations governing the recognition of attorneys or agents to practice before the Internal Revenue Service.

Enrolled persons are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any person disbarred or under suspension from practice before the Internal Revenue Service.

The Director of Practice announces in the Internal Revenue Bulletin the names and addresses of persons who have been disbarred or suspended from such practice, their designation as attorney or agent, and the date of disbarment or period of suspension.

After due notice and hearing before a Hearing Examiner, the Secretary, on appeal of the initial decision of the Examiner, has affirmed the Examiner's decision that the following person be disbarred from practice before the Internal Revenue Service.

Name	Address	Designation	Date of disbarment
Meyer B. Papermaster	Milwaukee, Wis.	Attorney	Jan. 12, 1966

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